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TRANSCRIPT
OF PROCEEDINGS

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PRODUCTIVITY COMMISSION

DRAFT REPORT ON THE AUSTRALIAN PIGMEAT INDUSTRY

DR N. BYRON, Presiding Commissioner
MR G. EDWARDS

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON MONDAY, 7 FEBRUARY 2005, AT 9.05 AM

Continued from 4/2/05 in Adelaide

DR BYRON: Good morning, ladies and gentlemen. Welcome to the public hearings for the Productivity Commission's inquiry into the Australian pigmeat industry following the release of our draft report last December. My name is Neil Byron and I've been appointed the presiding commissioner for this inquiry. Assisting me today is Mr Geoff Edwards who is a distinguished agricultural economist and has been working for the commission on this particular inquiry.

The inquiry began with a reference from the Australian government treasurer which we received on 31 August 2004. The commission is required to report on the competitive situation of and outlook for the Australian pigmeat industry, including both production and processing, and secondly, whether government or industry measures are necessary to enhance the competitiveness of the industry and if so, what measures would be necessary and appropriate.

We are very grateful to the many organisations and individuals who have already participated in this inquiry. We've visited piggeries, abattoirs and met with industry associations in most states. The purpose of these hearings this week is to facilitate public scrutiny of the commission's work and to get comment and constructive feedback on the draft report. We held hearings here nearly two weeks ago and since then, we've been in Perth, Brisbane, Sydney and Adelaide last week. We're working towards completing a final report to be with the government by 18 March, having considered all the evidence presented at these hearings and in written submissions as well as all other relevant information we've been able to obtain.

All participants in the inquiry automatically receive a copy of the final report once it's been released by the government which may be up to 25 parliamentary sitting days after completion of the inquiry and the transfer of our report from the commission to the government.

We always like to conduct these hearings in a reasonably informal manner but I remind everybody that we are taking a full transcript and so comments from the floor can't be taken. But at the end of the day's proceedings, we always provide an opportunity for anyone in the room who wishes to come forward and make a brief presentation or put a statement on the record to do so. Participants in inquiries like these are no longer required to take an oath but they are required under the Productivity Commission Act to be truthful in their remarks. Participants are welcome to comment on issues raised in other submissions or by other speakers here today.

Transcript will be made available to participants for validation and to check that little words like "not" have not been omitted, and will be available from the commission's web site as soon as possible after the hearing and after checking. Copies can also be purchased using an order form which is available from the staff here today. Submissions are also available on the Web or in hard copy by order form.

To comply with the Commonwealth occupational health and safety legislation, I am required to draw your attention to the fire exits, evacuation procedures and assembly points. In the extremely unlikely event of an emergency required evacuation of the building, the main fire escape exit is in the foyer just opposite the reception desk and the assembly point is in Fitzroy Gardens, just across Spring Street. The toilets are just near the lift and the reception. If you require any assistance, please speak to one of the inquiry team members who are here today. Can I ask anybody in the audience to please turn mobile phones off or at least to silent mode. That's the end of the housekeeping. I'd now like to welcome representatives from Australian Pork Ltd. The normal procedure here is if each of you can introduce yourselves in your own voice for the transcript, then it's customary to take about 15 minutes, but I think in this case it will probably take an hour, half an hour or as long as you need, and then we can have a discussion of the points that you've raised. Thank you very much for coming.

DR HIGGINS: I'm Paul Higgins and I'm chairman of Australian Pork Ltd.

MR COOK: John Cook, CEO of Australian Pork Ltd.

MS PLOWMAN: Kathleen Plowman, general manager for policy, Australian Pork Ltd.

MR OXLEY: Alan Oxley, ITS Global Consultants.

DR HEILBRON: Selwyn Heilbron, I'm a consultant to the APL.

DR HIGGINS: I'd like to make an opening statement, if we could, commissioner, and then we'll have the discussion and take questions, if that's okay.

DR BYRON: Okay.

DR HIGGINS: Firstly, we'd like to thank the commission for the opportunity to appear in the public hearing to comment on the draft report and its findings and to discuss with the commission opportunities to improve the robustness and analysis of the report, to ensure that its conclusions are well substantiated, since this, in turn, affects the recommendations it makes to enhance industry competitiveness and the future structure and sustainability of our industry.

This inquiry was made at the industry's request to the government. The joint industry and government working group that we're part of considered it an important and integral part of the industry's proposed restructure plan. An inquiry would provide independent assessment concerning the state of the industry from which the government can evaluate the restructure plan and from there, determine with industry the value and nature of the support best suited to the long-term restructure of our industry.

Unfortunately there was no consultation with industry by Treasury on the terms of reference for this inquiry which is disappointing and in our view deficient since this matter is of grave importance to the future of our industry and the livelihoods of people who depend upon it. We also note that the commission was provided only five months to deliver this report, whereas past commission of inquiries of this nature have usually taken 12 months.

As a result, we see the commission confronted with an extensive brief constrained even further by a very short time line in which to produce a detailed report addressing each of the points raised in the terms of reference. We can only imagine this has been a significant obstacle for the commission to overcome given its finite resources, as we are acutely aware of the deficiencies and the necessary information and data across the supply chain, both domestically and internationally, that are needed to be obtained and analysed in order to meet these extensive terms of reference. Regrettably, current time lines do not provide for this.

Industry is doing all we can to improve our long-term situation and shape our own future. We have developed an industry restructure plan principally driven by industry to deliver long-term fundamental changes necessary across the supply chain to establish global competitiveness and efficiency. We have worked hard to establish a once thriving export and we've continued to make significant investment in research and development to improve on-farm and supply chain productivity, including product innovation and development, and we're now actively engaged with retailers and consumers to capture the benefits from this.

Unlike other agricultural industries such as the sugar industry, we have not gone to the government requesting large amounts of taxpayer funds to facilitate adjustment. We have been specific in our requests for targeted short-term assistance as part of our industry restructure plan. The Australian pork industry is also different from other agricultural industries in Australia because we operate in an unfettered open market, competing directly with imports, which results in constantly shifting ground affecting profitability, investment decisions, risk management and the pace of structural adjustment within the industry.

We are not against free trade but we are asking for a fair go. This level of risk to Australian producers in effect is the result of foreign countries underwriting their pork production industries which in turn enables our competitors to be supposedly competitively priced but ultimately leads to a distortion of the global market, impeding the Australian pork industry's ability to compete on an equal footing, continually destabilising the industry, and therefore affecting its ability to structurally adjust over the long term.

Conversely, government policy here actually does the reverse. As an example of that, in some of my other work, I've been doing some work on the grain industry and ethanol industry, and just prior to Christmas, the government announced further capital grants programs for plants that produce ethanol from grain. There's two examples of that: a plant in Millmerran in Queensland was given a grant and based on their plans, they will be using 150,000 tonnes of sorghum. A plant up the road from there at Dalby plans to use 250,000 tonnes of sorghum. That equals 400,000 tonnes of sorghum in a market that actually produces 1 million tonnes.

Where my farm is near Echuca here in Victoria, Australian Ethanol Ltd has plans to build a similar sized plant to the Millmerran plant at Swan Hill, using about the same amount of grain. Now, we have no problems with that being a competitive industry in terms of grain but the situation is that the excise holiday that the government has provided to these other industries has created a subsidy for people to buy grain in this country competitively against us. So we have a situation where other countries are subsidising and helping their pork industries, whereas our government is actually producing policy - including the single desk policy - which we believe significantly harms us.

So for example two points that - the ABARE and BTRE inquiry into the $350 million biofuels target identified that producing ethanol would require a subsidy by the government of $500,000 per job created annually - not just a capital grant but $500,000 annually. On my numbers, based on the excise holiday that has been given to the industry to produce ethanol from grain and also the phasing in of ethanol excise after 2011, the plants once built can afford to pay up to $300 a tonne for grain before they would actually consider shutting down. So what we have is a direct subsidised competitor placed in Australia with government taxpayer subsidies to compete against our industry at the same time when our competitors are actually getting the opposite. We're extremely concerned that these plants being built will drive up the price of grain, which is our key feed ingredient, and feed is our key production cost.

In our view, in the report there has been a general failure to properly characterise and quantify the import support arrangements on global pork markets. APL expects the commission to be concerned about the distortion of international trade and its impact on investment in Australia, because these in turn influence decisions about what to produce. It appears that the commission is concluding that existing competitive pressures are enough to force gradual change in structural adjustment and therefore enhance industry competitiveness.

But these conclusions reached are generalised and not empirically based. This analysis is deficient because it misconstrues the state of the industry and fails to examine the pace of adjustment - including the social impact of rapid change - which is required to be satisfied under the commission's act. Significantly, the commission has not considered or proposed where the industry is to source capital to make the necessary adjustment. Simply put, if producers are to remain profitable they must as the report states adjust to market forces, and this can only be achieved through further investment of their businesses.

Now, if pork producers are to do this - to invest in their businesses - they can only really achieve the funds or gather the funds to do that in three ways. First of all from cash flow, which - given the current situation or the situation over the last few years, cash flow has not been there. Pork producers can borrow but the banks are disinclined to lend to pork industry based on the current balance sheets and the prospects for the future of the industry. We can also look at attracting new investors. So in my case I could look to bring equity investors into our operation. So I'd like to put a business proposal to the commissioner. Would you like to invest in a business where your competitors are subsidised and protected, where your own government actually increases your own production costs, and the current market situation actually stops you from producing a product which can be as cost efficient as you can? I don't think that profile is extremely interesting for investors and so that third part of possibly attracting capital is really closed off to us.

So in a situation where the commission has examined competitiveness and believes that competition will produce a structural adjustment, I agree with the general theory. The problem is it breaks down under these circumstances because there has been no examination of that pace of change, the structural forces, and how producers can actually obtain the funds and enable the change. As an example, at my farm we've been examining the construction of new tunnel-ventilated, fully slatted, environmentally controlled sheds. Now, we believe it will make us more competitive. Our problem is because of the balance sheet situation of our farm and the cash flow situation, despite the fact that those can produce quite large improvements of our competitiveness we're not capable of investing in those adjustments because of the situation we've found ourselves in.

The draft report in its current form fails to properly identify the longer-term state of the industry, and in particular there is no investigation of the link between structural change in the industry and the structural forces that have caused it and contributed to the continual erosion of the industry's competitiveness. No assessment has been made of the way in which the surge in imports is fed through the economic structures of the industry, and subsequent attitudes of business to investment and risk. There has been inadequate consideration of the impact of imports, the dynamics of trade in a global market that trades cuts and not carcasses, and finally a failure to consider profitability against the capital employed in the industry, which in turn reveals a lack of appreciation of the commercial factors that affect decisions about production, investment and risk.

This comes from someone who has personally invested significant funds over the last two or three years. We completely depopulated and repopulated our farm at considerable expense to reduce our own costs of production, and we believe we have done that - reduced those costs significantly. But we find ourselves, because of spending that money plus the effects of drought and import competition, in a situation not able to make further capital investments of that nature.

Evidence provided by APL shows that over the last 10 years there have been only three years where profitability has approached what could be regarded as adequate levels for long-term business sustainability, not the purported several years reported by the Productivity Commission. Furthermore, one of those three years could be largely attributed to the temporary ban of Danish imports due to the FMD outbreak in Europe. The commission finds that the case for industry-specific adjustment is weak, yet it ignores the long-term structural changes in the industry and consequent surges in imports that have caused so much damage. It restricts its examination to existing key government and industry programs, but notably missing are other traditional tools - direct industry assistance payments and trade measures, not just safeguard measures - to facilitate structural adjustment. A full assessment should also be undertaken to determine the relative merits of prospective measures in respect of structural adjustment and improving industry competitiveness.

Overall the report does not address the recommendations put forward by the industry, nor provide substantive solutions or the necessary analysis to enable to industry to address how this major impediment to industry competitiveness can be overcome. In its current form the draft report is inadequate on matters of critical importance to people and their livelihoods, and this is of great concern since the government, industry and broader community places much weight on the commission's capacity to provide a robust, objective analysis of the competitiveness of the industry and what the industry and government can do to change these circumstances.

We believe the timeline for the inquiry must be extended. The current state of the report demonstrates that the commission has been given insufficient time to address such comprehensive terms of reference. The industry is certainly supportive of the commission seeking an extension of its timelines, and is itself seeking meetings with the treasurer and has also written to the minister for agriculture on this matter. The commission must be given the opportunity to report on the competitive situation and outlook for the Australian pig industry as per its terms of reference, and to address the inadequacies in the current draft report, to ensure that its findings are based on rigorous substantive analysis and data.

It is not possible to provide conclusive recommendations without first addressing the competitiveness of the industry. Currently the draft report's conclusions are dangerous for leaving the impression that they are better based than they are, and this should be adjusted to reflect the inadequate information the commission has had to work on. It would be better for the commission to indicate where the factual basis is too thin to draw such conclusions. As they are, they paint an inaccurate picture of the long-term state of the industry, its competitiveness and sustainability, and fail to provide a way forward where government and industry can work together to successfully change these circumstances to secure a sustainable and competitive industry that builds on its already positive and valuable contribution to local, regional and national economies.

We believe our industry restructure plan - as we said before, derived largely from industry - is going through the process of controlling what we can control and taking active steps to change significantly things that can change the competitiveness of the industry. We need a thorough and substantive analysis in this process to contribute both to our thinking and to the government's thinking in terms of driving the industry restructure plan forward. Thank you.

DR BYRON: Thank you very much, Dr Higgins. That was very helpful. We could either discuss I guess the process issues or go into I think the more important substantive issues of the matters of fact. If I can just comment briefly, I do fully appreciate the importance of this inquiry to the industry and I'm on the public record as saying I guess in all the hearings that we've held, how impressed I've been with the skill, sophistication, management, professionalism of the piggeries and the primary processing units that we've visited. It's a very impressive industry. We understand the extreme difficulties that people have been going through over the last couple of years.

Your comment about the timing of this report - as you know, we were originally given five months; we then got an extra six weeks which we're now into. The draft report was written at a time when I guess we'd been going on this for less than 10 weeks. We've now had more than twice that amount of time and we have the staff Christmas Day off, but apart from that we’ve had people working seven days a week on this. I can assure you that what we know now is much more than what we knew at the end of November when this had to go to the printers, particularly through processes like this with the public hearings.

There was a distressingly large number of gaps in the information base compared to what I would have expected for a fairly mature industry like this one, when we started. Some of those gaps are now being filled; in other places we're just going to have to make the most sensible recommendations we can, given that some of the information that we'd like is simply not going to be obtainable in the time. But I can assure you that the strength of our findings and recommendations is proportionate to the quality of the evidence that we have to draw on - no more, no less.

If I can just go to the - I've got some questions of clarification and elaboration, not so much about - well, it will relate to the matters that you've just raised, but particularly through the 300-odd pages of submission that we've received from APL in the four components. I've got questions under general headings of Evidence on Profitability, about Structural Change and Assistance, about Degree of Assistance to Overseas Competitors, Safeguards, and then a few small things. As you said in your opening comments then, we've looked very carefully at the industry's restructuring plan. It is an impressive document. It seems to me that you've done the SWOT - strength, weaknesses, opportunities, threats - analysis very well, and to a large extent the industry already knows what it needs to do and is getting on with it. But there are still a few areas where we'd like clarification. So is that okay if we go through those issues, or is there another heading that you'd like me to add to the agenda for the discussion?

DR HIGGINS: That's fine. I'll just make a couple of comments first. Certainly our concerns about the report is not intended to be a criticism of the commission's capacity or diligence. It's an issue of the time frame which has been given to the commission. So I don't want it interpreted - our comments - in any other way than that. Secondly, you would appreciate as chairman of the organisation I haven't been involved in the complete detail of all of the submissions and work that has been involved. So I'll answer what questions I can but the other members of the panel - I'll refer to as we go through - will be answering those questions and raise any gaps we may fill at the end.

DR BYRON: I guess the first question is that since we began this inquiry APL was going to give us some very detailed country of origin price and cost data, which we're still looking forward to. Can you give us any idea on when we might get that international benchmarking information?

MS PLOWMAN: Well, as I understand it, there's two issues there. One is the sensitivity in pricing, the other one is the benchmarking. We only received that benchmarking report yesterday so we're in the process of going through that. We hope to get it to the commission by the end of this week. But it's still only in its draft form. As we did state to the commission earlier, that that was a commission report. It wasn't due for delivery until the end of January. The consultants had a delay of one week.

DR BYRON: No, I understand how things can slip. We're really looking forward to that and we're hoping that that will help fill in a lot of blanks.

MS PLOWMAN: From my brief look at it this morning, some of the points you've raised here about information gaps - one point I noted is because of this growing vertical alliance within, and global nature of the pig industry, companies are becoming particularly sensitive about providing specific data. That has become even more so now.

DR BYRON: That's quite understandable, and that's what we'd expect. Just on the subject of confidential profitability data, we made a highly sort of qualified statement in the draft report at the end of November that there seemed to be some indications that the profitability in the industry was finally picking up because the last quarter of 2004 - pig prices seemed to improve and grain prices seemed to be getting back down to more normal levels. We recognise the constraints and the sensitivity on profitability data, but can you give us any information on whether there is a trend of generally recovering profitability in the industry over the last six months or so?

DR HIGGINS: I think that's certainly the case. We don't do month-to-month or quarterly monitoring of profitability. The only comment I make on top of that is, you know, obviously I know what my profitability is like and it will take more than three or six months to repair the holes that have been created in our balance sheet over the last three years.

DR BYRON: I certainly didn't mean to imply that all balance sheets have been fully repaired just in a few months. I imagine that would take considerably longer. I also wouldn't like to stick my neck out and say that trend is definitely going to continue for a long time. Even if there is a sort of a recovery at the moment there is no guarantees on how long that favourable trend will continue.

DR HIGGINS: Well, I won't be taking you to talk to my bank manager then. Just maybe anther comment, probably - and it's more anecdotal than anything else. There has certainly been a recovery in our industry consultation process. When we went around both processors and farmers, looking at the situation in relation to the industry restructure plan I was struck by the lack of confidence of people. I invested in the industry in 1989 so I've been at this for 15 years or so now and through all that period there was a relative level of confidence, people willing to reinvest.

We asked each in each of those meetings that if the price was up for the next 12 months who would be willing to invest and I can't remember how many people exactly but around 300 people in total, and we had two people raise their hands. So while that's anecdotal, that's an indication I think of what's happened in terms of people's attitudes to risk and investment and how they see the industry forward - because, for example, in my presentation those sheds I'm talking about, if I have to build those, they require a 10 to 15-year return to be profitable and there is great concern in the industry about what five years looks like, let alone 10 or 15 years. So I do strongly believe that the risk and investment profile of people in the industry has changed because of the pressures which have been placed upon the industry.

DR BYRON: I think that's very important and maybe we'll come back to that later. But you said in the submission and in your comments that profits have only been reasonable for three years out of the last 10. To me, that begs the question of what do you mean by reasonable and is there a normal benchmark? I assume that there's enormous variation. It seems to me there's enormous variation between firms in the pigmeat industry. They have different capital structures and so on. So what do you mean by a reasonable rate of return?

DR HIGGINS: Selwyn, do you want to comment on that?

DR HEILBRON: I would make the comment that there's two aspects to profitability that I think the industry would like to raise. One is the one which has been alluded to now which is the appropriate time period over which you measure these things and I think one of the disappointing aspects of the draft report was the focus on very much a short term in some areas and a longer term in others. In respect of the profitability, looking back over 10 years or so in this industry there have been periods of short-term recovery.

But I think the key is the longer term structural pressures that the industry has been under and there doesn't seem to me to be any evidence that there has been a sustained turnaround in profitability in this industry over the period of time, notwithstanding some short-term recoveries in prices or the lowering of costs that have taken place.

I think the second thing is the measure and profitability I don't think can be indicated by purely a short-term absolute profit of some nominal amount in an industry of this kind. I guess another disappointing aspect of the report was that it made reference to profits occurring in three years out or 10 or whatever the case was. This is a capital intensive industry and having an absolute profit of a nominal amount on a capital intensive industry, as one would be aware, is really not going to mean very much. Now, I understand the industry did have some research conducted which was submitted, on what returns have been like and what appropriate level of return would be, and I don't believe that that was really reflected in the draft report.

DR BYRON: Do you mean the Ernst and Young survey?

DR HEILBRON: Correct.

DR BYRON: That's because it was given to us as confidential data and (a) we can't cite it in the report when it's confidential, but more importantly, (b) we can't expose it publicly for validation and confirmation. Therefore this inquiry, like every other inquiry, has to discount to some extent any evidence that can't be confirmed. The statement that we use I think was attributed to the Queensland Department of Primary Industries, who told us in their submission that between 2000 and the onset of the drought in early 2003 - I think the exact words were, "Three of the most profitable years ever in the history of the industry."

Now, that suggests that balance sheets would have been particularly healthy at the onset of the drought. It also suggests to me that if, after the worst drought in the century, balance sheets are substantially diminished, that's really not a surprise if we're going from a position when they're healthier than they've ever been before to an extraordinary period of stress with low prices and very high grain costs.

DR HIGGINS: I guess the main point I'm making in the submission is that a large part of that profitability was driven out of imports actually not being brought in from Europe during that process and so the - and I haven't got the data in front of me, but if you look at the pricing, if you take those years that you're talking about, the prime delivery of profit during that period was the period prior to Christmas in 2001. I'm not sure, whatever the year was, the prime contributor of profitability during that time was the closure of the market to imports from Denmark, because certainly as soon as that happened prices shot up here and certainly produced and made significant money during that period of time.

Now, to use figures where a sudden closure of supply to the market as an indicator of long-term profitability or sustainability of an industry - we don't believe is a proper way to look at the process. So the only time really during that period that producers made profits that, in our view, would be extraordinary were during that process. Now, there's two things in that. One is that the imports themselves were suddenly shut off. It wasn't a matter of saying, "Well, you know, a safeguard action has been put in place to equalise the competitiveness." They just were turned off in a matter of a few days.

So that made a big difference in terms of the structure of the industry, particularly as from Denmark it was mainly middles which are coming in and whereas from Canada it was mainly legs, and so switching the - it wasn't really possible for the processes in the market to switch from one country to another in that process. So an extremely sudden shortage was created by a disease situation that resulted in that, I think. We're happy to go back and work through those numbers but I would suggest that of the profit that was made during the years that you described, more than 60 per cent of it was probably made in a period of six or eight months of that time.

DR BYRON: We've also heard a lot of it attributed to the boom in exports of pigmeat thanks to FMD in Taiwan and Nipah virus in Malaysia that gave unprecedented access for Australian products into Singapore.

DR HIGGINS: There's no doubt that the Nipah virus outbreak in Malaysia, which was earlier than the period you're describing, contributed to a recovery in the industry. It's my very strong view that if that hadn't occurred in 1999 we probably wouldn't be here having this discussion, because I think a number of people - there would have been a significant shrinkage of the industry during that process. So there's no doubt that the Singapore exports certainly helped that process.

I think the Taiwan situation was slightly different. Again I haven't got the data in front of me, but if you examine the actual export volumes during that time you didn't see huge growth in the exports. I mean, we're talking about Japanese exports basically in that process. There was some product moved offshore but you didn't see 50,000 tonnes moved offshore. I can't remember the exact numbers but there was a fairly large increase in percentage volume terms. But the total volumes were still quite small.

DR BYRON: Yes, I'd agree with that, but small volumes at relatively high prices or at break-even prices?

DR HIGGINS: Well, the actual raw prices of the material was probably reasonably high because of the cuts that go to Japan instead of the cuts which are sold domestically, because they selectively take those cuts. In terms of the profitability of the individual exporters that do that process, I'm not really sure.

MR COOK: I understand that you actually heard from B.E. Campbell last week and I think B.E. Campbell were one of the players who, in particular, sent the high-yielding elements of the carcass into the Japanese market and B.E. Campbell's profitability would then be influenced on how successfully they placed the remainder of the carcass on the Australian trade. I think you've probably heard that the concern is that the price they get in Japan was reasonable and the price that they got for the heavier carcass remainder was very low, to the point where there was marginal, if any, profitability for exporting into the Japanese market.

So it may appear to have been very valuable revenues in terms of export, but the profit tensions occurred because they were then not able to place the remainder of the meat into the Australian market and get an acceptable price, an acceptable margin. As you probably understand, commissioner, that the weights into the Japanese market are much heavier than they are in the domestic industry, which means that you've then got fewer options in which to place the remainder of the meat.

DR BYRON: That's again something that I was going to ask about later, the question of having to place all the different cuts off the one animal, that even if you offered a very high price for one part of the animal in one particular market, if you have trouble getting rid of the other 90 per cent of the animal, it may not be such a great deal overall. One of the implications of that is that we can't really understand much about trade flows by just looking at the cost of production of that carcass and the selling price for one cut from that carcass in one market is actually far more sophisticated and complicated, isn't it?

MR COOK: Yes, it is. I think that actually brings this point that the pork industry have been talking about for a while, in terms of how is pricing affected by things such as other allowances and support mechanisms in other communities; to what extent does that then create the inability for us to compare like cut with like cut from one community to the next? That's the reason why some of our submissions have been talking about the interplay in the international market and the effect that these subsidies have had in terms of the competitiveness or otherwise of the Australian trade here in the Australian marketplace.

MR EDWARDS: I'm sure we'll come back to that one, but could I chip in with a comment on the difficulties of measuring costs of production in a satisfactory way and hence assessing profitability. We all know it's very, very difficult to measure costs of production. There are different ways of defining them. Different farms will have different costs of production according to any measure we choose. There are big questions about which concept is relevant. Is average cost the right one or is it the marginal cost? How do we treat joint costs? I know, although some pig producers are specialists, so the problem of joint costs is less of an issue than in some other areas of mixed farming.

Nevertheless some pig farmers are multi-enterprise people so joint cost problems do arise. There are problems of opportunity costs for labour. There are all sorts of difficulties. I doubt if anyone would disagree with the proposition that the idea that costs of production could be usefully used as a guide to policy on pricing for agricultural commodities was rejected by the 1960s in Australia, perhaps earlier than that, and some people in the room I'm sure will be familiar with the contributions of Prof Keith Campbell from Sydney University who played a big role in showing the limitations, indeed perhaps the folly, of trying to use costs of production as a guide to measuring real profitability in farming, and further, to guiding policies on appropriate prices for agricultural commodities.

Another approach to assessing profitability that's quite often used is to look at what's happening to production in an industry. We can be confident if a particular line of production is unprofitable over a period, then production will fall or at the very least, increase less rapidly than otherwise. We have an excellent example of this at work in Australia recently. As you all know, we had the disaster of the collapse of our reserve price scheme for wool in the early 1990s. Wool prices fell dramatically and remained low for an extended period. The number of sheep in Australia and the amount of wool production declined very, very dramatically. I even heard someone speculate that if prices didn't improve soon, we might have fewer sheep than people in Australia.

Now, obviously that was a very dramatic situation and a highly unusual situation for wool. When we turn to pigs, we see a very dramatic structural adjustment in the industry. From the early 1970s to 2003-04, the number of pig producers fell from about 40,000 to a bit less than 2 and a half thousand. That's incredibly rapid structural adjustment. I'm not aware of any other Australian rural industry where the number of producers has fallen so strongly. Putting it a little differently, the number of producers fell more than 50 per cent in each of the decades, the 1970s, 1980s and 1990s. However, over that long period, the number of sows remained fairly constant and production of pigmeat more than doubled and production of pigmeat rose substantially in each of those decades.

Now, the point I'm making here is that we've seen a steady pattern of increasing production of pigmeat in Australia over a long period and the general situation is that that has continued in the last several years, notwithstanding the reduced profitability of the industry for part of that time. So I'm making the point that if we measure the economic returns to producers by movements in production, it's not clear that a trend level of returns to producers is inconsistent with continuously rising pig production.

MR COOK: In other words, that the industry doesn't scale as effectively as you would expect in other industries.

MR EDWARDS: I'm not quite sure how to interpret that. Could you elaborate on that.

MR COOK: As you probably imagine, in terms of 40,000 producers operating into our industry, that would have been, you would imagine, a smaller participation by the broader scale opponents within the industry. I think what we've seen over the last, say, decade, is a growth of scale within larger focused enterprises. So despite the fact that you're seeing the industry move towards broader and deeper scale, we're not necessarily seeing the sympathetic improvement in profitability and margins as a result. So our industry does not seem to scale as many other industries do, where critical mass and volume leverage translates to financial advantage in the industry. There are obviously mechanisms here and we would argue that, again, they relate to some of the international factors that disrupt the flow of pricing, so therefore margin in that industry.

MR EDWARDS: I think we could come to the international market situation shortly, but we've been told that large-scale producers have succeeded in achieving significant cost reductions, vis-a-vis smaller scale production. We have been told that.

DR HIGGINS: Can I just respond to your original comment and I'll come to that in a moment. I think that the view about the 70s and 80s and early 90s is somewhat irrelevant for a couple of reasons. First of all - and if you go back even in the 60s - a large amount of the pig producers originally were actually - and it's one of the reasons my farm is located where it is - built around the dairy industry. So the vast majority of that number of fall that you see is actually farmers who have had skim milk and were going through that process, so once that changed, they no longer had an economic reason to do those sort of things.

Secondly, the 70s, 80s and early 90s existed in a totally different framework than the current situation is. Certainly I'm fond of thinking that I should have invested about 10 years earlier and I would have been a lot better off. So I think that's like driving a car by looking in the rear-view mirror because those things are structurally totally different from the situation we find ourselves in.

I would agree with you in the macro sense - and I don't have an economics degree, this is my bush accountancy stuff, so I might refer to some of my more learned colleagues in this process - that production volumes are a long-term reflection of profitability. If you look at your example of the sheep industry, then there are a couple of differences to our industry that you can't really translate those sort of examples across to our industry. As the director of ABARE says, the trouble with the sheep industry and the grain industry - and I may get into trouble by saying this maybe if I quote this publicly - is that the price of land within those industries are sticky downwards. So what he says, in the marketplace if BHP or National Bank - as we've seen in the last period of time - makes bad investment decisions or there's problems with their profitability, share prices adjust to adjust the capital or the investment return on those assets. In industries like the sheep industry, that just doesn't occur. What has happened in the sheep industry is partly reflected, as you say, by that demand, and secondly, by issues of land value and alternative land use, so people who had options have actually changed their operations over to other uses rather than produce wool, because they had those options. In our industry, that is not possible. We have a capital asset which is rapidly depreciating instead of one which is appreciating.

What happens in reality apart from theory is that if someone has got an investment, as I have, of 2 and a half million dollars in capital and buildings, you don't just go, "I'm not profitable any more, I'll give it away," you actually live on depreciation. Repairs and maintenance gets cut back. As I said, you sell $300,000 worth of land and tip it in. You do these sort of things. So while I agree with you over a five or 10-year period, if we're sitting here in 2015, I would say that what's happened in production from now to then is reflective of profitability. But in the short term, what people do is survive as long as they possibly can, and I believe that's what's happened over the last period of time. In fact, I've been a little surprised about the resilience of people during the last process and I believe many people are in a similar situation to me where they've basically got to the bottom of their balance sheets in that process.

So we've seen a lot of resilience because people have no choice. They can't go, "I'll put cattle where I put sheep" - because I can't use the buildings and the products and the structures and the capital investment I have to do something else, so I've survived as long as I possibly can, because if you look at the last year, if the bank had come to me in the middle of last year and said "enough", then I would have been left holding a debt of about a million dollars. They could have sold everything up and I would have owed them because what happens is the capital value of those structures are virtually zero in the situation where we found ourselves because no-one wants to buy them. Now, if that happens to a sheep farmer or other farmers like that, the land value is still there.

So in our situation - I'm talking about the general industry situation - you actually scrape and reinvest. I put money back in the farm where I already had money in other areas which had much better returns on investment but if I'd not pushed them into an area which I believed had a lower return of investment, then I would have lost the whole lot. So investment decisions and capital decisions are made doing that. So I don't think that is a reasonable way to look at the situation because as I said before, the 70s, 80s and probably to the mid-90s is totally structurally different in terms of the marketplace and it's my view that the effects of what's happened over the last two or three years will only be really, truly affected in production numbers if those sort of situations continue.

So if we go back to Dr Byron's comment about the profitability over the last few months, certainly if we have a situation where profitability is okay for the next year and a half or two years, then people will not fall out of production. If we have the reverse happening, I think we'll see quite large falls in production. If we have the reverse happening, I think we'll see quite large falls in production. The trouble is, if you wait to look at policy issues until you've actually revealed the macro trend, you will have people who have already been destroyed and the balance sheets of the people that survive are in very bad shape as well, so by the time you get to the point of understanding how production values reflect profitability, you've gone beyond the point - you've either got good profitability or you've got bad profitability and the results will already be out there in the marketplace. You actually can't act on the results of such an analysis.

MR EDWARDS: I understand that the best option for people when profitability declines is not always to significantly reduce production immediately. That's understandable. The reality of course is that there's significant uncertainty about the profitability in the next six months, then the next 12 months, then the next 18 months et cetera, and producers will respond; they will make their supply decisions in response to their judgments about those future returns. Some will be more risk averse than others. That's the reality. I do accept that because pig production by and large is a more specialised enterprise than others and you can't cut back on pigs and plant a few more paddocks of grain just because pig prices are down - that makes you a bit different, it makes you significantly different from mixed farms in Australia - nevertheless the reality is that thus far, I question whether we have seen significant reasons for expecting that there will be a departure from the trend of increase in the volume of pigmeat production in this country.

DR HIGGINS: We've already seen a reduction in production now. What I'm saying is from an analysis point of view, if you wait until production has significantly fallen, then the story is finished anyway because you will have had to have lost significant parts of production and those that survived will have been seriously weakened. You started off your discussion by saying that production costs weren't a way to look at policy; what I'm saying is that production share or production numbers aren't a way to determine policy either because they have significant weaknesses for the reasons that I've outlined.

I think from the comments John has made and my analysis there, is that explains largely why you've seen such a large fall in terms of the smaller operation, because as you say, the smaller operations have been part of other mixed farming operations. In fact, quite commonly those farms who might have 10 or 20 or 30 or 40 sows did so to augment grain production or to value add that. Their situation is different than ours as a specialist producer and representing other specialist producers, because they look at it and say, "I'm not going to continue to have those 20 or 30 or 40 or 50 sows because if I do so, it will drag my whole operation down," so they have taken rational economic decisions to say, "I'll get out to save the rest of my business." I'm the other way round; I've actually damaged the other parts of my business to save the pork part because I don't have any choices in those circumstances because of the reasons that I outlined.

MR EDWARDS: But of course, the smaller producers or mainly the smaller producers have been exiting the industry in substantial numbers, not just in the difficult recent years but over the last several decades.

DR HIGGINS: Yes, for the reasons that I said: a lot of them were based around the dairy industry and when they have had bad periods, they have looked at it and said, "I don't want to go through that again." In fact, some of them tend to exit when things are good rather than bad because there's no capital asset left in their pig production facilities, but they will sell the pigs when the prices are high because there's no capital asset left in their pig production facilities, but they will sell the pigs when the prices are high and because that's the time they can get out with the most capital intact from their investment.

MR EDWARDS: I accept that some producers will be not optimistic about investing right now, that's understandable, but we have heard from others who have told us they are investing in a substantial way.

MR COOK: Maybe we need to clarify some of that. As you can possibly appreciate, in some of the information we've been providing, the large retailers are working within their supply chains to better organise how they put product into their supermarket shelves, so there will be a small number of people who will be benefiting at the present moment for the fact that the retailers are working to regularise their supply lines and those businesses clearly can contemplate an increase in their throughput. Given the pressures we've been mentioning in our submissions, there is no guarantee that that volume is going to be generating the sorts of returns that could be anticipated in other industries, so you're back where Paul was suggesting earlier, and that is, at what point do you continue to have to use your infrastructure to try and get some modicum of return for the investments you've made historically? So there are a number of people who are expanding; it is as a result of the large retailers putting a lot of work into their supply chains. That will benefit a number of those participants. It may well come at a cost to the remainder of the supply chain.

I don't think we should be assuming for a moment that in the absence of all these other pressures we have that that increase in volume will generate the financial solutions that those industries are looking for or those participants are looking for. The pressures are the same across the industry; the issue is that there may be a migration of demand or supply from one part of the market or the industry to the other. In the absence of these pricing pressures being looked at carefully, margins with the industry will still be stressed, and on that basis, the balance sheets of even those expanding businesses are potentially put in peril.

DR BYRON: But that sort of supply chain reform that you're talking about seems to me to be going on not just in the pigmeat industry but in everything from lettuces to rubber washers and bathplugs, where the retailers are trying to get the best possible price they can. They're putting pressure on wholesalers, manufacturers and all the way down the line. Of course, the pig producers in turn try and get grain at the best possible price they can. This is something to do with competitive market capitalism perhaps, but that process has been going for a long time. Those who do enter into long-term supply contracts with the major retail chains presumably do so voluntarily at a price that enables them to make a decent income. Those who don't get those sort of long-term supply contracts may well be feeling particularly insecure and under threat. Again, that's probably just as true in lettuces or peanuts or anything else.

The importance of that is that it emphasises that these sorts of supply chain drivers, those processes, are going on sort of irrespective of what is happening with regard to import competition. Even if there were no imports at all, those processes would still be going on where the major retailers are trying to get product at the best possible price and they're entering into long-term contracts. It's a feature of most industries that's probably here to stay, isn't it?

DR HIGGINS: We would totally accept that. What we would say is I don't believe that government policy is driving up the cost of the input costs of making bathplugs, whereas that's what's happening in industry.

DR BYRON: Yes, okay, good.

DR HIGGINS: And I don't know about the bathplug industry or the washer industry or whatever else it may be, so I don't know whether their competitors are significantly subsidising and tariff barriering their production systems. So what I'm saying is part of our industry restructure plan is actually to say, "We want to transfer some of the risk," in terms of long-term contract pricing and you would have seen that plan as part of that process. So what we're saying is we believe those things are realities of the marketplace, as you say, totally agree; what we want is a fair trading situation where we can actually deal with those issues and control the issues we can control. So we would argue that the retailers are able to drive down prices more than they otherwise would because they have access to product coming into this country that is unfairly traded. If that was fairly traded, then we don't have any problems with dealing with the realities of the marketplace.

MR COOK: There's another component to that argument too, commissioner, and that is that we, as a community here within the pork industry, do not necessarily have access to a number of those very interesting markets that may well be the basis on which, say, some of our international competitors have built their businesses and their franchise. So today we find a situation where global competitors have free and unbridled access to Australia; obviously they have nil duty rates. We find ourselves unable as an industry to compete in some of those important overseas markets. So there's the impact of what happens in pricing, but equally are we able as a community to take advantage of better returns by competing in foreign locales that traditionally have been outside our ability to participate? We believe that our industry plan is another critical part of the program.

DR HIGGINS: Can I just ask - Selwyn wanted to say something. I think I've been hogging the microphone, so it may have gone past his point.

DR HEILBRON: Just a few comments: I think the analogy that has been made with all industry is not appropriate. This is a vertically integrated, capital-intensive industry and that has all sorts of implications for the way in which the business is conducted, the rates of return required and the options that people have, as Paul has pointed out. I also think it suggests that certainly processors will have a very keen view and idea on what their costs of production are and whilst we may debate what an appropriate measure of that is in an economic sense, from the point of view of ongoing practical commercial survival, if they don't have a keen sense of what their costs of production are, they won't be around for very long - growers, producers, that may not be as well formed - but I think that one of the necessities of an inquiry such as this would be to explore those issues and to get as much data as possible.

If it's confidential from the industry, then one would hope that the commission had the resources to be able to explore these issues which are necessarily complex but important, I would have thought, to determining the question of the competitiveness of the industry. I don't think using any form of proxy, such as what's happened to production, is really going to overcome that. Because of all of these issues associated with declining numbers, higher yields, there can be all sorts of factors associated with increases in production over a long term.

I think the second point would be that there seems to be a view, albeit implicit, that this industry has suffered a long-term decline and that this is in a sense a natural state of events and that it's been a continuous process. I think that ignores the very real structural break that happened in this industry during the mid-80s, where it turned from a situation of almost total protection against imports on quarantine grounds to very, very little protection virtually overnight and without any form of adjustment assistance at that time. I think that it's quite clear that the industry suffered serious injury as a result of that process and that has had substantial impacts on the conduct of business in the industry, and John and Paul have mentioned that the assumption that supply chain measures are the same in this industry as in others ignores the impact of imports on the price structure, the cost structure and what's happened to production.

I would also say that one would need to look at not only the level of production but what's happened to the level of consumption and the role that imports have played in taking an ever-increasing and heading towards a majority share of that consumption in that time period.

DR BYRON: Yes, that's a very interesting point to pursue further. But before I go there, can I summarise the discussion up till now about structural adjustment and get your reaction to it, that prior to 1995 and the quarantine reforms, there was enormous and continuous structural adjustment from 40,000 down to about 5000 producers and yet in the same time, total production doubled from 180 to 360 thousand tonnes. But that was in a world where we had quarantine and Australia was an island, so to speak. Okay, the game has now changed substantially. What we've argued in our draft report is that the industry is becoming much more integrated into global product markets with more import competition into the Australian manufactured pigmeat market - not fresh, manufactured - and with Australian exporters being more active in overseas markets, particularly Singapore and Japan and a few others. So we recognise that there's a great sort of divide in history pre the quarantine change and afterwards.

The consequences of the quarantine change, I think you're arguing, are still being worked through. Is that right? To a certain extent, whatever happened pre-95 is ancient history. Is that where we're going? The question of the dominance of imported pigmeat is a word that you've used in your fourth submission, and something that I don't quite understand still is that if we're importing 60-plus thousand tonnes of boneless frozen meat and Australia is producing - taking off exports, so there's probably 350-something thousand tonnes of carcass meat, maybe 200,000 approximately boneless. We're then saying that the 60,000 tonnes of imported meat, about half from Canada and half from Denmark, which only goes into the manufactured sector - ham and bacon, smallgoods - is actually determining what happens to prices and volumes in the other 200,000 tonnes of boneless domestic production.

That seems to me like extraordinary leverage, particularly when the fresh meat market, dare I say it, is totally quarantined: only Australian producers can supply that. It's quite striking, the argument that a relatively small - 20 per cent - amount of the total production, even if you say it's a third of the leg meat going into ham and a third of the middle going into bacon, is not only determining the prices that Australian producers get paid for their legs and their middles, but even determining the prices that Australian producers get for pork chops that are sold in supermarkets and restaurants. That seems to me like an extraordinary amount of leverage, even through the quarantine barrier.

DR HIGGINS: I guess what fundamentally happens is that if I produce a carcass tomorrow, then it goes wherever it goes, so if I'm selling on to someone else who is doing something with that carcass, then the assumption that the fresh meat is over here somewhere and the manufactured over there somewhere is not correct. For a start, cuts from that single carcass can go in both directions. So the overall return for a carcass is determined partly, even if there was no influence any other way, by what goes into the manufactured sector. Secondly, in terms of returns, what happens is that if we are producing 200,000 tonnes - I'm not sure that's exactly right but just for the argument - - -

DR BYRON: No, it's just a back of the envelope.

DR HIGGINS: 200,000 tonnes and 30,000 tonnes will come in, then 30,000 tonnes of what was going into the process market, assuming there's no growth in the market - talking macro things at the moment - gets displaced, because what I could sell there now gets sold over here. So now you have a situation where you've got 15 per cent more product in the fresh market than there was previously. I'm not sure we've done these in our submissions, but clearly some of the work that's been done in terms of pork consumption indicates that the demand-supply thing - and again I'm going to my bush accountancy thing - is fairly inelastic. So if you discount pork 10 per cent, you don't sell 10 per cent more pork. You have to really discount 50 per cent or whatever to do that. So small volume changes can make a significant difference in price.

My rule of thumb, which I've used as I've gone through in our business things, is that a 5 per cent difference in supply or demand can make a 20 per cent difference in carcass price. That's the rule of thumb that has largely fitted as you go through, and if you go back and look at those numbers in terms of supply that occurred say when FMD cut Denmark out of the process, you'll probably see those sorts of returns. The volumes weren't, as you say, that huge, but they created a 20 or 30 per cent increase in prices because of those interrelationships.

DR BYRON: One of the things that intrigue me about your restructuring strategy for APL is the increasing emphasis on the fresh meat market and the intent to grow that fairly dramatically. It seems to me that if more of Australian production was orientated towards fresh meat production rather than towards manufacturing, you would be much less vulnerable to impacts from imported product. Would that be right?

MR COOK: Yes, it is. We actually see, commissioner, as you could probably understand, that part of the reason why we are where we are with the balance between fresh and the remainder of the carcass going into smallgoods is we've yet to establish markets for those particular cuts. So there has to be a change to how our industry, retailers and even Australian consumers react to preparing dishes using fresh pork products which maybe traditionally have never gone to market before. So the use of minces in stir fries and strips are things which we see factoring into our business plans, actually using more legs to prepare steaks which enable different barbecue lines than were there previously.

We see these things as solutions but, as you can probably imagine, these things take many months, many years potentially, to stabilise, change eating behaviours, attitudes of retailers, to see them fundamentally make the contribution we think we'd like to see them make.

DR BYRON: But can I presume that the reason that historically 60 per cent of Australian pigmeat production has gone to manufacturing and 40 per cent to fresh is that manufacturing was seen as being a bit more lucrative, that the returns were higher, perhaps because of a larger carcass size?

DR HIGGINS: I think those things were largely determined by those sorts of reasons. Most farmers would sell a carcass - it's more long-term now, but certainly in the past - where they would get the best price for us, so where the best price was. That doesn't mean directly to a processor as such. It may have gone to a wholesaler who sold parts off to a processor and other parts to fresh meat, but where the net price was higher is where the product would go, just for reasons of natural economics.

The one frustrating thing for us is that if we grow fresh meat demand, if we were selling 500,000 tonnes of fresh meat and 30,000 tonnes of import came in, then obviously there's a lesser effect because it's a lower percentage of that variation. Our frustration is we seem to grow, and we believe we've grown, the fresh meat market, and then what happens in response is just more product comes in, in the manufactured sense. So actually capturing the value of that capital investment we do in marketing becomes problematic. All we're asking in this process - and to some extent I see this discussion as a little bit sort of a sideline - is that if that manufactured product was coming in at a fair trade competitive price, who cares? That's just the marketplace.

We're not here to defend someone at Manangatang or wherever else who's a high-cost producer, who can't economically supply under a normally competitive market. We're here to say we want a fair situation that allows people, as Geoff would say - people make rational economic decisions about whether they're competitive or not. Our main issue is that it's not a true competitive market because of the structure of the market, both in our cost inputs and our competitors.

DR HEILBRON: Could I just add that meat industries increasingly now are industries which produce cuts and trade cuts. The producer produces a body, but the consumer buys the cuts, so for the processor it's a matter of juggling what returns they can get from what cuts, and that ultimately gets fed back to the producer. In the situation where you've relied for many years, for example, as has been the case with the industry, on selling premium-priced legs into the market at Christmas and you have imports coming in, placing a cap on the ability for that premium to be extracted, it doesn't just affect the price for legs, because ultimately that's averaged back into the price that the processor is prepared to pay for the body from the producer. So there are quite clear linkages between the various segments of the market.

The commercial parties are acutely aware of this, and I notice, going through some of the submissions that have been made to this inquiry, it's quite clearly set out in I think the first one, which was put in by QAF, one of the major processors. They go through this over a couple of pages, and it's quite clear how they describe the process taking place.

DR BYRON: But we had evidence from a major both grower and processor and manufacturer in Queensland who said that he'd checked the prices just an hour or two before coming to the hearing, and I think he said that he could buy Queensland legs for $6.50 or $6.60, he could buy Canadian legs for $4.50: what should he do? Given that sort of disparity, it's quite clear why there's a lot of Canadian legs coming in.

DR HEILBRON: Yes, there is, but I think it's also worthwhile looking at some of the evidence that we've provided about how that price gap moves over a period of time, and I think that also indicates that once again we're talking about cuts and we're talking about periods of time. There are periods of time where there's no price gap between the imported and the domestic product, then there are periods when there are very, very substantial ones, and I guess it's foreshadowing the discussion that we'll have on trade works, but there are period of time when the producer in the overseas market, in Canada or Denmark or wherever it is, will find itself in exactly the same position as the Australian producer. There are times when demand for a particular cut will be very high and there are times when demand for a particular cut won't be high at all. That's the nature of the trade. It's between cuts and it's between period of points of time.

DR BYRON: And the competition is between firms rather than between industries?

DR HEILBRON: Ultimately it comes down to the firm that's in the position of having to try and maximise the returns from the body, but I guess I would suggest that there are broader-term impacts on the structures of industry as a result of those individual decisions. It's those that I guess we've been referring to over time.

DR BYRON: We seem to have moved into assistance for overseas competitors anyway. Many of the submissions that we've received have asserted that basically all imports are heavily subsidised. We've been looking for evidence of this, and it's been a bit like looking for weapons of mass destruction: you're pretty sure they're there but you still can't find them. We've asked all the people who've appeared before us, "Can you suggest where we might look for these?" We've been looking very hard. Do you have information on the levels of subsidies in the countries that export pigmeat to Australia?

DR HIGGINS: I hope the commissioner is not suggesting we should invade Europe looking for subsidies of mass destruction. I'll have to ask my colleagues to go through that in detail for you.

DR HEILBRON: Commissioner, I have seen the same publicly available information as I think everybody else has on levels of producer support in Europe. It seems to me that there is very, very substantial support provided to producers which will underpin the profitability of those producers in some way. It seems rational that they will be able to afford to incur lower prices paid for the pigs that they produce as a result of those subsidies. Tracking what the processor does once that body has been processed is extremely difficult.

For one thing, subsidies at that level are not monitored by the agencies that monitor support to producers. It is all measured at the farm gate, except if there are very specific aids given to processors. So it's a very, very complex matter to track through those levels of support and identify the extent to which they occur in the precise cuts which are imported into the country, and I would suggest it will be - your search would take a great deal of time to get to the bottom of that.

DR BYRON: Well, we have been in regular contact with OECD and with Dansk Slagterier, with the Danish Meat and Bacon Council, with universities' agricultural and economics departments in Denmark and other parts of Europe, with government agencies, with the European Commission in Brussels. We've gone through the government budget figures looking at all the subsidies under the common agricultural policy and particularly under the Danish budget. We can't find anything there that adds up to very, very much at all. They're relatively minor, tiny amounts. We're talking less than a cent a kilogram of export rather than - you know, we would need to be able to identify amounts in the orders of billions of euros or tens of billions of krone to find the level of subsidies support that people have alleged. So we keep looking but we haven't found anything yet.

We've found that the Danish middles haven't been eligible for any sort of export subsidies from either Denmark or the EU. We've also found what may be a misinterpretation of OECD figures that all of us, including myself, have initially assumed to be correct, and ABARE also initially assumed that they were correct. So ABARE is now also looking into this and considering previous statements on figures that may have been flawed.

DR HIGGINS: Could you expand that, please? Be more specific.

DR BYRON: Sure. There's a table in the draft report on page 48 with the OECD estimates of producer support equivalent. A lot of the producers that we've spoken to sort of challenged the OECD estimate for Australia as 3.59 per cent because they don't think they get anything, but that includes R and D, tax averaging, farm management deposits for those who are eligible, diesel fuel rebates, all sorts of things. The interesting thing is that the figure for US is not terribly different from Australia. The figure for Canada, apart from the Canadian Income and Stabilisation Scheme, would also be in the same sort of ballpark.

The one that really sticks out is the European Union. And I emphasise that that's European Union, not Denmark. They're not necessarily identical. 20.33 per cent out of the 23.93 is under market support. Now, the OECD defines that as measures that - in their case the tariff quota, but tariffs, quotas, import licensing, those sorts of things that have the effect of raising the domestic price. But the OECD also says that for any country that's an exporter or any product, the market support figure is in fact not applicable. The tariff support, quota support only applies for countries who are importers. So that even if that figure is correct for the whole of the European Union, it doesn't necessarily apply to a country that is not a major importer.

The other thing is that that figure is basically saying that those trade restriction measures of the EU have increased the EU internal pigmeat price by 20.33 per cent above world prices. Now, when we actually look at the prices within the EU and compare them to world prices at the same time for the same product, the same commodity classification, EU internal domestic prices are not 20 per cent above. In fact, they may be 20 per cent below. The interesting question from Denmark is that all the data that we can get suggests that the Danes, when they export outside of the EU, receive a higher price than if they sell within the EU 14 or 15. So that suggests that that market support figure for Denmark is negligible, in which case Denmark is back in the same ballpark as Australia and the US and Canada. I mean, I'm not making that as a definitive categorical statement but the way that the data are taking us at the moment that's what we're thinking about.

MR HEILBRON: Commissioner, I would be very careful about the use and interpretation of that data. The way in which those support measures are measured, the factors which they take into account, are economic measures. When looking at the trade flows one would have to be very, very careful, even about whether the cuts actually correspond to the tariff codes. That's the level of detail of analysis that has to be done if we're seeking to track a flow of support through to an ultimate impact on prices in an international market. The OECD numbers are aimed at addressing the wedge between domestic and international prices, but a whole series of factors and analyses are rolled up into producing that 20 per cent number. It does not necessarily mean that if you go and you have a look at the price for a particular cut of meat in a supermarket in Denmark that is going to be boosted by 20 per cent over the price of an equivalent cut of meat in Australia. The data, in my view, is just not sufficient to support that kind of end point, if that's where we're seeking to go. I think the data just doesn't support it.

DR BYRON: We're comparing the FOB prices from Denmark for a specific commodity classification, which may not be a cut. I accept that - but an eight-digit level commodity code. The prices that they get when they send for that to Australia is substantially higher for the other product which they send to the other European Union countries, and it's consistently been so for years - not quite as high as the price they get when they send that commodity classification code pigmeat to Japan but nearly always higher than what they'd get within the other EU 14.

MR HEILBRON: Sorry, can I just finish in terms of the OECD data? The OECD data also - and this has been acknowledged to me by the OECD - does not identify a whole series of other support measures, particularly those which exist at the state level and regional level; in other words, below the national level. They only have the sketchiest idea of, for example, the impact of grants given by local or state authorities, which can be quite significant for meat works, feed lots, all sorts of things. So I just reiterate the point that the OECD data is a good macro-level guide but I would be against trying to trace that through to assess the impact on particular products because I just think they're there are too many discontinuities in the data to be able to make that data - - -

DR BYRON: Would the same apply for provincial assistance in Canada?

MR HEILBRON: I just don't know.

DR BYRON: But it could.

MR HEILBRON: It could. It could. It's been acknowledged to me that, particularly in the case of the United States, the OECD relies - and I've documented this in research - the OECD relies on an estimate, for example, from the USDA of what subnational support is, and it was I think a couple of billion dollars, which seems very low, given that every state in the United States has got an incentive. For example, just about every state in the US levies fuel taxes and property taxes. Those are substantially rebated, in some cases completely waived, for agricultural enterprises and some processing enterprises. There are also deals done on a one-off basis for feed lots and meat processing works and all sorts of things not picked up at all. My guess would be that a lot of the member state data in the EU would be picked up but not perhaps local authority level, and there's a lot of assistance given to - and even city states in Europe give a lot of assistance to processing works and so on for employment reasons.

As far as the data reflected higher costs within Europe compared to exports within Europe and then outside of the country, I can't explain those. In order to get to the bottom of that you would really need to beaver into exactly when that happened, what time of year, what the alternative markets were for those cuts. It varies from year to year. It's - - -

DR BYRON: Month to month, actually, but we've got monthly data going back a for years and it's consistently substantially higher; the FOB price to Australia than the FOB price to other countries, including the EU 14 - and it's a mystery.

MR HEILBRON: It's a mystery.

DR BYRON: Yes.

DR HIGGINS: Can I just clarify, commissioner, in the attachment 1 to your report, the report that was commissioned from Prof Nixon, it actually says the opposite. So I'm confused by your statements being different from your attachment in your own report.

DR BYRON: Yes. Well, as I say, in November, when this was put together, we assumed that this OECD figure was correct. That's why we put it in there. ABARE had assumed that this was all correct. Clair Nixon had also assumed it was correct. It was just that as we started digging and digging and digging through all of this there seemed to be more and more anomalies and so Clair Nixon and ABARE and OECD are currently all going through it again.

DR HIGGINS: So, I just quote - - -

DR BYRON: But Clair Nixon is basically a specialist in the US and Canada, being an American, and he said he's looking at it.

DR HIGGINS: I just quote one of the quotes we've put in our submission, which is one page 30 of our submission, full submission.

> Clair Nixon says that the European Union enjoys certain competitive advantages. Beneficial crop production policies that have reduced the cost of feed will continue to be an important benefit to pig producers and enable them to remain competitive in the global market.

Now, that quote goes on about the two-tier pricing. I've left that out because of this discussion.

DR BYRON: No, but we're - - -

DR HIGGINS: You're saying that as well or just the - - -

DR BYRON: No, we're just following up on all of that. We're checking everything we've been told with everybody who's told it to us, and trying to cross-check, because there are serious inconsistencies. But this started because, I guess, APL and QAF and others are saying that the difference in average cost of production in Denmark and average cost of production in Australia suggests that - you know, "How can they do it so cheap? There must be a subsidy somewhere." So we've just started digging, and we've now got lots of other people helping us dig, and the - it's nowhere near as clear-cut and self-evident as we thought when we put that table in the draft report.

MR COOK: Certainly we've actually as an industry tried to best understand the circumstances of Australian participants as compared to obviously the pricing that would be prevailing say in Canada or in Europe. Our tracking commissioner indicates that there is in actual fact a heavy discount of meat landed in Australia as compared to the comparable pricing operating in Europe. That is something that we have satisfied ourselves of by carefully going through the actual invoice value of product imported into this country by a number of the largest importers.

So it is curious that when you look at it at the macro level, you get one picture, and yet when you actually get down, as you indicated earlier, to the farm enterprise level, you get a picture which is more reflective of the concerns we've had as an industry. As you can probably imagine however, that inevitably there are degrees of confidentiality and a sense of concern, too, that in the event that this is a pivotal part of how you maintain margins in an extremely competitive industry, to what extent are you able to actually provide that information as broadly as we would otherwise like for fear of deteriorating relationships and effectively closing doors which have been important to the profitability of that particular firm.

So the figures are suggestive of the trends we're suggesting. How are we able to bring that to the commission's attention? That is what we're working on at the present moment. I would also hazard a guess that in a situation where we today in this industry do not have any duty payable on these imports, I think we have to wonder is there the opportunity to disclose the value for importation which suits one set of arguments without that necessarily affecting the overall landed cost of the product. So are we finding a situation where one set of figures are being used for the purposes of how it's perceived on the outside, knowing fully well that what will ultimately define the relationship between the exporter and the importer is the true landed price, and I do know that in actual fact that seems to be a very different figure to the one that you're working on.

DR BYRON: That's a good point. We're basically getting very different answers whether we looked at the individual shipment of a piece of meat and all the rest of it, the national trade statistics and the OECD and the Euro stats and all that sort of stuff. When we look at the budgets for the European Commission and for Denmark, you know, if there was some budgetary support, which line is it in? There don't seem to be any lines that are anywhere near big enough to contain the sort of subsidy level we're talking about. We've looked at export restitution, we've looked at freezer storage and all these sorts of things. Subsidies of mass destruction; they're well hidden.

It might be time now to just take a break for 15 minutes, have a cup of tea. There's still a lot more that we need to discuss, particularly safeguards, and then there's the sorts of things including single desk and import quarantine on grain and possibly welfare issues and other regulatory issues that have the effect of increasing import prices for the pigmeat industry, because up till now we've been mainly talking about things that lower the prices received rather than increasing unit costs. But if we can adjourn for say 15 minutes. Thank you.

DR BYRON: Thanks very much, ladies and gentlemen. I think we were discussing assistance, overseas competitors, and some of the informal discussion over the tea break has suggested that this remains extremely complicated and, as I think I said before, we seem to be getting different stories on whether you look at individual transactions for a specific cut or shipment, as opposed to looking at the statistics from Denmark, whether you - is there anything else that you wanted to say about the discrepancy between the prices received and apparent costs of production, recognising what Geoff said before, that costs of production is very rarely, if ever, an exact and highly credible number and that I imagine the Danish industry, like Australia, has an extraordinarily wide range from large to small producers with different costs of production?

DR HIGGINS: I don't really want to go too much more into that now, but I just make two comments. The first one would be that, you know, clearly we would have the view that it's not necessarily in the interests of either Denmark or the European Union to clearly identify and establish these costs and demonstrate them to the world, and clearly they try and create complex systems in this process. The second one is that we believe it's extremely important that the mystery of the subsidies of mass destruction is properly gone through, so we believe that these issues and the discrepancies that you discovered and investigations that we are also doing, we need to get to the bottom of this because we believe this issue is critical to the outcome of the commission's report.

So two things: firstly, we believe that again it strengthens the case which we'll be asking for an increase in the length of time for your deliberations, and secondly, we're happy to work with you and try and coordinate those efforts to get to the bottom of whatever is there, and whatever other information we can find and would like to have some input into the information that you find in this process.

DR BYRON: Thanks very much for that.

MR EDWARDS: Could I just - - -

DR BYRON: I think I was going to make the same point that you are, that irrespective of whether, what, how, assistance may be given in other countries, it doesn't necessarily imply that Australia should do the same or apply an equivalent or offsetting trade restriction. To some extent it may be something of a moot point, that if those international prices are distorted for whatever reason in whatever way by whoever does it and that is likely to continue indefinitely, unfortunately, then to a certain extent one could argue that what Australian producers have to do is live with it and get on with it, and make whatever adjustment decisions, expansion or contraction or whatever, recognising that, yes, it's extremely unfair but, you know, that's life.

DR HIGGINS: I'll just make two comments on that. One is firstly, I think that before we move to that point we should establish the facts and I think it's extremely important that we do so, otherwise if we can have that second discussion without the facts then it's problematic in itself. The second one is that I believe that, as I talked to you about before, in terms of accessing capital to do the changes which we believe are needed, our industry restructure plan has a number of changes in it which we believe, regardless of the subsidy levels or trade tariffs or unfair distortions of whatever they may be, will make us more competitive in the international trading place.

My concern is that if farmers cannot access the capital to make those changes then the ability to actually implement that plan will be severely curtailed and I'll try to make this point from the point of view - in your report what you're saying is that these sort of competitive pressures or whatever will make people more competitive and that if we put in place safeguards or other processes as short-term redresses for these unfair trade issues, that they don't give the producers the incentive to actually change and restructure.

I think that that's certainly the case if we talk about a 20-year process of, you know, a safeguard process or whatever because I do believe that people would sit back and say, "Well, you know, we're all going to be right for the next 20 years." But I do believe it's important in the short term to look at structural adjustment measures which may include or not include safeguard measures to enable producers to make the changes that will make them more competitive, because I think there's a significant risk that if they do not get access to capital because there's no confidence in the marketplace, that we will not be able to make the changes to be more competitive and therefore while competitive pressures are pushing in the right direction in terms of change, that the structural issues in terms of access to capital will make those responses weak or inadequate.

DR BYRON: This is the point I wanted to take up when you mentioned this morning about only two or three out of 100 people put their hand up as being willing to invest if current market conditions were to continue. If, hypothetically, it was announced that there was going to be a tariff or a quota or something tomorrow and it was going to be halved in 12 months' time and phased out the year after that, and knowing that it's 40 weeks from, you know, conception to plate, would anybody actually change or do anything? If you said, "Okay, for the next year we've got a buffer of protection, but if it's taking 40 years to produce new product to sell to the abattoirs - - -"

DR HIGGINS: 40 weeks, I hope.

DR BYRON: 40 weeks, sorry, 40 weeks - then will people even respond to that? Your submission, like many of the others, has talked about some sort of trade restriction as providing respite, breathing space, you know, an opportunity to, as you say, get the capital together to make the necessary restructuring that will underline and enable the future competitiveness of the industry. The question is how long would the breathing space need to be, to give the right signal, because if it's only a year or two, people will say, "Well, you know, there's no point in changing for that." If it's 20 years then they say, "Thank God that's over, we can sit back and relax and put our feet in buckets of champagne." So what would you suggest?

DR HIGGINS: I'd agree with the sentiment of what you're saying. If I can give you a couple of examples: in the initial restructure plan process we believe that carcass weight is one of the big drivers of competitiveness on two fronts. If you think about farm production being a manufacturing business, pig farm production being manufacturing business, then we have significant overheads, both in capital and operating costs, within the breeding herd. So every extra kilo that can be produced per sow doesn't carry those significant overheads.

So if you look at our farm, for example, just in rough figures those costs are about $50 to produce a weaner and about another 70 to 90 dollars to finish that pig off. So every extra kilo doesn't carry that $50 in the process. So if we look at that, being able to do that, I can't just click my fingers. I've got to build a combination to hold those pigs. So that can be done in a reasonably short time frame but it requires the market to lead that change. I can't just go and put up those shares tomorrow and say, "Now, I'm supplying you with 90-kilo carcasses," just like, you know, a car manufacturer saying, "Well, I'm not supplying you - I'm only going to supply you with a truck from now on instead of a station wagon, take it or leave it." It just doesn't work

In terms of the time periods - and maybe Alan can comment more on this, but our safeguard measures are generally limited to four years, even though they can be extended to eight years. Our view is that that level around that four-year period would be a sufficient time to go through some of these processes in terms of the industry restructure plan, to change the market in terms of issues of carcass weight, fresh meat consumption and those sort of things, to make us more competitive. So we would totally agree that a 20-year period or - you know, which in theory as a permanent protection level is ridiculous in the extreme.

But certainly because of your understanding, as you've said, in relation to the investment process and the production process, then a one-year or 18-month period is too small to do that. So it would have to be somewhere in between those figures and we'd be suggesting somewhere between that normal four-year safeguard process or an extended period from that, but we're certainly not advocating permanent measures to redress these trade issues.

MR EDWARDS: Could I just ask, we are talking here about pigs for the fresh market or for manufacturing, these bigger pigs?

DR HIGGINS: No, we're talking about, well, two aspects. One is about being more competitive because the cost of production are lower. It's also lower through an abattoir. We own abattoirs, it doesn't cost you much more to kill a 90-kilo pig than it does to kill a 50-kilo pig, so the cost per kilo is much lower. So those are the cost issues. In terms of - and we've already talked about the Japanese market, for example. One of the restrictions on the Japanese market has been that if you produce their specifications it is based on the loin cut, which requires you to really produce a pig of around 95 kilos. Now, that ranges about 88 to 105 generally.

What has held back some of our exporters has been that those products are domestically in the market that are left behind. So the Japanese essentially want a tenderloin, you know, the fillet and a collar butt, and so other products are left behind off a much larger pig. With the rest of the fresh meat market not geared for that sort of product, that has meant that they have suffered deep discounts in the process of selling the rest of their cuts. So I often use a story that, you know, if I want to sell a pig and you gave me $150 for the ears to feed to your dog then the long-run economics would say if I need 160 the rest of the carcass eventually will come down to $10. So it's about those mix of cuts, as Selwyn has talked about, in terms of the trade, not the actual individual cut as itself. Does that answer your question?

MR EDWARDS: Well, no, not totally. The point I have in mind is that we have been told that although there is some pressure for producing bigger pigs that would give economies in growing and in processing, but the domestic fresh market anyway has a strong preference for the smaller pigs. We've been told that on a number of occasions. I'm just trying to clarify that you are talking about getting this meat into the domestic fresh market.

DR HIGGINS: We'd be primarily driven in the fresh meat market. We're not talking about processing pigs because - we would like to get some change in the processing market. So for example, if you go to the US, our restriction in the processing market is essentially the size of the middle, because generally the product which is sold here is loin or full rasher bacon, whereas if you go to the United States for example, you can't find that. I was there recently and all you can find is the belly bacon or the streaky bacon. So the restriction in terms of the processes have generally been the size of a middle in terms of producing that product. So we see the initial drive as being particularly around the fresh meat market.

Now, certainly the current situation - I'll get John to comment in a moment - has been that preference for the smaller pig. During the industry consultation process what we said was, the Americans are producing a 98-kilo pig which is being sold for fresh meat or for processing. We actually had a Dutch farmer who was present at the meeting at Young I think or Grenfell or one of those, who said the specification he was selling to, before he moved here, for fresh meat in Holland for example was 92 kilos. We say that the beef industry manages to sell products to retailers, to consumers out there, off a carcass which varies from 120 kilos to

400 kilos.

So internationally it is done different in the pig market. In Australia it's done differently in other species. I mean, if you told the beef industry, if the retailers told the beef industry tomorrow, "You'll produce beef for our retail shops at 50 kilos," they would get some language I probably wouldn't want to use in the circumstances and within six months they would have no meat, because they just won't stand it. So what we need to do is to change how retail meat is done in this country to actually be able to produce that larger pig. It's not a matter of pushing that towards them. It's a matter of getting to the retail process and actually finding out and changing their minds about how that product can be marketed.

One of the reasons we brought John on board in terms of the CEO of APL was because we were looking for someone with his history of - you know, involved in Kelloggs and all this sort of process, to work our way through those issues about where those restrictions are and why they are, and I'll get him to comment. But he has told me that when he first went to Coles, when he first arrived, he asked what specification was best for Coles and he got six different answers from five different people and eight different reasons for those six different specifications. So there is room to move in that process.

MR COOK: What I wanted to say here to that very good question was that a lot of industries find something to use as the base on how they unitise and cereal category will be how many boxes can you get on a pallet for shipping through the distribution system? So one of the early questions I asked of one of the retailers is, "When you think about an ideal carcass weight what do you see as determining that carcass weight?", and it turned out to be two pork chops sitting on a plastic tray where that plastic tray is a common tray used in the retailers for the meat that they would put on display.

What that meant was that no-one had actually gone and spoken to consumers about what consumers were looking for when they went to supermarkets to buy their meat. What we've done inside APL with the retailers is we've actually gone back to many consumers and tested the extent to which the meat they're now buying from the pork industry is meeting their requirements for taste, texture, size, pricing, the applicability to the meals that they're preparing. What we have found is, not surprisingly I guess, that there's a lot of learning within that research such that the major retailers will have to, if they're going to satisfy consumers in the future, go back and look at things such as carcass weights, portion sizes, how meat is displayed. What we recognise is that that will then enable the abattoirs, the boning rooms, APL and the retailers to work in partnership to give a set of different outcomes to the one we've inherited.

So in terms of, if you think it through, rather than actually the industry saying, "We want to work towards heavier carcass weights," what we've effectively said is we need to better understand is there an opportunity to use heavier carcasses to give better outcomes in the marketplace for our consumers. If we're able to do that, then that will pull heavier carcasses through the distribution system and everyone will obviously be better off economically as a result. So rather than actually having a pipeline push strategy, this is pipeline pull, on the basis of understanding emphatically what consumers are looking for and then working with the industry to deliver it.

Now, another fact which you might not be aware of is that traditionally retailers undertook a lot of the butchering practices in-store. There is a move in modern retail to actually take case-ready product into supermarkets, so what we see this enabling the entire industry to do is actually use carcasses better within the supply lines to meet the particular requirements of particular retailers within particular stores. They can buy their tenderloins or their hams, their bacons, in the appropriate volumes to suit their promotional calendars. It's not that they buy a carcass and then have to find ways to completely sell the meat through the five or six days in which it will still be available within the stores. That was one of the drivers as to why they went smaller; if you've got a smaller carcass, it's easier to handle, occupational health and safety issues are easier, there's less meat to sell.

Now, with the significant changes which are occurring in the meat distribution system with case ready, the fact that we as an industry are understanding more emphatically what consumer requirements are, we recognise that those issues and a lot of those decisions are now back on the table.

MR EDWARDS: Your submission says that you have a target of increasing fresh pork consumption from eight to 14 kilograms by 2008. That's a 75 per cent increase. We know that traditionally the prices of other meats - lamb, beef and chicken and perhaps fish - are important. The price of those other things relative to pigmeat is important in determining pig consumption. What can you say to me to disabuse me of the idea that in the absence of any discussion in your submission about what you're assuming about future price relativities for pork and other meats that that 75 per cent target increase in pork consumption per capita within three, four years is anything but an item on a wish list?

MR COOK: A couple of reasons to have a level of confidence: if you actually go to supermarkets today, you will see that the retailers now are lining like products amongst themselves, so you will have an area for mince where you'll have minced lamb, beef, pork and chicken, and it's not uncommon to actually have those pricings almost being exactly the same. If you go to a supermarket today, you will probably see the mince operating between $8.99 to $10.99 per kilo. Stir-fries will be 11 through to 13 dollars per kilogram and you will see pork and lamb and beef cubed, there for possibly going into stir-fries.

The same sort of approach is adopted by the retailers with respect to roasting joints. You will see a price per kilogram around $6.99. So today we're finding ourselves - as we've gone through the consultative process, I have been somewhat encouraged in the fact that in the last 12 months, the retailers have chosen to put higher pricing than we've ever seen applicable to the pork category because they have line priced with the other meats. That to me says that we are winning sales against lamb and beef and chicken and seafood on the basis that people are looking for an alternative. The retailers' volumes across the entire industry, I have to say, are extraordinarily strong over the last 12 months behind what we've been doing with the industry to try and make pork an appealing meat or an alternative to how many meals of chicken and lamb and beef people are prepared to plan on each week.

So today we find ourselves line priced, today we find ourselves with very strong growth indexes over the last 12 months, despite the fact we've been line priced on a comparative basis per kilo to the alternative meats. It is true that lamb and beef in the ensuing years may well be lower. It is also true that the retailers have actually used - and you've possibly spoken to the retailers - the retailers will tell you that they have taken the opportunity to use pork to give some of the margins they were not otherwise earning on the pricing of the higher lamb and beef prices at the present moment. So in the event that there are stock pressures back off lamb and beef and the opportunity exists to lower the prices, my sense is that pricing on lamb and beef will drop, as would pork. The comparison here is the line price for stir-fries, roasts and minces, so effectively I think the comparability is carried forward. Over the last 12 months despite, as I've said, the higher prices, we have managed to achieve the volume that we'd actually like to see achieved to hit that 2008 target.

DR HIGGINS: To quantify that a little bit more, Geoff, for example, Woolworths has announced at their recent AGM that their business plan for the next three years is to increase pork sales from 7 per cent to 15 per cent of their total meat sales, so they're planning an over 100 per cent increase as share, not in the raw numbers, on their meat sales.

DR BYRON: Does that give you confidence?

DR HIGGINS: Certainly it's a lot better than saying they're going to sell less.

MR EDWARDS: Does Woolworths say what assumptions they are making about future prices for the competing meats in that forecast?

DR HIGGINS: You'd have to ask John about that.

MR COOK: Again, I think they imagine that the cycle for lamb and beef has still got 18 months to run. I think they envisage that at some point when supply gets back to normal, they will be able to look at the relativities on pricing, but right now, they have factored - as you'd probably imagine, retailers worry substantially about what products they've got to go into their supermarkets tomorrow and keep their consumers happy, so I think there's a recognition that in time, these volumes may well come back to normal. They may have a bit more flexibility on pricing than they've had over the last 18 months to two years. That said, they're extraordinarily appreciative of the volume growth that's been evident there in the pork industry and not surprisingly, where they have been able to take the pricing up, it has made a disproportionate financial contribution to the activities of the fresh meat area of their supermarkets.

MR EDWARDS: I think if you can achieve this target, it will be a success comparable to the success of the dairy industry leaders in winning the $2 billion industry adjustment package.

DR HIGGINS: We can have a debate about whether it's a success or not, but anyway - - -

DR BYRON: Can I come back to the question of safeguards and trade measures, in your second submission it was, I think, you suggested a tariff rate of 85 per cent on legs and 32 per cent on middles, something like that. I was just wondering if you could talk us through the developments that would follow such a decision. It doesn't have to be that, but I think I quoted before some figures that Canadian legs are $4.50 and Australian legs, they're asking 6.50 or something, so I assume that there would need to be a fairly substantial tariff or equivalent to basically dislodge the Canadian product from the market. I'm just wondering if we can talk through what happens if a tariff of 40, 50 or whatever per cent was introduced tomorrow or a couple of dollars a kilo, something like that, what happens next? What would be the ramifications of all that? How would it work out?

MR OXLEY: Can I ask if we will still have an opportunity to address some of the more general comments about the possible place of safeguards in your inquiry aside from this particular question?

DR BYRON: Sure, yes.

MR OXLEY: Ask Selwyn here. He's done the sort of sketch reasoning behind the numbers which are in the report.

DR HEILBRON: I'd make a preliminary point on that: the number that you've quoted is an estimate of the kind of peak level that would be required at a certain point in the year based on past trading patterns and the gap between the imported product and like domestic product. The impact of a tariff would depend on the period for which it was applied, the level at which it was applied and any other measures which were associated with it, so as an a priori thing, I can't really say what that would be. I'd illustrate that by if you were to take the view, as is indicated by the analysis, that there's only certain times of the year when there is that type of price gap and the remainder of the year it may be negligible or even to the advantage of the Australian product, and if you applied that tariff as a kind of variable levy which only worked for a certain period of time, it would have a completely different set of impacts than if you applied it as a flat rate which occurred right throughout the year.

DR BYRON: So it's not necessarily a uniform, annual - - -

DR HEILBRON: Absolutely.

DR BYRON: It would have triggers.

DR HEILBRON: Correct.

DR BYRON: The triggers would be what?

DR HEILBRON: It would have to be obviously the price at a certain time of year; the import prices would need to be monitored if you were going to take a variable levy kind of approach. I guess the point I'm making is you can't really assess that without knowing what the detail - or the assumption of what the precise tariff would be and the measures which were to be applied to make it work. I think it's equally erroneous to assume, just because it's a tariff at a certain level, that it will have certain impacts, to suggest that it will necessarily mean that there would be a massive impact on prices to consumers and that demand for pork meat would fall and it would be substituted for other meats. It may be correct in theory but it depends once again on the precise nature of the measure, how it was applied and what other measures were applied in concert with it.

That analysis was done really just to give an idea, as best we can, of the type of price gap there is between the domestic and imported product and when it appears to operate, to illustrate that it's not a continuous process, that the industry is not continuously behind the eight ball in terms of prices against domestic product. The short answer is we haven't modelled what the impacts would be of that. We have some idea from theory but it depends on precisely what the assumptions are about the way in which the measure would move and would operate.

DR HIGGINS: Can I just also ask, when that information was supplied to you, were they talking about net costs or at what point were they pricing in those products? For example, a frozen boned-out leg versus a fresh boned-out leg has cost differentials on it in terms of actually - it's not just saying, "That one is $4.50 and that one is $6.50."

DR BYRON: Shrinkages and losses and disposal of potentially contaminated carcasses et cetera, I'm not sure - I don't recall him giving any of those qualifications, so whether it was like with like is an interesting point. But the difference seemed fairly substantial; whereas with middles, for example, the price for middles from Denmark and the price for middles from anybody in Australia were within a couple of cents of each other and he said, "But I'll be continuing to buy the middles, even when they're more expensive, because of the quality differential." So presumably they were also taking into account the shrinkage and the moisture and the costs of quarantine compliance and all those sorts of things.

But I guess what I was trying to think through myself, and I thought you'd be able to help me, is that if the tariff equivalent to a couple of dollars a kilo went on to any imported product, one theory would expect that the domestic product would price up by approximately the amount of the tariff which is - - -

DR HIGGINS: My bush accounting - - -

DR HEILBRON: It depends on all sorts of things. It depends on the absorption of margins by retailers and processors. There's no - I mean, what exists in the textbook does not necessarily apply. It depends on competitive conditions in the market ultimately where the retailers see their price points, a thousand different things. We can say that on the one hand, yes, it may lead to higher prices of an indeterminate amount. We can also say on the other hand it may lead to increased returns for processors, enable them to invest, gain productivity, and within a period of time, prices may return to their previous level.

DR BYRON: It will presumably always lead to increase in profitability for domestic users, if it's just the reason why they typically support trade restrictions. But what I was interested in - two things. One is the magnitude of the impost on domestic consumers, and recalling that that is not only the amount of tariff multiplied by the import volume, but the amount of tariff across the entire market - the domestic equivalent is priced up to match the duly paid price of the import. That suggests to me, just on the back of an envelope yesterday at home, that it could well be in the order of half a billion dollars a year that consumers would pay extra if there was a tariff of something like $2 a kilo or $2000 a ton.

DR HIGGINS: I think anecdotally for example, if you talk to the retailers, information I've been given personally in the last sort of year or so is that the beef price points for example they've reached within the retailers have reached a maximum, and every time they try to push those at a level to create a margin that retailers would like, because they don't like not making money on things, as you well know, they have hit a price resistance impact point with consumers.

So the examples that John gave in relation to line pricing, and while we don’t -

you know, obviously the retailers don't like sharing their retail margins specifically with us - we believe those are very high on pork at the moment because of the relativities of beef and lamb. So my view - and someone can make some comment - is that it's obviously a very difficult process to model this, but that a large part of that will be absorbed by the retailers in the process because they are pricing at a level already which they believe is as high as they can because they're line pricing with other products where they believe they've hit resistance on products. So therefore even if there was a rise in prices paid to producers under those circumstances, I think it's highly unlikely that retail prices of fresh meat would rise at all.

DR BYRON: Because it would all be absorbed by reduction in wholesale - retailers' market.

DR HIGGINS: For fresh meat.

DR BYRON: The other possible implication that occurred to me was that if the price of imported meat to be manufactured into ham, bacon and smallgoods in Australia went up by a couple of dollars a kilo as a result of some measure that was take tomorrow, and if the domestic price also moved accordingly and manufacturers just said, "Okay, we'll pay the new going rate. We'll just pass through our margins," and they start marketing their ham, bacon and smallgoods at $2.50 a kilo more than it used to be, would there be a reaction from Canada or Denmark to say, "Hey, ham, bacon and smallgood prices have just gone up in Australia by $2.50. Rather than exporting frozen uncooked meat for them to manufacture, why don’t we just export the manufactured product directly."

The higher wholesale price for manufactured pigmeat in Australia might well stimulate overseas suppliers to choose to send manufactured rather than raw, in which case I'm wondering if it's possible that the Australian industry might end up supplying a hundred per cent to a much, much smaller Australian manufacturing industry, and that could well be a bit of a pyrrhic victory in the sense that, you know, you would still have the only suppliers on the Australian manufactured meat market, but if there's a huge influx of Canadian hams or Danish bacon ready packed, ready to go to the wholesalers and retailers, it's not obvious that the growers are going to be any better off.

DR HIGGINS: I think there's a whole PhD probably in that description.

DR BYRON: I'm just sort of making this up as I go along, but it's just a scenario, is it at all plausible that something like that could happen? Is it something that anybody who is - is there a simple reason why it can't happen? I assume that there's no tariff restrictions or quarantine restrictions on the import of manufactured product that complies with Australian processing quarantine.

DR HIGGINS: The main restriction I think is the issue of distance. They both come in frozen right now. If you'd like to go out to the nearest supermarket, you go and freeze bacon for a month and then get it out and see what it's like at the end of that process. It's possible to produce bacon from frozen meat that's of reasonable quality, but the actual freezing of smallgoods creates considerable issues in terms of quality. So there are issues in that sense. The second point would be that the questions that have to be answered to answer your question would be issues of shelf life and other things like that. So even if you were shipping fresh ham from - - -

DR BYRON: I've heard of long-duration shelf-life hams for example.

DR HIGGINS: I don't know if someone knows much about that either, but to answer your question, we'd have to go through all that. You may be making things up as you go along. I don't really want to make things up as a response.

MR COOK: Can I make a general comment here?

DR HIGGINS: Is it something worth worrying about? Is it conceivable? That's all I was going - - -

MR COOK: There are a lot of distribution inefficiencies that would be built up inasmuch as the industry at the present moment brings, you know, large quantities of sort of stackable distribution efficient legs and middles. When you actually break that down, there's a lot of air, space, packing materials that will have to be factored in, and I think we can probably assume today that the smallgoods industry here in Australia already has excess capacity. It's hard to imagine that in actual fact all the distribution efficiencies obviously the competition for volumes that is clearly here evident within Australia within the smallgoods area, that that would prove to be a competitive opportunity for Denmark and Canada, I have to say, but it's something that will have to be modelled.

But I think there are a number of things which you would imagine would prove to be very shocking in terms of the cost equation. It is likely to tilt it more in favour of continuing in a bulk format rather than a broken-down format.

DR BYRON: Thanks. Alan?

MR OXLEY: As Selwyn said, the number was put forward to I suppose open up discussion. Your queries perhaps begin that process which the draft report did not. The draft report said, "You're not authorised to consider the question as to whether safeguard measures should be considered or not," and I think in the comments back to you, the point has been made that maybe that's mixing up the legal requirements for any member of the WTO to undertake in order to - the steps they have to go through before they can put a safeguard measure on, as opposed to the question of looking at the use of border measures as an instrument to support a temporary period of protection which is what the industry has been seeking. In fact it didn't seem to restrain the commission's draft report from then saying about safeguard measures that, "Anyway, even if we're not going to look at them, they're blunt and inappropriate, do not create incentives to adjust and disadvantage the consumer; far from clear that such actions would be the most appropriate."

Your question about what is the right level is actually not a different question to the question you have to ask, if the commission was in fact going to accept that there was a case for adjustment and therefore what was the appropriate instrument, and the basic point that I think was sought to be made was among the range of tools to look at, border measures were an instrument available. How satisfactory it would be would depend on the case and circumstances; a sort of Economics 101 analysis of why you shouldn't use safeguards anyway that really don't pass that test. You'd have to ask the same questions if you were going to argue to the government for some form of subsidy assistance might be made; in other words, the answer of, "What's the level that works?" would be how you model the circumstances to match the need for adjustment that you've identified.

Now, I might just make a general comment: it was disappointing that the idea of using safeguards was dismissed. APL did ask the commission to recommend to the government that it should initiate the inquiry; whether the commission wants to do that or not is its call evidently. It didn't seem to us there was anything that actually that excluded the commission from examining how border measures might be a tool to use for a period of restructuring. Now, you're right about the various effects of the tariff and you need to work out where the costs might fall and on which element in the community, but the elegant thing about a temporary period of a fixed tariff is that it actually leaves the industry to work out how it's going to restructure itself, particularly if there's a certainty that the tariff is going to disappear. One thing we do know about tariffs, as we've seen recently with tariff cuts, is that when industry know a tariff is going to fall, they do act to anticipate it.

One of the things that's disappointing is that we wondered whether some of the thinking about use of safeguards might have actually been characteristic of I guess the way in which historically we've looked at safeguards in Australia. We actually don't have a great history. One thing that's been a bit overlooked I think is that the reforms adopted in the Uruguay round of negotiations actually altered the safeguard provisions in what were then the GATT from what were a loose and permissive form of protection which Australia had quite a bad record of exploiting. They allowed temporary imposition of tariffs with no checks, no surveillance of any significance, no penalties for abuse. The safeguard agreement that was adopted is an instrument for adjustment. It's time bound, it's monitored. The terms of its use have to be negotiated. Parties whose trade is affected have a right to seek some compensation. That's not unusual in trade; that's a device that's been used in GATT under article XXVIII with tariffs from the time it was negotiated. That doesn't seem to be recognised in the summary analysis of why you mightn't consider safeguards in the PC's report.

We noticed in the citrus inquiry, for example, that Commissioner Cosgrove did actually analyse whether a tariff was usable or not in the industry and sequenced his way through it, and one thing we did notice in the report is that there didn't seem to be any sort of systematic sequencing of analysis of what sort of measure might be effective. Perhaps that's explicable by the fact that you hadn't yet arrived at the conclusions to whether you thought the industry merited support for adjustment, but nevertheless, the case that was put forward was really meant to be in that spirit, so in a sense, the short answer to your question is if one was to consider a tariff - and I think our submission was to say, "Could we please look at how that might work?" - the sorts of questions you're asking, I think we might have hoped that it might have been part of the core work of the commission in terms of looking at what sorts of instruments might be used, if the commission of course concluded that the industry merits some process of adjustment.

DR BYRON: I have no problem with that, Alan, but as you've just said, we've actually done this in a two-stage process. Do we think there is a case for industry assistance specific to the Australian pigmeat industry; and having concluded as a provisional interim draft conclusion that it didn't look like there was much of a case for that, there didn't seem to be much point to go through an argue what the options were and which form it should be delivered if we've already reached the interim conclusion that the case for a special pigmeat industry assistance program was fairly weak.

But now, having more time and having had more information in response to the draft report, I think it's not giving anything away to say that we will almost certainly go through and spell out what the options are and what they might look like and the consequences and the pros and cons of - even if, hypothetically, we were to come to a firmer conclusion that we didn't think there was a strong case for a special structural adjustment assistance, but recognising that governments don't always take our advice, we could then say, "But if you did want to give some form of structural assistance, these are the pros and cons of different ways of doing it," and whether it's a quota or an ad valorem or done through the safeguards or whether it's done through trigger prices or Japanese-style gate pricing or whichever way, we will be able to spell out what some of the consequences of that might be. Not having done any sums at all, I have no idea where that chain of reasoning would take us to.

There was some feedback in some of the other submissions about - we seem to be saying that we didn't care what the rest of the world did and trade distorting policies as long as the Australian consumers benefit. That's, I think, a misunderstanding of what we actually did say. We were talking about these trade distorting policies - and the commission, as you know, has a very long record of being opposed to them all over - and then saying, "Even though these things might be terribly unfair and reprehensible and they're distorting trade, the inescapable conclusion is that at the moment it seems that consumers get a better price." That's not to condone it. It's not to justify it. It's not to say we think it's a good thing. But it's just an inescapable fact that unintentionally the European and North American taxpayers are providing cheap ham and bacon for Australian consumers.

Whether the benefit to consumers is greater or less than the cost to Australian pigmeat producers, we've made no judgment at all on that. But those are the sorts of things that we're going to try and go into much further over the next month or so. Did you want to say something?

MR COOK: I think that's an incredibly sort of gratifying position personally, I have to say. When you actually think of the conclusions in the 98 review, there were a number of things there which were likely to be foreshadowed that were going to impact on the pigmeat industry moving forward. It was then hoped that the suggested measures that would emerge from government would arrest or address or in some way mitigate those consequences. I think as we've now sort of seen, what was expected to occur has now occurred. We have had a review of this in 98 which drew some conclusions about the appropriateness of a safeguard. Alternative mechanisms were put in place which, unfortunately, does not seem to have addressed the issues.

So on that basis I guess your objectivity now is gratifying, the fact that these issues need to be on the table and they need to be carefully thought through. We have seen what we expected to see, it seems, over the last six years and with that comes, I think, the obligation to try alternative means to try and help this particular industry structure itself to one which is more sustainable economically.

DR BYRON: But the very reasons that led, like Prof Richard Snape to conclude measures that directly promote industry restructuring and an export focus might be more appropriate than safeguards measures. I still recall the discussions that we had in 98 about this. All of the reasons that were discussed at that time and have been discussed in other inquiries, including citrus, of - you know, if the objective is to promote industry restructuring, is a trade restriction, whether it's safeguard, countervail or whatever, is a safeguard measure necessarily the best way of achieving those restructuring objectives?

Now, one of the things that we've discussed, but not very much in the draft report, is that a trade measure tends to work like a production subsidy in that those who produce most of the product are the ones who get most of the subsidy, most of the subsidy effect. The imposition of a tariff of a couple of dollars a kilo would have a far greater effect on the largest companies that produce most of the pigmeat than they do on the little battling marginal small-scale producers. From a government policy point of view I suspect that governments are much more likely to introduce a structural adjustment package that's targeting for smaller producers in remote and regional areas or people where there's some specific social and economic policy objective rather than to provide a measure where most of the benefit goes to two or three large multinational producers.

MR COOK: If however we look at the circumstances of the industry as we now find it, well, we've gone, as we said, from 40,000 down to 2300-odd producers. We've already seen a substantial departure of the smaller-scale operators from the industry. We're now left, I think, with a core of people, as Paul was indicating earlier, that are there for reasons that they've heavily invested in the industry. So I don't know to what extent we have, really, the ability to say, "Who are we now trying to protect and how many are there anyway?" If we look at the context of the last six years where those sorts of assistance packages were made available to try and keep people into the industry, we'd have to conclude today that that's patently failed because we've lost a lot of membership.

So is the time necessary to now look at this pragmatically to say, "What are we trying to achieve within the pork industry as we now find it?", and the points we were making earlier about scale, we have to remember that the issue here is not simply one revolving around producers. Today we have significant excess capacity in a lot of the meat distribution systems, and they also provide a lot of the employment, the value increments, for regional and rural communities. In the absence of keeping producers producing the pig such that they can then go through the meat pipeline, what impact is that going to have on the entire supply chain? That, as you've probably read, is another very important part of our industry restructuring plan, to think through those issues so as to involve the full supply, from producers through to retailers.

DR BYRON: That's all I was trying to elaborate, the point that Alan read out about trade restrictions being a very blunt instrument when it comes to achieving structural adjustment; that the line that this organisation has generally followed is that if structural adjustment is what we're trying to achieve, let's be very clear about who we want to achieve what and then target any government measures to make sure that we achieve that. It's not obvious that a trade measure, unless it's very, very skilfully finessed, is going to achieve that.

DR HIGGINS: Can I just understand, commissioner - I mean, I thought it was the commission's role to look at the issues of competitiveness and recommend what their view was, not to second-guess government policy and therefore to be saying, "Well, the government usually does this or this. So therefore we won't worry about recommending something different." Surely the question the commissioner has to ask is about the competitiveness of the industry. As Geoff has already said earlier this morning, if we can achieve just one strand of the industry restructure plan, he's saying that will be a greater victory than the dairy industry restructure.

My view is if we can change the carcass measurement systems, the contract pricing systems, the way the product is consumed and marketed in terms of products and feedback in the carcass weights, increase consumption of fresh meat by 75 per cent, eradicate some of the diseases that are present in the country - I don't want to go through the whole lot but if we can achieve those things in five years, well, we've achieved, in my view, the most far-reaching structural change of an industry in the agricultural sector in this country ever in the shortest time frame. Imagine going back to the beef industry or the wool industry just to change how their product is measured. That's just one part of what we're saying.

So surely the question is for the commission, in terms of a situation where the industry is saying, "We want to restructure and do these things," that the commission needs to look at what may be the best possible macro policy settings to enable the industry to create those results. Therefore - Alan is more experienced that I am and Selwyn in terms of some of these issues, but surely that's the key question.

DR BYRON: Well, what, if anything, does the government need to do to enable the industry to achieve all those things that the industry itself has identified and committed to?

DR HIGGINS: Well, our argument is that the government has already committed to some of those issues, as we've detailed, in relation to CRC process and home grown, et cetera. Our main concern is that the level of uncertainty, the low level of cash flow in the industry is going to make change, capital investment in change, extremely difficult. Therefore we need some sort of macro policy setting that will reduce that uncertainty and provide those cash flows to create some of the change. If we do not, then the chances of achieving that industry restructure plan are seriously weakened.

MR EDWARDS: Could I ask the question, why should this organisation or the Australian government look favourably upon the suggestion that is intended to help the Australian pork industry attract sales from the Australian beef and lamb and chicken industries?

DR HIGGINS: Why do you say that?

MR EDWARDS: Well, my understanding is that you're looking to the government to help in one way or another to achieve the various parts of your strategy and, clearly, increasing pork consumption is a key part of that strategy.

DR HIGGINS: Well, clearly, government does assist industries in terms of trying to assist them to be more competitive. So in a general question the answer is obvious. Secondly, our issues are also making us more competitive in a global market. So it's not just about the situation in terms of other competing industries. And thirdly, our premise is that all we want is a fair level of policy setting. So, for example, if I go back to my original introductory comments in relation to subsidies for ethanol production raising my internal costs in relation to those competitors or those other industries, government policy is already restricting my ability to compete with those industries. So all we want is a situation where there's a fair policy setting where there is no adverse subsidies actually restricting our ability to compete.

MR EDWARDS: Well, I find it much easier to be sympathetic to an examination of options that might reduce unintended adverse effects from policies in areas such as assistance for ethanol or drought assistance, but that seems to me to be rather different from assistance for encouraging consumption of one particular Australian meat.

MR HEILBRON: No, not necessarily. That depends on where you draw the boundaries of the market. Is the market between a couple of red meats and white meat or does it extend to protein. In a sense protein - we can talk about grain, we can talk about all sorts of things.

MR OXLEY: Can I - usually there's little merit in talking about morality or ethics in public policy and how that has effects on things. But I think the record shows that the process of adjustment that this industry has been put through was the least artful that the government has imposed probably in any agricultural sector inasmuch as - and this is actually why the original case for a safeguard measure argued itself. It was when the government bound the tariff for pigmeat at zero Uruguay Round on the presumption the quarantine arrangements weren't going to change. Now, the quarantine arrangements in fact did change. There was an IRA taken which had an extremely dramatic structural effect on the government, yet this organisation was never asked to manage the process of change it has been with others. And this industry has had no structural adjustment plans.

Now, the fact that it was a botched and artless process of change is no argument for doing things differently, but I don't think it's actually irrelevant, if it is government policy to say they would like a viable pigmeat industry. In terms of your tools, yes, commissioner. I mean, I don't see why you shouldn't have a crack at trying to do something a bit nuanced and there would be ways of - you could have a mixture of a tariff designed to give some breathing space to the larger industries and maybe some targeted direct assistance programs to smaller producers. There's no reason why you couldn't consider a mix.

I'll just make one other observation. To me what comes to mind about the safeguard measure is obviously what's utmost in your mind, is immediate economic impact of the various parties with the change of the economics. But to me, I think what gives the tool an interesting value is, as I said before, the dramatic effect that is created by a blunt impact of fixed productions. I mean, you're right: a tariff is a blunt instrument in terms of the impacts it has, but so is a fixed producing tariff. I would have thought that subjecting the industry - you may return a tariff to a certain level, then have a fixed period of time where it's going to reduce, is a much more effective way of restructuring the industry than the government fiddling about, trying to give one company size some sort of support, one region some extra support. You are letting the industry sort itself out and it's actually what has driven the process of tariff reform in this country.

DR BYRON: Yes. I've just noticed the time and we've gone a bit over, but is it okay by you if we keep going for maybe another 20 minutes, half an hour? Nobody has got a plane to catch?

DR HIGGINS: We did have.

DR BYRON: Sorry.

DR HIGGINS: I've already changed it.

DR BYRON: I forgot what I was going to say now. We've been talking about - Paul what you've said is, you know, the industry needs the confidence and the cash flow to generate the funds to achieve the restructuring, after which the industry will be internationally competitive and so on. With the safeguard measures or other trade measures, we're basically talking about ways of increasing the prices received for producers. The other side of the coin is to look at reducing the costs that producers have to pay and that immediately takes us to the major item of grain and the way many others in hearings have put it to us is that they're competing on the world price in selling their pigmeat but they can't get the grain at world prices in buying their major input of raw material.

So if we're going to be consistent about saying, "Well, the Australian pigmeat industry is becoming more integrated in the global markets," that should apply not only to the sale of pigmeat in Australia and overseas but also in the supply, in the access to raw materials, and it seems to us that there is a particular combination - I think it's probably quite unintended but nevertheless effective - of the quarantine restrictions on grain imports and single-desk marketing of wheat and barley and so on in South Australia, that the combined effect of those two policies may actually be much larger than the effect of one of them alone.

The effect of having single-desk wheat marketing is much greater because of the restrictions on importing grain during the drought. If those quarantine restrictions weren't there, the effect of single-desk marketing on grain using industries probably wouldn't be as great as it is now, and conversely the effect of the quarantine restrictions on grain imports wouldn't be so bad, except that you've got single-desk marketing. So you've got two quite different pieces of government policy apparatus that are put up for quite different reasons but they seem to be having an interactive effect.

DR HIGGINS: I'll make a slightly broader comment than that, in that we, obviously because of our own interest in terms of future marketing and our costs of production, don't believe in dismantling quarantine barriers to a level that's going to expose agricultural industries to risk. From our point of view, if you go back into the late 80s, early 90s, I believe the industry fought quarantine battles on the basis they didn't want product in here. I think that situation has fundamentally changed because we see, if we look strategically at our future competition - as you put it, integrated global marketplace - that our disease status is going to become one of our key competitive advantages.

I say that for two reasons. One is that obviously it's a cost of production issue and I was talking to Geoff in the break about, you know, we depopulated my farm and got rid of some disease and it significantly reduced our costs. So there's that on one aspect. The other aspect is I believe that marketing product which is from farmers or countries which don't have those diseases and also because pork production involves, if you have those diseases, antibiotic uses. The marketing product not using antibiotics is going to become an important niche market and I think eventually a ticket to actually playing the game.

So when we've looked at those quarantine issues, we have tried to look at our strategic competitors. So if you look at, say example, the United States we're never going to bear the United States on economies of scale, just not going to happen, not worth worrying about, thinking about. But their production systems, because of their economies of scale - and I'm a veterinarian as well as a pig farmer - are extremely vulnerable to disease. So diseases like PRRS and PMWS, they have in place - what happens in those large farm operations is, it's a bit like if you went and stuck 5000 people in the town hall here and left them there for a month and every five minutes you put three people that had flu in one end and 100 people that didn't and kept rotating them around.

You get these big epidemic fluctuations in terms of disease. So we see the Americans or the Canadians particularly having trouble with that because of their economies of scale, so that on one hand they've got a strategic strength which reduced their costs but it actually makes them vulnerable and therefore more likely to have problems in terms of marketing and antibiotic use in the future. So we see those quarantine things as very important to our strategic future.

Our policy outcome, our requirement is that we receive, as you stated, grain at a competitive global price. We see the solution for that is not dismantling the single desk or indeed enabling imports. What it's about is making sure that we only pay the export parity price of product which is exported from this country. That means we can actually get product which is grown here and avoid the quarantine issues and we can be in a situation where single desk doesn't have to be dismantled at all if that's an advantage on the world market.

Now, we've had discussions with the grain producers that argue and say our point is ridiculous. My response to them has been a circular argument which is, "If we're not paying above the price which you'll be paying and you put the policy in place, it will have no effect. If we are paying above the price we should be paying because of the structures, you should be, you're rorting us and destroying our industry, so therefore it should be put in place." So I can't think of a scenario where an export parity pricing situation for our industry should not be put in place, because it gets around those quarantine issues.

I think from a cost of grain point of view, if you look at imports, importation creates a safety valve on top of a certain level of pricing. But because the whole supply chain here is set up to push grain out rather than pull it in, the costs of doing so are actually quite expensive and so it actually does create a valve in terms of, you know, a maximum price at which product can reach. But with the added situation, as we've talked about already, about grain, about subsidies for ethanol and quite large grain production use, which we believe is going to be channelled into that, the number of times we're going to hit those sort of - you know, get up to those sort of ceilings is more.

What we're more worried about is the difference between the export parity price and the import price and how much of that average price we're going to pay in extra grain costs because of government policy across those range of issues.

DR BYRON: So would the way of solving that problem be to put some sort of requirement on AWB or other single-desk marketing organisations that is basically like a price control that says if the domestic grain using industry wants to buy grain, the price can never be more than the current grain export price for that grade or something like that?

DR HIGGINS: Yes, that's what we're saying and essentially we're saying that the government provides a whole lot of regulatory support and licences for a variety of organisations, the banks, and as part of those advantages it gives those organisations it actually puts community requirements or other requirements on the licences they grant, and we believe the policy should be the same for the monopoly licensing that has been given to AWB over the process.

DR BYRON: But absent of such regulation, the directors of AWB would have a fiduciary responsibility to get the best prices they can for grain at all times, wouldn't they?

DR HIGGINS: Absolutely.

DR BYRON: So to protect themselves from legal action there would have to be some sort of mandatory regulations.

DR HIGGINS: We're saying under the current regulatory framework they should act. They would be acting illegally if they actually, you know, were trying to sell product at a lower price to others in that process and damaging their own shareholders - not necessarily their suppliers, more probably their shareholders. But we do believe that, you know, not in the legal sense, there has been what could be described as a rort in that process which is raising grain prices to the domestic users.

DR BYRON: Moving on a bit, we've talked a bit about a number of sorts of regulation in Australia that may be relatively small in their effects per kilo of meat produced. But as you say, in tight situations it all adds up. So at the end we're thinking of planning controls, environmental regulation, water requirements, animal welfare restrictions, all these sorts of things. The argument that has been repeatedly put to us was that every time Australian government or any of the state governments impose a regulatory cost on producers in this industry, which their overseas competitors don't face, then it's just making it that much harder for Australian firms to compete. Is that your situation, your position?

DR HIGGINS: Yes.

DR BYRON: Okay.

DR HIGGINS: Sorry, do you want me to expand - - -

DR BYRON: No. What follows from that - I mean, some people have said therefore all these things should be abolished because they hurt pig farmers. I would think that the line we took in the draft report is basically to say, "Well, these measures should be fully justified and no more stringent than they need to be and when imposing such regulatory standards government agencies, Commonwealth and state, should be cognisant of the impact that compliance costs will have on the international competitiveness of these firms." Can we go any stronger than that?

DR HIGGINS: Well, take the example of animal welfare. You can look at, say, the British situation. The British situation, they've had animal welfare requirements put on them that have not been applied to the rest of the European Union. They certainly claim that the costs associated with those have made them less competitive and contributed to the very large flaws you've seen in the British industry in terms of production numbers.

DR BYRON: And meat can come across the channel that doesn't comply with those UK welfare requirements.

DR HIGGINS: Yes. So we would argue from an animal welfare point of view, if the Australian community, which we agree is completely right of the Australian community, wishes to apply welfare standards to products that it wishes to have, so ham and bacon and fresh meat and those sort of things, they have an absolute right to do so, but that the policy becomes nonsensical if half or 30 per cent or whatever number you pick of the product which they're eating is actually derived from other countries which don't apply those standards.

So we would say if we have standards applied to ourselves then they should be applied also, either via a regulatory process or even maybe a tariff process or whatever, identifying those costs and applying them to the product because otherwise what they're doing is actually driving - the general community thinks that those welfare standards are actually improving and welfare standards for pigs, what they're actually doing is driving production towards countries which don't have those standards and actually reducing the overall welfare of animals, if you think about it in a global context, and in a global context, as you've stated throughout this hearing, that's how we have to operate and so we can't be forced into a situation where we have to be integrated into the global meat marketplace, but have standards set on our production and actually increase our costs in that marketplace.

DR BYRON: Alan, do you know if that's consistent with SPS et cetera or is that extraterritoriality in projection of Australian requirements offshore?

MR OXLEY: SPS broadly is justified on health and safety grounds, not welfare grounds, so - someone is butting in in my ear there are no global regulations on animal welfare standards. The EU has them on the table in (indistinct) but I would not expect that they would get any concessions for them.

MS PLOWMAN: They're also being deliberated in Codex.

DR BYRON: Codex?

MS PLOWMAN: Yes, as I believe a forerunner to eventually the WTO.

DR HIGGINS: There are obviously other policy mechanisms; for example, if the current rewriting of the animal welfare code requires that stalls be changed in some way, in terms of either size or how long animals can stay in there or you can't use them at all or whatever that may be, then clearly there's a case for some capital support to make those changes if those standards are being applied within the

Australian community but not applied to our competitors.

DR BYRON: I think the New Zealand welfare code allows 10 years for the introduction of these. Does that sound like a reasonable time, given the depreciation life of the major capital assets? If you had 10 years to phase in a new production technology, is that sufficient advice, or do you think it needs to be even longer?

MS PLOWMAN: It depends on the technology, but with respect to animal welfare and the analysis that we have done, we've actually supplied to the code writing group that 10 years is not sufficient. We need around 15 years, 14 to 15 years, to make those kind of changes and you have to look very carefully about what changes they're asking for, the use of the sow stall, the space dimensions et cetera.

DR HIGGINS: That's without a system process to do it with; they were saying as part of a natural turnover of industry capital, either with assistance to change those things to producers, then that period could be shortened.

DR BYRON: That's right. If the government wants to bring it in faster, there's a quid pro quo that they'd need to pay.

MS PLOWMAN: That's our argument.

MR EDWARDS: Could I just take you back there, Paul. You would draw a distinction between the appropriate role of the government in helping local producers adjust to a new welfare code, depending on whether similar codes were being introduced or had been introduced in our competitor countries?

DR HIGGINS: I'm sorry, I'm not sure if that's a question or a statement, Geoff. I'm not sure what you're asking me.

MR EDWARDS: Yes, I'm asking for you just perhaps to confirm that you think the Australian government assistance to the local industry would be appropriate if it was requiring our industry to introduce a new, more expensive welfare code, if overseas countries with which we compete are not doing similarly.

DR HIGGINS: I think that's part of the argument, but clearly - and this doesn't apply just to animal welfare, it applies to other issues - if the Australian community wishes to change the standards with which we can do our business, then clearly investment decisions that were made six months ago based on the existing community standards, there's clearly a case for either phasing in those changes or assistance to actually achieve those changes because it's a requirement of the community that wasn't in place six months ago. There's plenty of cases where those things happen because of changes in community standards, so it's not just about what our overseas competitors are going to do, it comes back to those issues you were discussing before about relative competitiveness with beef or lamb or fish or other protein sources. Clearly, regulatory impediments which make our costs higher have changed the investment situation.

MR EDWARDS: Yes, I find myself wondering, for example, about an increase in occupational health and safety standards that raised the cost of Australian pig producers. Now, would your view on what it was appropriate for the Australian government to do by way of assistance be independent of whether other competitor countries were introducing similar OH&S measures?

DR HIGGINS: I haven't really had time to think through those issues, Geoff, but my first reaction is that those are things which are applied more uniformly across the whole of Australian industry or a different situation than ones which are applied specifically to individual industries.

MR EDWARDS: Okay.

DR BYRON: This same debate comes up frequently in things like clothing, textiles and footwear tariffs, a product coming from China where they don't have labour standards and OH and S and all the rest of it, and to what extent Australian producers should be either protected or assisted is sort of unfair competition.

MR COOK: There are a couple of examples of things we have done that might be able to help clarify again something that we've actually built the industry plan to try and do, and that's, as best able, for the industry to manage some of its own arrangements and its affairs, environmental guidelines. As you can probably imagine, a lot of the states and municipalities around Australia had what were differing points of view as to what they would like to see happen in the event that a piggery was to be licensed or seek an expansion to their operations. APL developed a program to work with state governments and the large municipalities in which big assets find themselves, and we've now emerged with some guidelines which hopefully will be used and will be binding on obviously investors, municipal governments, state governments, when looking at proposals to expand operations. Our sense is that the fragmentation and the lack of uncertainty that was applicable because an operator may approach a municipality for an expansion, we've actually given some guidelines on which there can be some predictability as to what he may have to do to get a positive outcome in a development application.

It's my hope that we, as an industry, continue to look at dealing with the fragmentation and emerging with a cohesive predictable outcome because we've tried to create the ability to get those people interested in these outcomes in the one room and come up with a consensus outcome. So my hope is that in the event that social mores change and if there is the ability to work with various groupings, we do so. In the welfare area, Kathleen, as you've just heard, has actually answered a question where there is an active group working on that very area, hopefully going to create an outcome which the community can actually identify as obviously a positive set of outcomes.

DR BYRON: In view of the time, I think I'm going to have to wrap this up fairly soon, but I'd like to give you the opportunity to say any concluding comments, any particular suggestions of things we need to follow up most in terms of priorities.

DR HIGGINS: Could I just clarify one other thing first, commissioner.

DR BYRON: Sure.

DR HIGGINS: In the draft report and in the discussions you and I had, there was - I can't remember the exact numbers, I haven't got them in front of me - something like an 80 cents a kilo difference or something in the Australian middles price that Denmark was receiving from Australia compared to what it was in other countries. There was a statement in the draft report that the difference was only minor. I'll make some other remarks and I'll - - -

DR BYRON: Yes.

DR HIGGINS: There were a couple of things I'd just like to make comments on in closing and we'll just come back to clarify that issue in a moment. First of all, we would like I guess in the final report highlighted some of the points you've made today in terms of your draft report and the short time it was prepared in and whatever changes made to this one because we have been concerned, as what happens sometimes in the media happened with this report, people take up the executive summaries and don't read the rest and all this sort of process and you end up with articles, as we did in the media from the draft report basically saying that you'd thrown out anything we wanted and it was all a load of rubbish, which is what was published in The Australian. You haven't seen that article?

DR BYRON: No.

DR HIGGINS: I'll send you a copy of it. It was Alan Wood.

DR BYRON: No, it's news to me.

DR HIGGINS: Yes, it was basically - we can send it to you. But things have picked up in that matter which, if people don't understand it and are short for time and look at executive summaries, they don't understand the depth or level of analysis and the difficulties you've had through the process, so we would like those sort of things highlighted in the final report, particularly if there are changes in some of your conclusions and the data.

Secondly, we are very happy to work with you, both to work through those issues which you talked about earlier about subsidies and distortions where there seems to be considerable confusion in relation to the data, so any way we can assist you in that, we're happy to do so; also pursuing our earlier comments regarding the extension of time, because we think it's very important these things are actually got to the complete bottom of rather than making some assumptions along the way, so we would support you in that.

Thirdly, I'd like to emphasise that in no way in the industry, in terms of when we're talking about assistance for structural change, we're talking about long-term protection measures, what we're talking about is how do we get this restructure plan best implemented so that producers who are cost competitive have the best chance of being cost competitive in the future. So we're not about protectionism, we never have been; what we do ask is that where government policy is distorting our input costs that some redress is made to those, and where unfair trade and distortion is occurring, that something be done about that, at least in the short term while we can make the large changes we've put together in the industry restructure plan and get those in place.

In the draft report, it said that exports of middles from Denmark - this is Denmark - were $4.65 a kilo, whereas for non-EU countries, the price was $5.43 a kilo in terms of middles on page 50.

MS PLOWMAN: Box 3.5.

DR HIGGINS: That box goes on to say that:

> There is a relatively small difference between prices received by Danish pigmeat producers for middles exported to Australia to be made into bacon, and prices received for all Danish bacon exports.

Now, I would strongly argue with that, given the difference that you have established. It was about 80 cents, I think; the difference between $4.65 and $5.43 is 78 cents. Now, if you think of the middle of the pig being roughly one-third of its weight, to use an approximation, then a difference of 78 cents a kilo would make a difference of about 25 to 27 cents a kilo in the carcass return. That is about 70 per cent - this is my own personal view - of the long-term profit that I'd like to make on my capital investment. So I think we need to look more closely at those issues because quite small differences in terms of cents per kilo can make huge differences to our profitability as producers because of the low margins that are present in such a large capital-intensive business.

DR BYRON: Okay.

DR HIGGINS: Does that make sense?

DR BYRON: It might take me a while to think about and digest all that and make sure that we're comparing like with like.

DR HIGGINS: I just wanted to make sure that in the final report you make those clarifications because I think those differences are quite large in terms of final carcass price and the contribution that might make to profits.

DR BYRON: I think we're going to have to continue to go backwards and forwards. If I may be so bold, we'll show you ours and you can show us yours, and we'll try to get to the bottom of it all. But I think part of the difference is, as we were saying before, we're sort of working from national trade statistics and you're working from individual shipment invoices, and there do seem to be significant anomalies there.

DR HIGGINS: As I said, we're interested in working as much as we can with you and cooperating, because we believe the analysis needs to be robust, as robust as it possibly can.

DR BYRON: I believe exactly the same thing. I'd just like to thank you, as the executive, and the staff and all the members of APL, all the state affiliates and so on, because I appreciate that this has been a very difficult time for the pigmeat producers and they're all desperately battling to manage their own businesses through tough times. But, as I said before, I've been personally very impressed by the professionalism and the dedication of Australian pig farmers and the way they sort of know to the fourth decimal place where every penny is coming from and where it's going to. They may call a spade a bloody shovel, but they never confuse a silk purse and a sow's ear. I think they've been very resilient going through these extremely tough commercial conditions. They believe passionately in the industry and want it to have a future, so we're trying to be as professional and as thorough and meticulous as those producers are.

We know what our job is and we're very carefully considering every piece of information we get from every submission and from every participant. Not everything finds its way into the report, but everything that we receive is very carefully thought about. I just thought I'd reassure you on that. I thank you all very much for taking the time and trouble to come here and help educate us and fill in some of those gaps, and I look forward to some more exchange of data and information as we try and get to the bottom of all this. Thank you very much.

DR HIGGINS: Thank you.

DR BYRON: Thank you, ladies and gentlemen. I always say at the end of the hearing anybody else in the room who wants to come forward - I think we can now adjourn the public hearings.

AT 12.48 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

INDEX