6th October 2004

Pigmeat Inquiry
Productivity Commission
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Dear Commissioner

Submission to the PC Inquiry into the Australian Pig Meat Industry

This is a submission from **Australian Pork Farms Group** to the Productivity Commission Inquiry into the Australian Pig Meat Industry.

I wish to address among other things, issues relevant to the sustained profitability and competitiveness of our pork business, including the damaging impact of imports on the industry and the need for appropriate trade measures to be implemented to benefit the Australian pig industry.

BUSINESS OVERVIEW

The Australian Pork Farm Group is made up of 3 businesses:

- Shea-oak Piggery Joint Venture (formed in 1992)
- Wasleys Piggery Joint Venture (formed in 1994)
- Australian Pork Farm Pty Ltd (formed in 2001)

Together the group represents approximately 15,000 sows of the SA Industry's combined 50,000 current sows.

The owners and shareholders of the above operations represent some of the major independent piggery operators in SA and Victoria. Over the past decade these independent family farmers came together to buy out (or takeover) the assets of Metro Meats (ex Adelaide Steamship Company) who had decided to divest themselves of their piggery assets. These farmers pooled their resources and pig farming investment capital to create larger enterprises in the belief this was required to be competitive for their long term futures.

Recently, the group (prior to the IRA and FTA announcements!) took the decision to purchase the George Western Foods pig farms in SA.

A summary of the key aspects of the combined businesses today would be as follows:

- 15,000 sows producing in excess 250,000 pigs per annum sold to key abattoirs in SA and Victoria.

- All sow farms are owned but have a network of contract producers in both states they house and manage up to 50% of our total production. (These contract sites take no market risk and receive a flat fee for use of facilities and/or labour).

- Until recently the group had grown through capital reinvestment and/or acquisition from 7200 sows at the beginning of 2000, to today's 15,000 sows. (All expansion plans are now on hold due to industry uncertainty).

- The group employs over 120 people directly and our 'contract' enterprises have (we estimate) another 30 plus full and part time staff.

- The group contains the major shareholders in AusPork – the marketing and abattoir owning entity developed to assist stronger supply chain linkages 'Beyond the farm gate'.

- The group is a direct Capital investor in the Big River Pork abattoir - as it saw this investment as critical to ensuring long-term competitiveness and to give marketing options domestically and overseas.

RECENT FINANCIAL TRENDS

Over the last 2 financial years, the general trends across all 3 businesses would be as follows:

1. None of the businesses made money due to the affects of the drought that impacted across 2 financial periods, plus the impact of lower pig prices driven largely by the effect of imports on local supply.

2. Losses were significantly reduced by spending 'nothing' on repair and maintenance items unless absolutely critical – spending which will have to be caught up in future years.

3. (confidential information)

4. (confidential information)

5. All but essential Capital expenditure stopped.

6. We cut staff and ran on the bare minimum with minimal training investment to see if we would survive.

7. Average carcass weight is currently around 72kg. This has dropped from a high of close to 80 kg less than 2 years ago, due to the demands of supermarkets for lighter pigs coupled with the un-profitability of selling carcasses to Japan. Essentially this market demand (and response) has <u>increased</u> our cost of production by $0.10 / kg with no change in returns.

CRITICAL ISSUES FOR ON FARM COMPETITIVENESS

Rather than repeat topics that we feel certain a combination of APL and/or other submissions will highlight, we have chosen to include below only issues that we have had direct experience with, and/or feel are somewhat unique to us and our businesses.

In addition, I personally spent 15 years in the US industry in 2 of their largest pork production systems. [Murphy Family Farms (350,000 sows) and Heartland Pork Enterprises (65,000 sows)]. I have intimate knowledge of their costs and systems approach. I will at times refer to this experience as our key issues are raised.

1. Although not unique to our business, a fundamental issue is feed grain pricing. The issues that arose through the 2003 drought highlight how the Australian Pig Farmer is on the one hand asked to compete in a global marketplace for pork, but our major input (feed grain) is influenced and biased by the pricing monopolies in Australia's grain industry. When the <u>same</u> grain is sold for $300 plus /tonne domestically, but offered for less than $200 /tonne for export, there is an obvious flaw in the process!

   This is coupled with the situation where the various boards can quote 'pool' prices that they have no requirement to deliver upon at that price – but this effectively becomes the pricing point for the market. The 'single desk' legislation allows this situation to exist as was made to look at its farcical best during the drought if you were a domestic livestock producer!

2. As a business we constantly talk to Pork Buyers about long term pricing that would add stability to our business. We are happy to create contract agreements that add price stabilization over extended periods (3-10 years), where we give up money in high markets, and in return, have some protection in low markets. This has been very difficult (almost impossible) to encourage. Buyers constantly say they …. 'cannot be out of step with competitors' in a low market or they will lose business. (Could it be that pressure on short term Quarter by Quarter earning results creates this situation?).

   Assistance from any avenue in helping/encouraging these arrangements would be most beneficial.

3. As a business group over the last 2.5 years we have supported the push of product into Japan. We know and understand the value of heavy carcasses for reducing our cost of production. We also realize the need for Australia to be in an 'export' market for the long term - not just in and out only when it is profitable for us.

This approach has gained us "nothing" during this 30 month period. We estimate we have lost in excess of ($1,000,000) compared with selling in the domestic market, with only 6 of the 30 months where we have actually made more marginal dollars (comparing total returns vs. total costs) than selling domestically.

We finally stopped supplying these carcasses in the last few months after pushing for a more equitable, long term sharing of the margins between farms, processors and a Japan Importer. It was refused.

4. As an industry we must maintain our advances in improving on-farm technology/management practices. The restructuring of APL and their altered priorities has left the Pig Industry R&D programs lacking –and in danger of taking away critical people and infrastructure for long-term research. The CRC has huge support within industry – both financial and involvement by all segments – and must be supported by government. Otherwise there is no doubt Australia's position as a leader in aspects of pig research will disappear.

   In my time overseas, the comments made regarding Australia's R & D were always very positive, with amazement at the amount of work coming from Australia given the size of our industry.

5. As has been said many times - Australian pork producers do not mind competing with other industries, but the playing field needs to be level. This includes the various 'overt' subsidies that occur both in Europe and North America – usually not directly to pig farms but to their input (grain) and/or marketing costs and/or compliance costs (Labour; EPA; QA). I believe APL is outlining many of these for the Commission.

   However, a recent, very relevant additional item came to our group's attention. It was announced on the 28th of September that ……. "The European Commission approved a new 2 million Euro 'investment' in promoting pork." It states this is directed entirely at promoting Danish pork outside the EU. This subsidy is directly to <u>the</u> major Danish exporter of pork, with Australia being one of the countries specifically targeted.

   Another example of the type of subsidies that are "killing" any sort of competitive position we have in our industry.

6. A further example we fear is that our Industry is going through a major Animal Welfare review. Every indication is that there will be significant changes in the way we are allowed to handle and house animals, which will likely increase costs of production directly, as well as need significant new capital investment.
   If this occurs, and these new rules are endorsed due to consumer and society demands on animal welfare, will the government insist that the same rules also are in place for pork from North America?

   My personal 15 years in the US industry showed me that over the last decade <u>over 80%</u> of all new construction kept breeding animals in an environment that will likely be illegal in Australia. If the government does not specifically rule that welfare standards must be the same, we will, yet again, have a tilted playing field where outs costs are increased – but not our competitors. Because unless it is ruled illegal by the government, manufacturers will ignore this and either buy product anyway, or use it as a pricing mechanism against farms.

Either way, we lose and have no recourse! Consumers will insist on welfare standards but then in the main will still buy the cheaper option, especially if Supermarkets have no incentive to focus consumer attention differently.

7. There is no doubt that the major global industries we compete with are much larger than we are. Additionally, they are usually geographically closer together. This allows the 'efficiencies of scale' to be exploited. I would particularly highlight the following where I have experience with 'actual' USA and Canada costs, and where size/volume creates huge efficiencies:

    -Environmental compliance (after subsidies).
    -Feed manufacturing costs.
    -Transport of feed and pigs.
    -Abattoir processing costs.
    -Boning room costs.
    -Packaging and distribution.

    Australia must restructure to gain some/all of these efficiencies, or find additional new competitiveness. It can do this - but will take time, assistance and some unique approaches to how this restructuring can be implemented.

8. Due to the volatility in returns, coupled with ongoing industry uncertainty, the environment to continue to invest to grow, or even maintain, existing infrastructure is not there. Given;

    - drought,
    - followed by poor pig prices,
    - followed by the IRA decision and its threat to future health security, and
    - now the even more rapid rise in import levels,

    Why would anyone continue to invest in the industry?

    There are too many risks, with too little upside. Imports will only make market gyrations worse, with less potential for farms to have a good period to make back losses, as more manufactures order <u>more</u> imports whenever they feel the price is too high. They can make this decision within a 2 month period. (Please refer to AusPork's submission for examples of this).

CONCLUSION

Our businesses have one of the largest investments in the pig industry in Australia. We have always felt the opportunity for success and growth was available for those who ran their businesses. We feel we have done this - but recent events beyond our control and taken out of our hands put serious questions in our minds as to why we should continue, or at the very least reduce our size and commitment. The government with its various recent actions gives us no reason for optimism – and in a capital intensive industry that requires continual investment for updating, this is a climate that points us in the wrong direction.

We need some level of relief with time for the industry to restructure. At the same time, an indication of support or otherwise for our future needs must be made clear by the government – or if we are too insignificant to survive, then we will plan our exit. Import levels, with no upper limits, are creating havoc in an already cyclical industry. When combined with monopolistic power of the key supermarket chains (unique to Australia in the degree of influence they have), we are in a squeeze that is creating chaos in our industry. Every other country gives some reasonable protection to its agriculture industries, especially when;

- It can be competitive if on a level playing field
- There are reasonable reasons/rationale for protection.
- It is a major employer in rural economies that are crying out for employment.
- There are clear reasons for the government to consider a safeguard action.

I would be happy to talk about any of these points further to the Commission and can be contacted at 0421 072 779 or by email at amrk@ozemail.com.au.

Additionally, I or someone from our group would be happy to further address the Commission if required. We would like to attend and/or present to the Commission in the public hearings scheduled for December 2004. Our preference is to attend a meeting in Adelaide.

Yours sincerely

Rod Hamann

CEO Australian Pork Farms Group