APL Submission 1

Productivity Commission Australian Pig Meat Industry Public Inquiry

19 October, 2004

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1. Executive Summary

- In August 2004, the Treasurer and Minister for Agriculture, Fisheries and Forestry, announced that the Productivity Commission (the Commission) would conduct an inquiry into Australia's pig meat industry. A key aspect of the inquiry was that the Commission was to take into account the "competitiveness of the industry, including competitiveness relative to international competitors, and efforts taken by the domestic industry to enhance competitiveness". The Commission was also to consider what measures "are necessary and appropriate" to enhance competitiveness.

- Australian Pork Limited (APL) welcomes the opportunity to present a submission to the inquiry. APL is the national representative body for Australian pig producers. It is a producer-owned, not-for-profit company combining marketing, export development, research, innovation and strategic policy development to assist in securing a profitable and sustainable future for the Australian pork industry.

- Based on past experience, it would take the Commission a year to determine properly the condition of the industry and recommend appropriate action to improve it. In the view of APL, the five month timeframe set for this inquiry is inadequate to satisfy the terms of reference. APL is similarly constrained by the timetable. It does not provide adequate time to prepare a submission covering all issues raised in the terms of reference or by the questions raised by the Commission in its Issues Paper.

- APL formally requests that the Commission seeks an extension of the term of the inquiry as soon as possible

- Due to the nature of the terms of reference and the very short timetable, APL wishes to advise the Commission that this is the first of four submissions our organisation will be making to the Pig Meat Inquiry.

- The second submission will address details concerning the competitiveness of the industry, including a draft of the industry restructure plan and will be forwarded in late October. APL asks that the Commission note the restructure plan is still in draft form since it is undergoing industry consultation and will not be finalised until early February 2005.

- APL's third submission will analyse the impact and effectiveness of existing and recent government and industry programs and will be provided to the Commission in mid November. The final submission will be tabled at the Sydney public hearing in early December. This will provide updated information on the specific initiatives APL aims to pursue as part of the industry restructure and will identify government measures to enhance the competitiveness of the industry.

Injury & Provisional Safeguards

- This Inquiry was the response by the Government to a request by APL for immediate imposition of provisional safeguard protection against imports. That request was not made to secure continuing protection against imports (that is not permitted under the World Trade Organisation (WTO), nor sought by the industry), but to secure temporary protection while orderly restructuring of the industry can be undertaken (that circumstance is provided for in WTO rules.)

- The Australian pig industry is in serious trouble. A substantial part of the industry is not globally competitive. Most small producers are losing money and returns on assets are negative. A major producer is in receivership. Major investment has been withheld. Over the last two years the number of pork producers in Australia has fallen from 2,642 to 2,323.

- The impact of imports has contributed to the situation in which lower pig production and substantial excess capacity exists throughout the industry.

- The commercial problems of the industry are the result of a steady and significant increase in imports. This increase followed the removal of trade protection after commitments to liberalise the industry in the Uruguay Round and loosening of quarantine restrictions, also to align quarantine management with new WTO disciplines developed during the Uruguay Round. The rate and extent of increase in imports was unanticipated.

- Any producer who had borrowed money to invest in this industry over the past five years would have failed to improve their equity position to

- any degree. This has in turn totally discouraged further investment in the industry by those companies who have shown a tendency in the past to invest in pig production. As facilities get older, without the ability to reinvest in up to date technology, the global competitiveness of the production sector will continue to decline.

- If the rate of imports continues at existing levels, or increase as is likely then the consequences for the industry will be severe. Imports are likely to increase due to the seasonal pattern of trade in pig meat (imports usually rise significantly in the last quarter of each year); second, global market conditions, which are assumed to favour continuing availability of supply from countries exporting to Australia; and third, the likely further relaxation of quarantine import controls.

- The increase in imports, which is anticipated before the end of 2004, is likely to cause significant disruption among pig producers and result in greater hardship and more dramatic changes in market share than would be the case in a planned program of restructuring. This would be damage that could not be repaired. We anticipate further financial losses across the industry, including bankruptcies and loss of livelihoods among producers.

- Under WTO rules, governments can impose provisional safeguards without the usual requirements to have an investigation beforehand if the circumstances are "critical" and delay in imposing safeguards is likely to "cause damage which would be difficult to repair".

- The analyses in APL's submission clearly establishes the causal link between imports and the damage caused; there is direct correlation between rises in imports and falls in domestic prices. Imports *alone* are causing serious injury to the Australian pork industry as a consequence of Australia complying with WTO obligations and that this, in turn, is adversely impacting on the competitiveness of the industry.

- Immediate action is required, as is provided in the WTO rules, to prevent avoidable financial ruin across the industry.

- APL therefore requests the Commission to make an immediate request to the Government to restrict imports. This will create a breathing space for the industry to stave off financial ruin while the inquiry can be undertaken and a restructuring program can be properly designed and implemented in an orderly way. The case is presented in this document that injury has occurred and a case for provisional safeguards exists.

- Once provisional safeguards are imposed, WTO rules require a formal inquiry to be established to justify imposition of continuing safeguards. On the assumption that the Commission will want to consider the option of recommending maintenance of temporary import protection while a restructuring program is implemented, APL will follow this submission with a full case for imposition of safeguard measures.

Profitability and margins

- One of the biggest financial challenges for Australian pork producers has been the combination of ongoing lower prices received for pork and the high cost of feed inputs. Recent industry analysis has highlighted that there have been massive swings in profitability over the last 10 years and that during this period there have been only three years - 2000, 2001 and mid 2002, where profitability has approached what could be regarded as adequate levels for long term business sustainability. One of those three years were the direct result of a ban on Danish imports due to the European Foot and Mouth Disease outbreak

- These factors have created an extremely high level of financial uncertainty. A higher risk environment normally requires a higher level of profit margin than that required in a low risk environment, but this has not been the experience of Australian pork producers.

- Feedback to APL from processing companies indicates that most of the meat "displaced" by imports in the manufacturing sector is sold into fresh meat sectors causing an oversupply and hence falls in wholesale prices. The manufacturing sector can use frozen pork for many of its product lines and there are increasing volumes of low cost frozen product available from other countries. (However, the smallgoods sector has not increased by the volume of the increase in imports.)

- This results in Australian fresh bacon weight pigs, grown for further processing and the key driver for industry prices, having to compete directly on price with frozen imports. This has had the combined effect of driving down both consumer prices for processed pork products and farm gate prices for Australian grown bacon weight pigs.

- Therefore, the impact of imports on pricing of baconers has important ramifications for the fresh pork market due to their inter-relationships.

- There has been a noticeable persistent downward trend over the last 10 years in market prices for bacon weight pigs at the farm gate level, whereby there has been price decrease of around 30 cents per kg. This is a price decrease in real terms of over 10 percent.

- Critically, the porker/baconer relativity has fluctuated and generally trended upwards. This improvement has not, however, resulted in a tangible shift towards porker production relative to baconers. Prices to producers have trended down over the last four years.

- Although domestic consumption in pork has been rising steadily throughout the 1990s, it is largely the result of declining pig prices and increased imports driving the retail sector further down. (Since January 1991, per capita total consumption of pork products has grown by 27.3 percent to current levels in July 2004 of 22.35 kg.) As consumption has increased, industry margins between the farm gate and retail have remained relatively constant, and the retail margin has widened over time. The trend lines for retail continues upwards, while the prices received by producers remain comparatively flat; implying supply chain intermediaries are making increased profits.

- These factors suggest that per capita pork consumption could come under pressure and thus present a reason for producers to be relatively conservative as to future increases in per capita consumption, or at least recognise that increases in consumption may well come at the expense of lower prices.

Exports

- While the recent depreciation of the Australian dollar has helped export competitiveness, Australian exporters remain much less competitive than three years ago. Demand from overseas markets for Australian pork has increased substantially over the past four years, from just 2.6 percent of Australian pork production in 1997 to approximately 16.5 percent in 2004, peaking at 21.5 percent in January 2002. Australia's key export markets place a particularly high level of importance on food safety and animal heath issues. Therefore, the Australian pig industry's "clean green image", built on its "world best herd health status", underpins pork exports and is vital to the continued competitiveness and growth of the industry and to accessing and developing both new and existing markets.

- However, the industry's competitive advantage, its clean green image, is under further threat from the newly established pork import protocols, which fail to reduce the level of risk posed by the disease Post

Weaning Multisystemic Wasting Syndrome (PMWS) to an acceptably low level. The industry's costs of production are also under threat should this exotic disease take hold in Australia, since eradication is not technically feasible and control measures are difficult to implement. Animal health costs would increase significantly and production would decline, due to productivity losses and mortalities.

Key cost of production - Feed Costs

- A significant challenge facing the industry is security of feed supply at world competitive prices since feed costs represent a substantial proportion of production costs. Feed grain prices have been highly volatile in recent years, due to drought, Australian Government quarantine regulations for the importation of grain, lack of a dedicated feed grain market and limitations to the use of alternative feedstuffs.

- Statistical analysis of variation in feed costs shows that over the last 10 years shows that the range of prices was $271 to $440 per tonne with a mean feed price of $348 per tonne. In other words, under current market conditions, forward planning scenarios for farm budgets need to be able to accommodate a feed price variation of +/- 20 percent around the mean. Given feed costs account for 55% of production costs in non drought years, this equates to +/- 11 percent of total farm expenditure at risk from feed price variations.

- Droughts are the key driver of high feed prices and the feed price impacts of such an occurrence are unlikely to be able to be accommodated from working capital, even with what might be regarded as otherwise sustainable profit margins. Any policy measures that can be usefully adopted to reduce the volatility of feed grain prices will clearly be of enormous benefit to the overall sustainability of the industry.

- APL views the current single desk arrangement as posing significant challenges in attempting to obtain internationally cost competitive feed. When one company holds most of the grain, they are in a monopoly position to charge what they like – particularly when supply is short and quarantine restrictions make grain imports costly. There may be many domestic buyers but they are all effectively forced to trade at the price set by the Australian Wheat Board (AWB). The AWB export monopoly kills price competition on the domestic market and the effect is most pronounced in times of shortage.

- APL is particularly concerned by analysis showing that the Government's ethanol policy will further distort the feed grain market

and bring about increased pressure on scarce feed resources both from price and supply bases. The ethanol subsidies will adversely affect intensive livestock producers as the proposed ethanol plants would compete directly with the intensive livestock industries for grain. The excise subsidy of 38 cents per litre equates in real terms to an indirect subsidy on the industry's grain inputs of $152 per tonne[1]. The effect of these subsidies will be to create an artificial shortage, which will be accentuated in drought years.

Supply Chain Efficiencies

- A significant issue that has emerged from APL's initial overview of the supply chain is the need to improve the competitiveness of abattoirs, boning rooms and smallgoods manufacturers independently of any action undertaken by other sectors of the industry to improve competitiveness and efficiency.

- Anecdotal evidence indicates that the existing number of processors presents a challenge for achieving efficiencies relative to that apparent in the processing, abattoir and small good sectors amongst our international competitors. Too many processors can result in too little profit for the participants and /or profit that is disproportionately shared across the supply chain (e.g. producers lose a substantial amount of money with high grain prices and low pig prices), yet simultaneously we see abattoirs, boning rooms and some smallgoods manufactuers reporting losses on pigs.

- Since APL is essentially an information service provider and does not trade in pigs its ability to drive supply chain change is limited, therefore the impetus for such change essentially relies on market forces. However, given the urgent need to capture supply chain efficiencies and become globally competitive, and without relief from imports, industry would be looking to government to provide assistance in expediting realignment of the supply chain.

- The domestic pig meat industry, therefore, faces a significant challenge to ensure that Australian producers are effectively positioned to capture any future market growth. For there to be a sustainable Australian pork industry, three key factors are apparent: more control over market prices is required; costs of production need to be reduced and where

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[1] Development of Regional Fuel Ethanol Industries Based on Grain Feedstock and Possible Effects on the Lot Feeding and Pork Industries"; Macarthur Agribusiness; 2003

possible stabilised; and efficiency needs to be optimised. These issues and others will be addressed in detail in APL's subsequent submissions.

In summary, APL's key recommendations regarding the issues addressed in this submission are as follows:

1. ***APL requests that the Commission makes a recommendation for the imposition of provisional safeguards.***

2. ***The Commission identifies Government measures and considers industry measures (as detailed in APL's draft industry restructure plan) that can be adopted to reduce feed price volatility and enhance feed competitiveness.***

3. ***APL recommends the Commission identify the measures required, taking into account the strategies detailed in APL's draft industry restructure plan, to provide greater transparency of market pricing and reduce price volatility.***

4. ***APL recommends the Commission highlight the need for Government to provide assistance, to expedite the realignment of the supply chain.***

5. ***APL recommends that the Commission identify the necessary Government, taking into account APL's draft industry restructure plan, that are required to establish a globally competitive supply chain and appropriate measures to safeguard the industry's competitive advantage – its 'world best" herd health status.***

6. ***APL requests that the Commission seeks an extension of the term of the inquiry as soon as possible***

2. Injury resulting from imports and the case for provisional safeguards

2.1 The injurious impact of imports on the Australian pig meat industry

a. Rising imports a long-term trend

In 1998, the Productivity Commission considered the case for applying WTO safeguards against imports of Canadian pork. It found that imports had increased following relaxation of import restrictions as a result of a commitment in the Uruguay Round to bind pig meat imports at zero and to relax quarantine import restrictions, consistent with the obligations in the Agreement on Sanitary and Phytosanitary Measures, which was also negotiated during the Uruguay Round. It further found that imports have increased at sufficient a rate to warrant temporary tariff protection.[2]

The pig meat industry has significantly increased its competitiveness during the period, but rising imports are threatening its capacity to manage restructuring in a deliberate manner. The breakout of the Nipah virus in Malaysia created an unexpected opportunity to develop an export market in Singapore and, along with steady expansion from a small base of exports to Japan, earnings from exports ameliorated for a period the impact on the industry of the progressive suppression of prices in the domestic market caused by increasing imports.

However, the industry still had a significant degree of restructuring to undertake to establish a competitive base that would enable it to compete with imports and develop sustainable exports markets.

Imports of pig meat have continued to expand since then. This is shown by imports either over the five years since the review by the Commission or over the last three years. The combined circumstances facing the industry in 1998 have intensified in the recent and immediate past. Imports from Canada have continued to increase and Denmark has since entered the market.

Imports were around 7000 MT at the time of the 1998 Safeguards Inquiry.[3] Five years later they are nearly eight times higher. Increases have increased steadily between 2001 and 2003.

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[2] The Government did not impose safeguards, but instead provided limited package of industry development assistance.

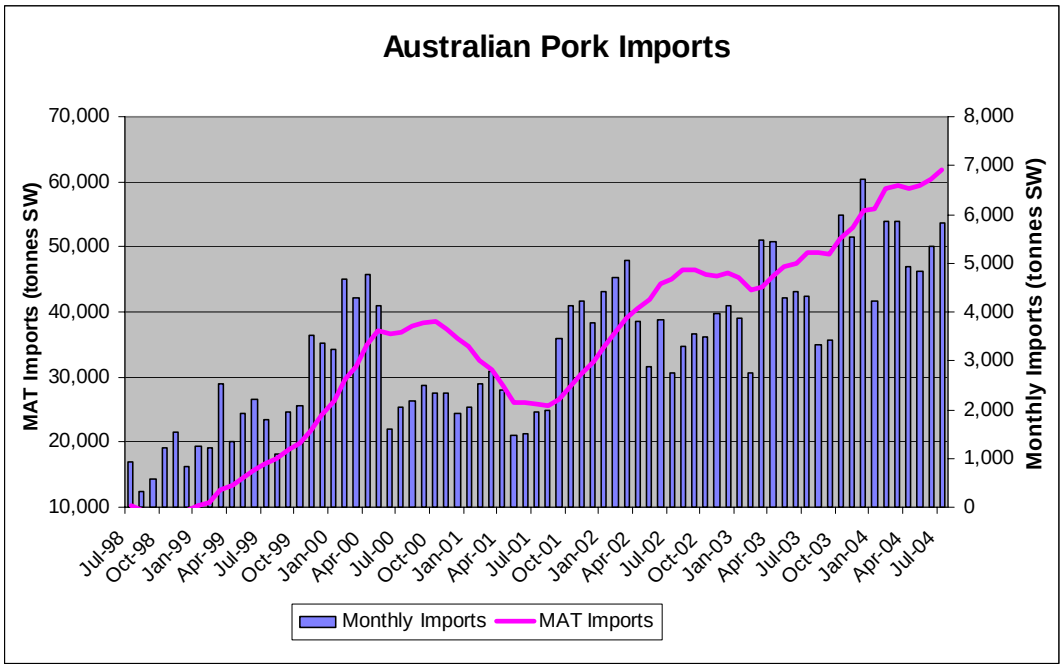
[3] See Productivity Commission, Pig and Pig Meat Industries, Safeguard Action Against Imports, Inquiry Report, Report Number 3, November 1998.

In the following sections, imports over the past three years will be analysed and the injury to the Australian pig meat industry will be assessed.

b. Imports increase absolutely

There has been a dramatic increase in imports in absolute terms in recent years. This is evident from Chart 1 below.

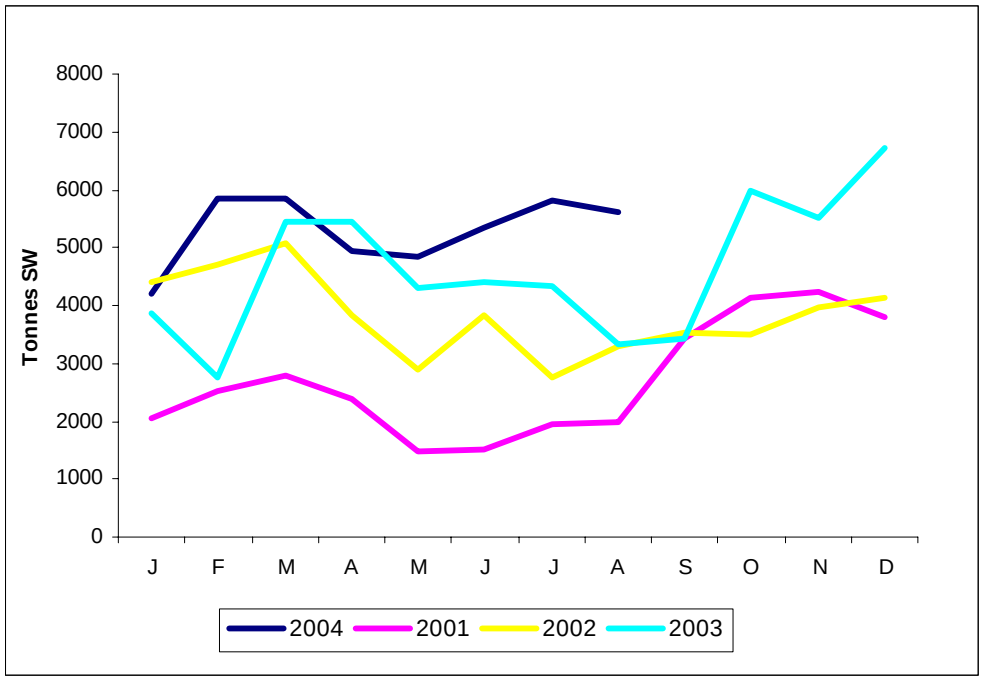
Chart 1. Australian pork imports Jan 2000- July 2004



Source: APL 2004

There was a particularly strong surge in imports from the end of 1998 to the middle of 2000, when the 12 month Moving Annual Total (MAT) rose from around 10,000 MT to 40,000 MT. The next surge was from the middle of 2001, which is still underway, during which time imports have risen from around 30,000 MT to over 64,000 MT (Chart 2).

Chart 2. Australian pork imports 2001- 2004, Volume SW

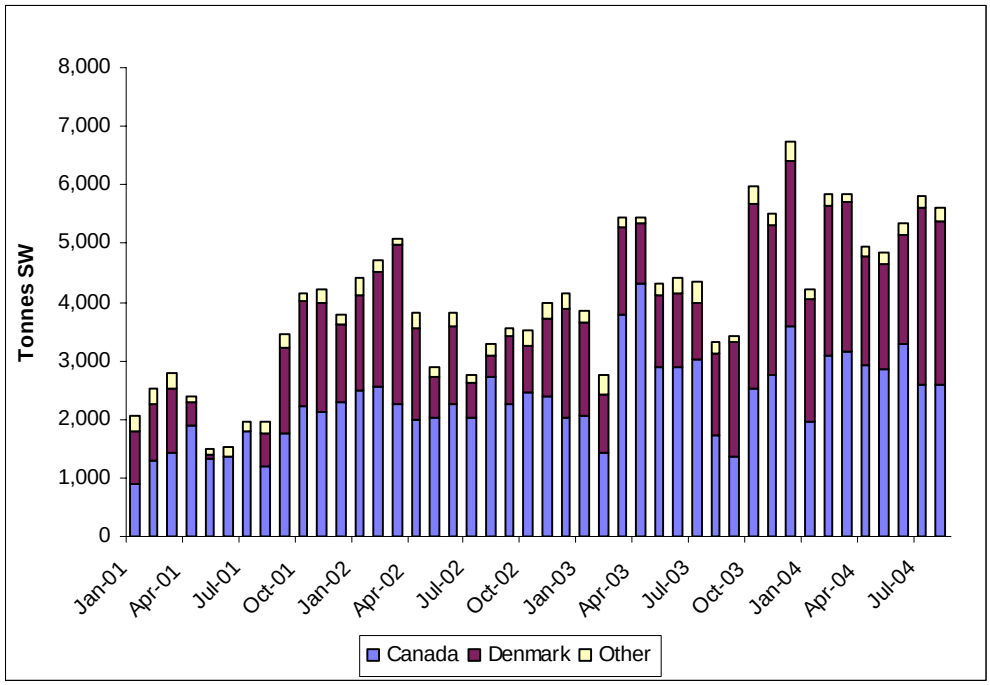


Source: APL 2004

Chart 2 above compares the seasonal patterns of imports from 2001 to 2003 with imports to date in 2004. A rise in imports in the last quarter of 2004 is anticipated.

Chart 3 below shows the share of imports between Canada and Denmark, the principal suppliers to Australia, and reveals the consolidation of Denmark's role in the import market. Of the roughly 64,000 MT, around 32,000 MT came from Canada (mainly frozen, uncooked, boneless legs) and around 28,000 MT from Denmark (mainly frozen, uncooked, boneless middles). For the Safeguards Inquiry in 1998, the focus was on imports from Canada since at that time there were negligible imports from Denmark (Chart 3).

Chart 3. Monthly pork imports, Jan 2001 – July 2004



Source: APL 2004

c. Imports increase relative to production

Imports have also substantially increased relative to production. To measure import penetration relative to production, boneless leg imports need to be converted to a carcase weight equivalent. To calculate the share of imports relative to production in the 1998 Safeguards Pork Inquiry, the Commission used a factor for converting boneless imports from Canada into a carcase weight equivalent of 1.69, described in the tables in this section as COMMISSION data. It was lower than the factor of 1.79 used by the Pork Council of Australia, described in tables as COMMISSION A data.[4] These calculations have been used to compare contemporary statistics.

Using either calculation, there has been a dramatic rise in leg imports relative to production (Table 1). (It should be noted that production and import data is for the year ended July 2004). Canadian imports as a share of total Australian pork production has risen from 3.9 percent at the time of the Safeguards Inquiry to 13.5 percent currently (COMMISSION basis) or from

[4] Not e the PCA used a conversion factor of 2.13 in 1997-1998.

4.8 percent to 14.4 percent (COMMISSION A basis). Canadian imports share of leg production has risen from 19.3 percent to 66.1 percent (COMMISSION basis) or from 22.2 percent to 66.4 percent (COMMISSION A basis).

Table 1. Pork production and imports

	COMMISSION Data	Conversion	MAT	MAT	MAT
Productivity Commission (COMMISSION)	1997-98	Factor	Mid-2001	Mid-2002	Mid-2004
Pig meat production	343131		367663	400426	400000
Fresh meat production	137252	0.40	147065	160170	160000
Production for processing	205879		220598	240256	240000
Middles and shoulders	135880	0.66	145595	158569	158400
Leg production for manufacturing	69999	0.52	75004	81687	81600
Leg production/pig meat production		0.20	0.20	0.20	0.20
COMMISSION Calculation Basis					
Canadian imports	7985		17418	25150	31839
Canadian imports CWE basis	13534	1.69	29522	42627	53965
Canadian imports % of total production	3.9		8.0	10.6	13.5
Canadian imports % of leg production	19.3		39.4	52.2	66.1
	COMMISSIONA Data	Conversion	MAT	MAT	MAT
Pork Council of Australia (COMMISSIONA)	1997-98	Factor	Mid-2001	Mid-2002	Mid-2004
Pig meat production	357000		367663	400426	400000
Fresh meat production	124950	0.35	128682	140149	140000
Production for processing	232050		239981	260277	260000
Middles and shoulders	135880	0.59	139939	152409	152246
Leg production for manufacturing	76577	0.56	78864	85892	85801
Leg production/pig meat production		0.21	0.21	0.21	0.21
COMMISSIONA Calculation basis					
Canadian imports	7985		17418	25150	31839
Canadian imports CWE basis	16989	1.79	31178	45019	56992
Canadian imports % of total production	4.8		8.5	11.2	14.2
Canadian imports % of leg production	22.2		39.5	52.4	66.4

Source: Productivity Commission data, Pork Council of Australia (PCA) data. Note: The PCA conversion factor was 2.3 in 1997-98 and currently 1.79.

As noted previously, imports from Denmark have grown from negligible levels at the time of the Inquiry to over 29,000 MT currently. To estimate import penetration levels, a similar analysis to that carried out at the time of the Safeguards Inquiry has been undertaken and the results are in Table 2 below.

Using conversion factors from industry sources, assuming that half of middles and shoulders production is middles and that all Danish imports are middles, Danish imports would be equivalent to over 56 percent of Australian production of middles for manufacturing. If the most recent three months of Danish imports were annualised, they would account for around 60 percent of middles production – approaching the level of import penetration to that of Canadian leg imports (on the COMMISSION's calculation basis).

Table 2. Pork production and middles imports

		Conversion	MAT
	1997-98	Factor	Mid-2004
Pig meat production	343131		400000
Fresh meat production	137252	0.40	160000
Production for processing	205879		240000
Middles and shoulders	135880	0.66	158400
Middles		0.50	79200
Danish imports	NA		29014
Danish imports CWE basis	NA	1.54	44682
Danish imports % of total production	**NA**		**11.2**
Danish imports % of middles production for manufacturing	**NA**		**56.4**
Notes:			
1. Assumes half of middles and shoulders production is middles			
2. Assumes all of Danish imports are middles			

Source: Industry sources

d. Imports have suppressed domestic prices

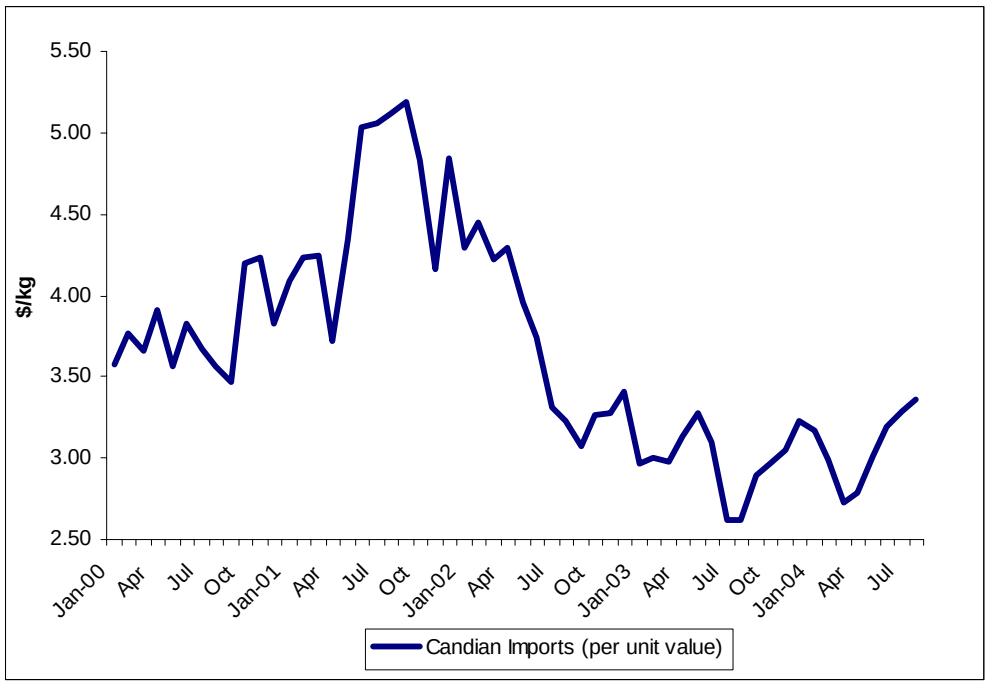
It is clear that imports are increasingly dominating key segments of the Australian market. In the case of Canadian imports, these dominate the leg

market. Danish imports have a substantial share of the middles market (primarily used for making bacon).

Both leg and middles imports have had a noticeably adverse impact on the domestic pig industry. This operates primarily through the impact of imports on prices for pig meat products in the domestic market. Notably the cuts of legs and middles together constitute almost two thirds of the animal.

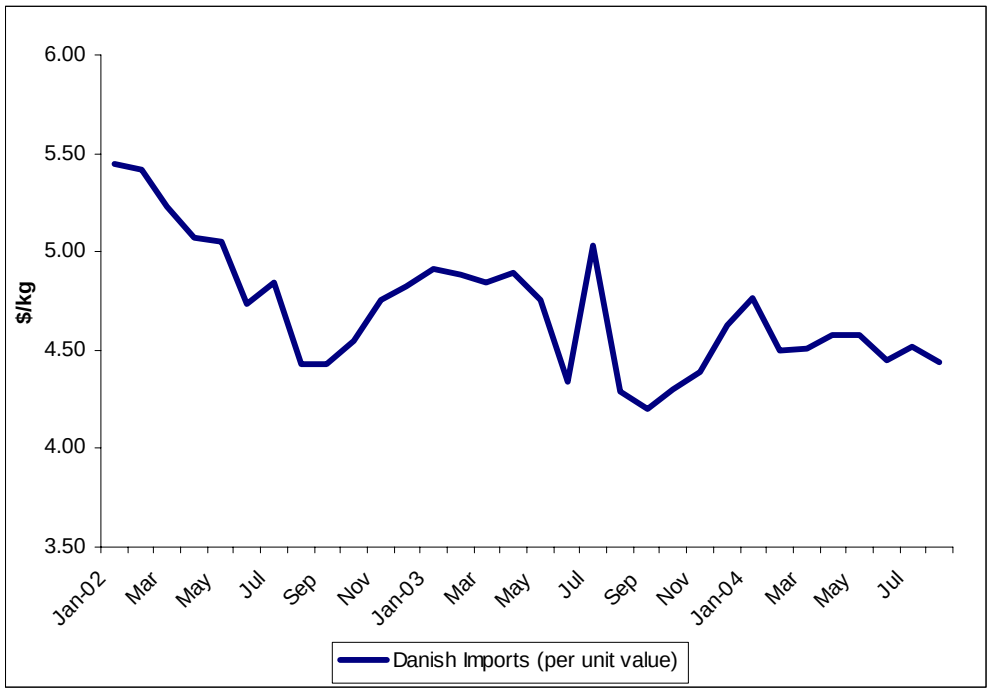
Prices (measured as unit values) of imports from both Canada and Denmark have been on a downward trend over the period of the import surge dating from mid-2001, as is shown in Charts 4 and 5 below.

Chart 4. Canadian imports – per unit value



Source: APL 2004

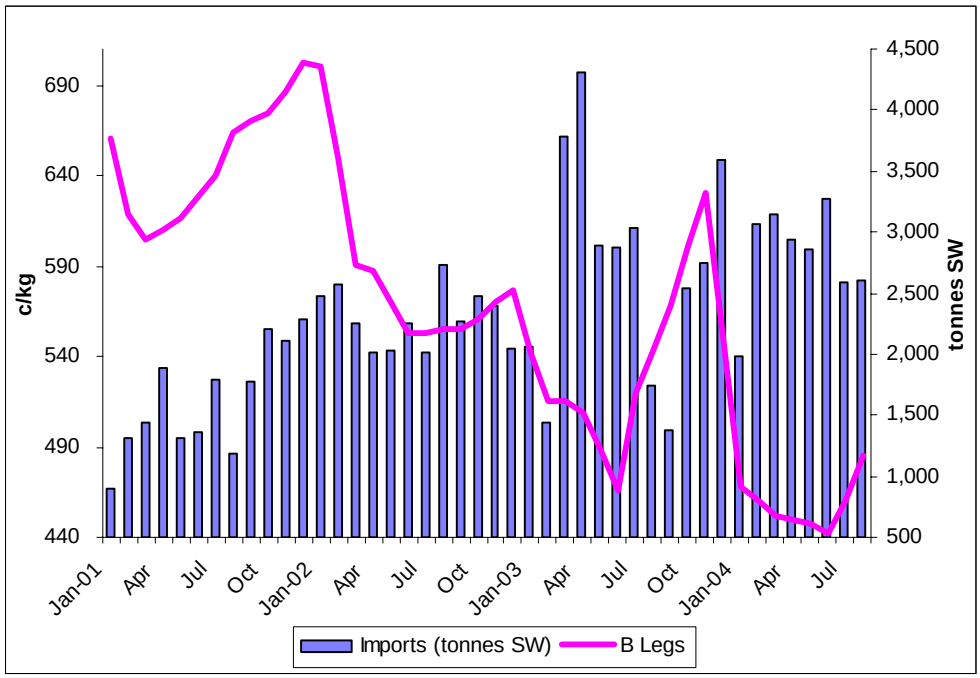
Chart 5. Danish imports- per unit value



Source: APL 2004

As Chart 6 below shows, in the run-up to Christmas, demand for leg hams rises. This provides a key element in the yearly income for the domestic industry. The high levels of imports over the past few years have depressed prices for boneless legs in the domestic market. Moreover, the latest surge in imports has undermined this normal seasonal price recovery.

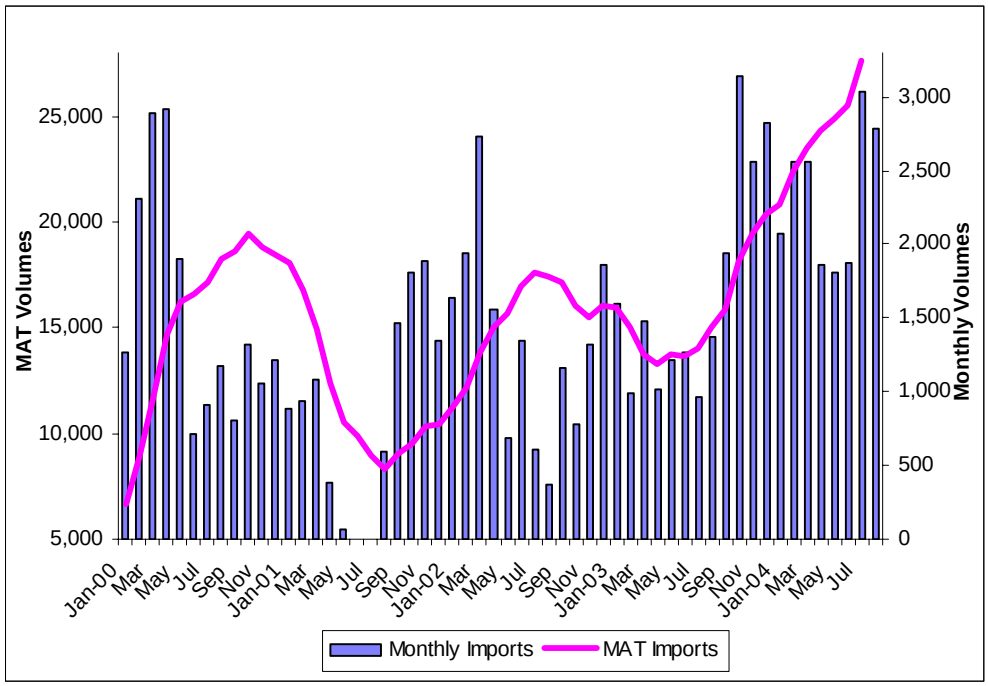
Chart 6. Canadian imports/wholesale leg price



Source: APL 2004

Danish imports have been a major factor in the import surge over the past three years (Chart 7).

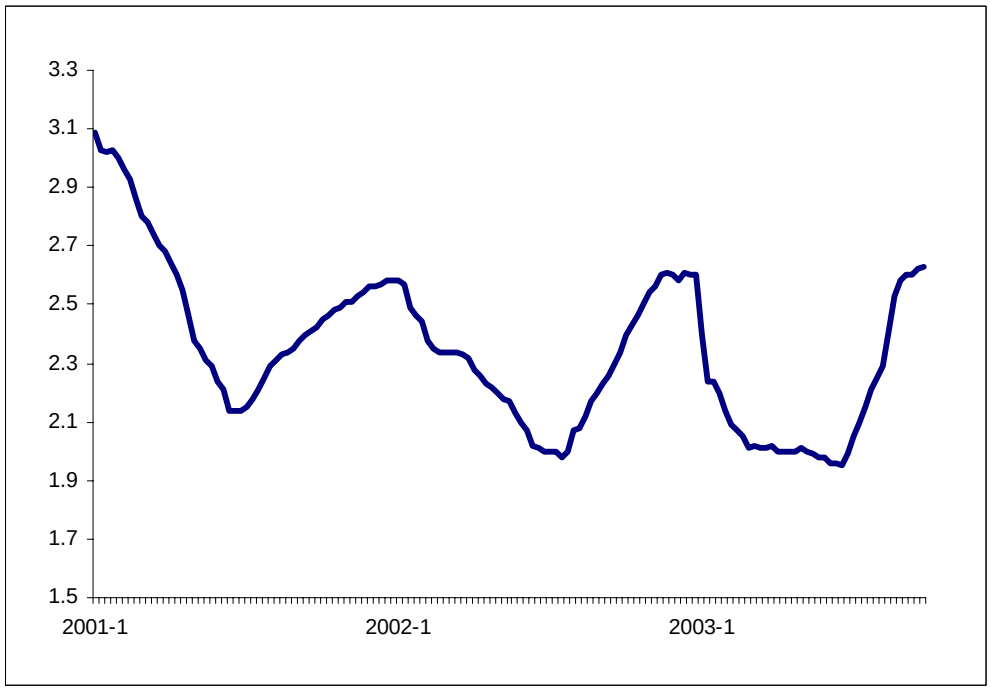
Chart 7. Pork imports from Denmark, volume SW



Source: APL 2004

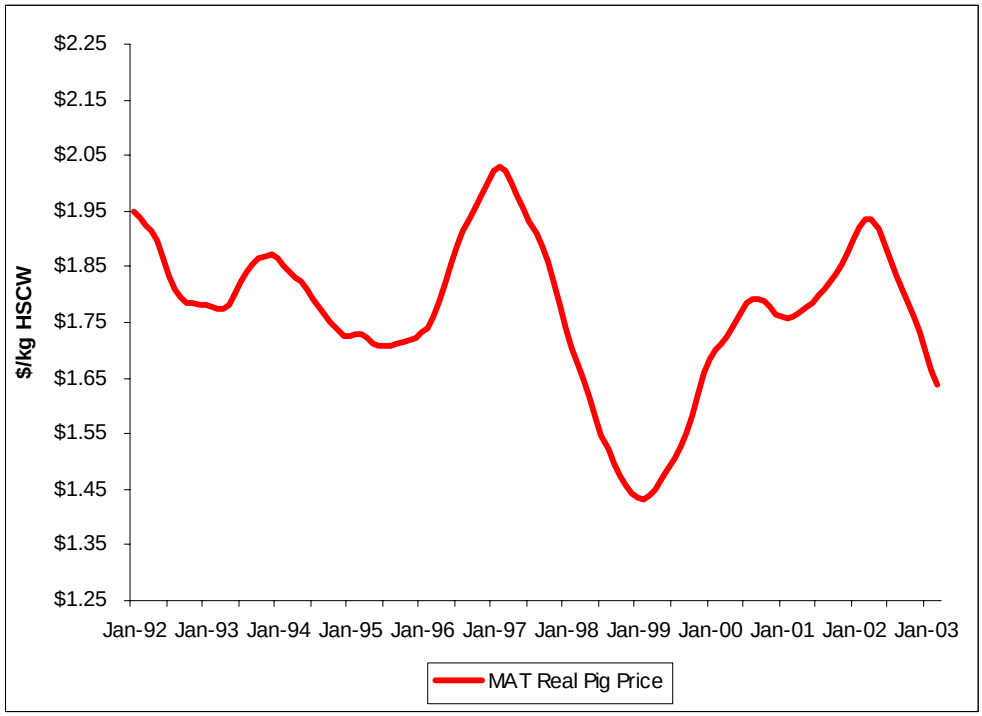
The high levels of imports over the past three years are reflected in the downward trend in producer prices over the same period. (National Prime Prices are used below, a combination of APL data from 2003 and before that a combination of QPPA and APL data). In real terms pig prices fell from around $1.90 in January 2002 to around $1.60 a year later (Charts 8 and 9).

Chart 8. National prime price $/kg HSCW



Source: APL 2004

Chart 9. MAT real pig prices (Base year of index 1989-90=100)



Source: APL 2004

It should also be noted that the pig market consists of essentially two segments differentiated principally by the weight of the carcase. These are the retail sector, 50 to 70 kg HSCW and manufacturing sector 70 to 90 kg. A third segment less than 10 percent is export with a weight of 90 to 110 kg. Pigs can be directed to all markets by simply altering the age at which they are sold. Therefore the prices in each market are strongly linked, with any differences tending to be fixed by the different cost of production associated with producing a light or heavy carcase.

A significant proportion of the 70 to 90 kg HSCW carcases are traded via wholesale boning rooms. The major customer for these boning rooms is the manufacturing sector, especially for boneless middles and legs (66 percent of the pig). The price for these two components is set by the relative price for like imported products. Therefore the carcase price in this sector and effectively the whole market will be set by the price of imports.

In the past, with production weak and a lack of supply, the latter has been the main driver of prices. In the current market however, it is no longer a factor as manufacturers have an unlimited supply via imports. This can be called upon within a short space of time, approximately 5 to 6 weeks. This compares to the domestic production cycle of 40 weeks from the time an extra sow is mated to when the progeny are ready for sale. An example of this in operation is the price rally in recent months. The rally was initiated predominantly via a shortage of pigs for sale relative to demand. The domestic shortage was a result of producers leaving the industry because of the adverse trading conditions of the previous 18 months[5]. In the past such a short-term production constraint is a normal occurrence in the industry and effectively has allowed the industry to survive periods of drought - for example where cost of production rises for a period, people leave the industry, supply drops, prices rise and remain relatively high, and producers have an opportunity to recover over the next 12 months. Domestic production will eventually increase as producers re-enter the industry or existing producers expand. This is the "Classic hog cycle".

Currently however, the supply shortage has effectively triggered an increase, and threatened further increases, in imports by the manufacturers. Wholesalers cannot pass on the price increases required for them to cover the increased carcase cost if they rely on domestic pork. Manufacturers will simply increase imports. Producers are now faced with no further price increases, which they would normally expect at this time of the year. At

[5] This was the result of the combined impact of the drought, the significant rise in feed costs and rising imports.

worst they could be looking at price decreases, which could potentially take many below cost of production.

It is also important to note that as demand for pigs and parts in the manufacturing sector is restricted by imports, producers cannot redirect pigs into the retail sector without causing significant downward price pressure on this sector. The retail sector has a relatively stable demand throughout the year, with an increased requirement at Christmas. While significant time and funds are being directed at increasing the demand from the retail sector, this is still a slow process. **Thus imports also have a direct influence on pricing in the retail sector, even though imports cannot be directly marketed as fresh pork in this area. This is a critical point to appreciate.**

e. The adverse impact of imports on pig production

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f. The adverse effect of imports on processing (slaughtering and boning)

Processors have seen the prices of pig meat products depressed by imports, as Charts 4 and 5 above indicate. However the full impact of import-affected prices will be felt by the processing sector imminently. This is because as pig production falls (as discussed above) processors will have fewer animals for slaughter and boning. Indeed the reduction in pig production and hence availability of pigs for processing is evident in Chart 11 above, with MAT production showing a declining trend from the beginning of 2004.

This will mean in the short-term excess capacity and hence higher unit costs of production. Anecdotal evidence from one processor indicated boning room throughput had declined by one half in 2004 compared with 2003 and unit costs (fixed and variable) increased by 30 percent.

This will put pressure on processor profitability, including those processors who received assistance to expand capacity with the assistance of government industry assistance programs. Information of processor profitability is normally highly confidential to the processor concerned. The Commission may be able to discern evidence of this from confidential data provided to the Inquiry by individual processors.

The current and imminent injury expected to be experienced by processors provides a justification for provisional safeguards to be applied consistent with the WTO Agreement on Safeguards. The justification for provisional safeguards is discussed below at section 4.

g. Other factors affecting the industry

Exports by the industry have increased substantially in recent years. Exports are currently around 52,000MT, with about 23,000MT going to Singapore and about half that amount going to Japan.

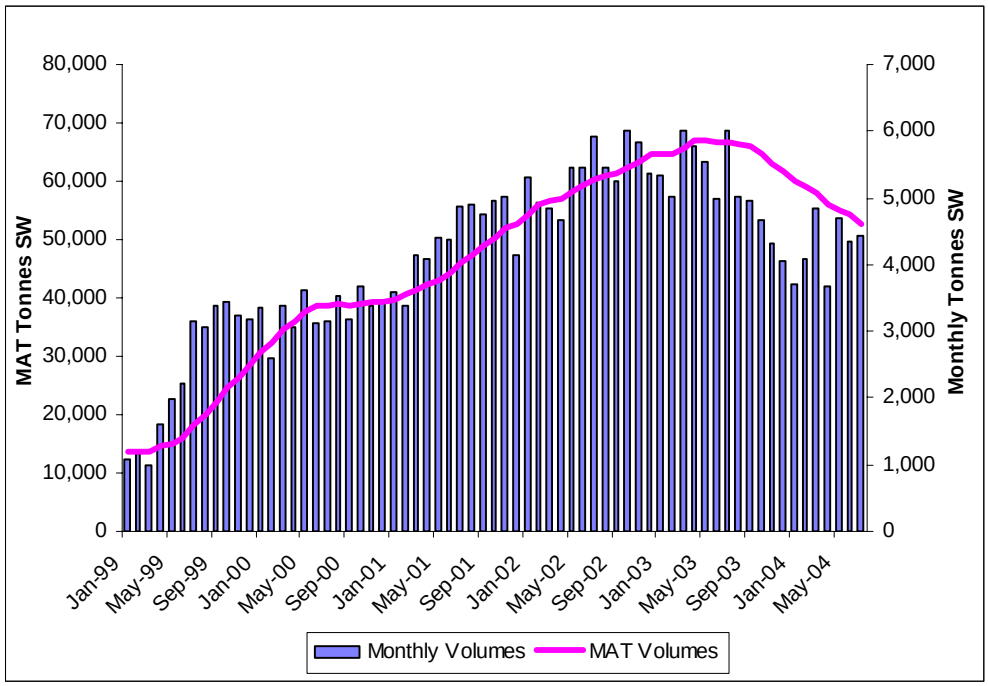
Export growth since the late 1990's has been predominantly to Singapore, the demand being for chilled, bone-in product following the Nippah virus outbreak in Malaysia, hitherto Singapore's major supplier.

Exports have flattened out over the past few years and have fallen in recent months, reflecting a number of factors. In relation to Singapore, exports to that country have been relatively stable but it has begun importing frozen pork from Brazil, the pork processing industry of which country receives substantial government subsidies.6.

In relation to Japan, there has been a much sharper decline in exports as Japan increased imports from the US, Canada and Denmark, and also activated safeguards against imports under the WTO.

[6] To illustrate this point, the incentives offered by the State of Goias for the new Perdigao pork and poultry plant at Rio Verde, including provision of infrastructure, such as electric power, water, the area for the factory sold at nominal prices, loan subject to ICMS (a form of VAT) taxes funding, with loans repayable after 20 years available to cover 70 % of the ICMS due and loans payable at low interest rates (under Project Fomentar). It is understood that the total value of tax credits and loan subsidies for the investment is in the region of R$2.0 billion over the twenty-year period (equivalent to around $US700 million or nearly $AUD1 billion).

Chart 12. Australian farmed pig meat exports

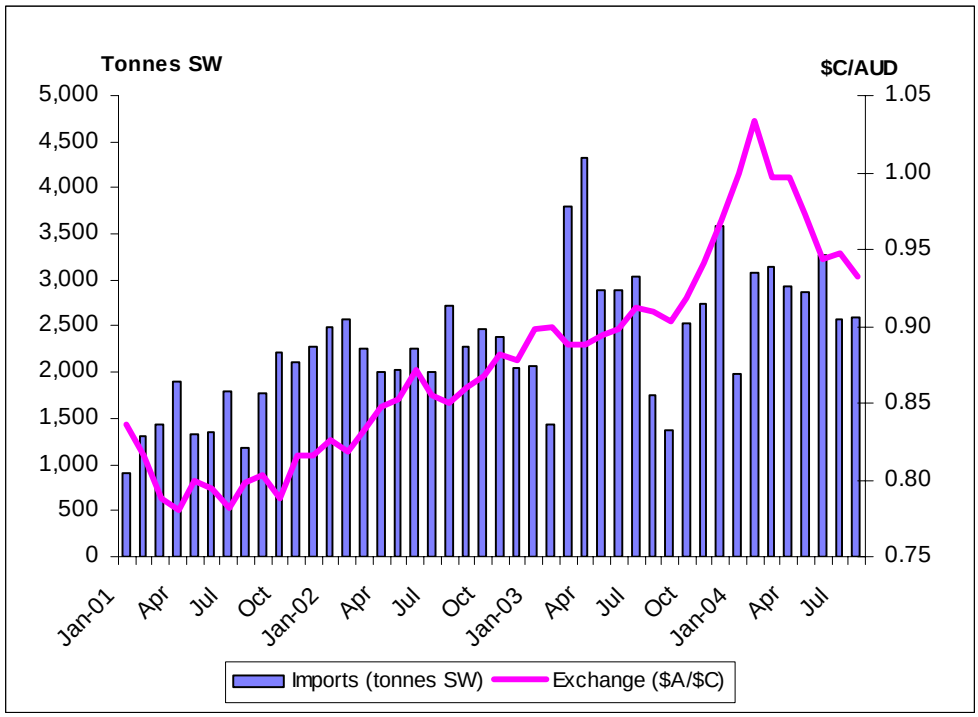


Source: APL 2004

Overall, exports by Australia on a yearly average basis remain at reasonably high levels. The injury being experienced by the Australian industry cannot be attributed in any significant way to export trends. Over the period of continuously rising imports since mid-2001, exports served to ameliorate to some extent the amount of damage caused to the industry – since export growth has stalled over the past twelve months, the damage to the industry caused by imports has accentuated.

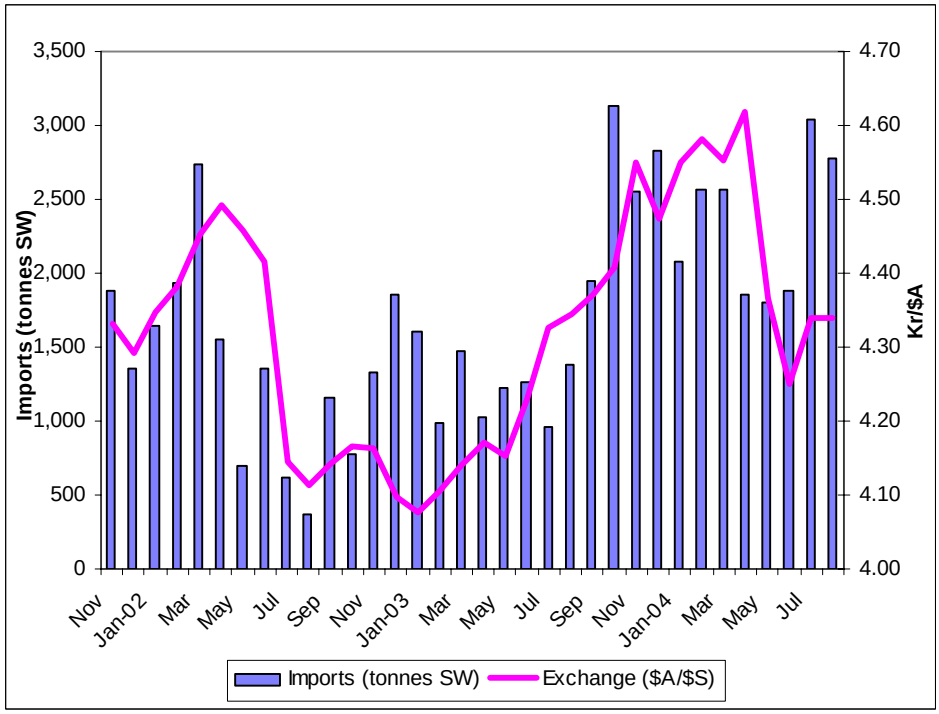
Finally, the exchange rate cannot be considered as a factor causing injury to the industry. The period in which the industry has suffered injury includes periods of both strong and weak exchange rates, yet imports have experienced a sustained and substantial rise in penetration of the Australian market. As indicated above, exports have been reasonably firm (Charts 13 and 14).

Chart 13. Canada imports/FOREX Correlation



Source: APL 2004

Chart 14. Danish imports/FOREX Correlation



Source: APL 2004

h. Conclusion – imports have reduced profits, production, sales and capacity utilization

There has been a marked rise in imports of products (principally imports of boneless legs from Canada and boneless middles from Denmark) that compete with production by the Australian pig meat industry over the past three years, in both absolute and relative terms. The imports have come to dominate key segments of the Australian market.

The depressed prices resulting from imports have also undermined industry profitability. This is evident at both the pig production and processing (slaughtering and boning) levels.

For producers, according to the survey conducted for APL by Ernst and Young, average profit per pig slaughtered fell from $22.70 per pig in 2001/02 to negative $24.40 in 2002/03 and a forecast negative $31.77 per pig in 2003/04. Faced with substantial financial losses, production has started to contract with slaughter numbers for the year to July 2004 decreasing by 4.3 percent over the previous year, owing to difficult market conditions.

Import-affected prices for pig meat have seen producers losing tens of millions of dollars according to industry sources. In mid-2003, a major producer Danpork went into receivership. APL has estimated that 5 percent of pig producers have left the industry permanently since August 2002.

Processors have seen the prices of pig meat products depressed by imports however the full impact of import-affected prices will be felt by the processing sector imminently. This is because as pig production falls (as discussed above) processors will have fewer animals for slaughter and boning. Indeed the reduction in pig production and hence availability of pigs for processing is well underway. This will mean in the short-term excess capacity and hence higher unit costs of production. Anecdotal evidence from one processor indicated boning room throughput had declined by one half in 2004 compared with 2003 and unit costs (fixed and variable) increased by 30 percent. This will put further pressure on processor profitability.

The industry also faces serious injury in the longer term as investment is also being adversely affected by the rise in imports and depressed returns. This is evidenced by the anecdotal information.

It is clear that imports have had a critical impact in causing serious injury to the domestic industry. Other factors, such as exports, the exchange rate, and weather conditions have also affected the industry, however, evidence

suggest that imports remain an independent factor in bringing about and inducing the serious injury suffered by the domestic industry. For example, during the period of rising feed prices owing to drought, **producer profitability has been squeezed as imports mean cost increases cannot be passed on in prices to purchasers of pig meat**.

APL notes that the impact of imports on sales, production, profitability and capacity utilisation would be better assessed with additional and more detailed information from producers and processors in the industry. APL is currently in the process of obtaining this and will endeavour to analyse this when available, with a view to determining whether it further supports the case for serious injury. If so, APL will seek to submit this information to the Commission at a later date.

i. Imminent consequences and managing them

(Confidential information removed)

(Confidential information removed)

2.2 “Serious injury”

Imports are causing serious injury to the Australian pig meat industry. The WTO provides that if this occurs as a result of compliance with WTO obligations, members can take temporary action to restrain imports to protect industry while action is taken to make the industry competitive. The WTO provisions were designed to act as a safety valve in the event that commitments to liberalization created greater disruption to domestic producers than had been anticipated.

The WTO defines serious injury as meaning “a significant overall impairment in the position of the domestic industry”. Impairment is measured by negative impacts on the levels of sales, production, profit, productivity, capacity utilization, earnings and employment in the domestic market. The foregoing section demonstrates falls in performance of those categories are occurring in the Australian pig meat industry.

The imports need to be like products made by the domestic industry if it is to be demonstrated under WTO rules that they are the cause of serious injury. Canadian legs and Danish middles clearly compete with pig meat products made by Australian producers and processors. Imports from Canada and Denmark have dominated key segments of the Australian market.

Imports need to have increased markedly for the damaged caused to warrant temporary restraint of imports. Imports have increased steadily since the Productivity Commission found in 1998 that imports up to that point in time were causing serious damage. Canadian imports have continued to increase and Denmark has entered the market, virtually equaling Canadian imports. Import growth has been significant in the last three years.

It is clear from the foregoing that increased imports have caused the serious injury experienced by the industry. As noted in Section 3, other factors such as fall offs in exports and drought have also had adverse effects on the industry. The analysis in the section, however, clearly establishes the causal link between increases in imports and the damage caused. There is direct correlation between rises in imports and falls in domestic prices, as shown in Section 2. Low prices in turn are causing losses and falling rates of return on investment.

The Commission found in 1998 that imports of pork products caused serious damage to Australia's pig meat industry. The review of the situation in Section 2 demonstrates the economic factors which show imports in the immediate preceding period are causing serious damage.

The legal requirements for a determination of serious injury under WTO rules which is required to impose temporary restraints on imports are elaborated in further detail at Annex 1.

2.3 The case for provisional safeguards

WTO rules do not allow the use of temporary safeguard measures in the form of tariff protection to restrain imports without specific pre-conditions being met, such as an Inquiry first being conducted by a designated authority to determine that imports are causing serious injury and notification to the WTO and provision of opportunities for consultation and comment to other WTO members whose trade may be affected the restrictions on trade.

However in critical circumstances, where delays in action may cause damage which will be difficult to repair, WTO rules permit immediate imposition of "provisional safeguards" for up to 200 days without having to satisfy the prior requirements of a formal inquiry and notification and consultation.

The justification for this action is serious injury or threats of serious injury. The terms justifying use of provisional safeguards are set out in Annex 2.

a. Critical circumstances

The circumstances in the pork industry are critical. Returns on capital for most small producers are negative and most are losing money. Levels of debt are high. One large producer is in receivership. APL has estimated that 5 percent of pig producers have left the industry permanently since August 2002. Essentially, the sector was insolvent, and only because of vertical integration and financial position of the parent companies, were these enterprises able to maintain production. The industry is already experiencing serious injury.

There is threat of further injury. Imports have continued to increase, and as Chart 2 in Section 2 shows, a spike in exports is anticipated in the last quarter of this year. There is also the prospect of increased imports when quarantine

restrictions on the import of pork as proposed in the final Import Risk Assessment[7] on pork imports become fully operational.

It is clear that, unless the industry is protected from further increases in exports which are most likely as demand spikes seasonally in the next quarter, and may be further added to if quarantine restrictions are further eased, there will be widespread bankruptcies and significant hardship in the industry.

b. Damage difficult to repair

The forecast increased in exports will cause damage which will be difficult to repair.

It is a universal experience that unplanned foreclosures by financial institutions cause much greater hardship than orderly settlement of financial affairs. The financial and personal cost to individuals is always greater.

There is also greater disruption to production when bankruptcies occur. In industries in the non-traded sector, new businesses will in time establish to re-supply demand. The pig meat industry however is significantly exposed to competitively priced imports which could be expected to rapidly to take up the demand previously supplied by the Australian suppliers who leave the industry suddenly. Given that the industry continues to face challenges in meeting import competition for some products, it would certainly be difficult for the Australian industry to regain the market share likely to be captured by foreign producers following an unplanned shake out in the pork industry.

It may well turn out that once the Australian industry restructures, its share of Australian consumption of pork may well be less than the present share. Ideally, such a restructuring should occur in an orderly way which optimizes the opportunities for Australian producers to reorganize, secure the necessary capital and expand the general scale of production in the Australian pig meat industry.

Commercial experience shows us that when financial shake outs occur, the financially strongest and most competitive enterprises expand market share. **It is a distinct possibility that Danish and Canadian pork imports will secure a larger share of the Australian pig meat market under those circumstances than in those applying if an orderly restructure of the industry occurred.**

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[7] Final Import Risk Analysis on Pig meat, Biosecurity Australia, February 2004 at http://www.affa.gov.au

APL contends that there is a straightforward case for a preliminary determination for provisional safeguard protection against imports from Canada and Denmark under the WTO Agreement on Safeguards. Such action is warranted to counteract the injurious state of the Australian industry and to assist it achieve competitiveness and viability.

The WTO Agreement on Safeguards was specifically designed to provide respite against imports in the event commitments to liberalization created greater disruption to domestic producers than had been anticipated. It permits the reintroduction of protection on a temporary basis. Safeguard measures can be applied provisionally subject to a preliminary determination that certain criteria specified under the Agreement is met.

c. Provisional safeguards are simpler to impose

No inquiry is required before a provisional safeguard is imposed. The WTO Agreement requires a "determination" to be made. That determination can be made by any government authority. The most logical would be a Minister. The WTO provisions require that the determination finds that serious injury has occurred, or is threatened. As demonstrated in the preceding paragraphs of this submission, it is clear that there is serious injury and that it is also threatened.

There are obligations if the provisional safeguards are imposed. These are set out in detail in Annex 2. The most important is to hold within 200 days of the imposition of the Provisional Safeguards, a formal Inquiry by a designated authority (in Australia's case the Government has designated the Productivity Commission as that authority) to demonstrate that imports are causing serious damage to warrant temporary tariff protection.

If that Inquiry fails to determine the conditions of the WTO provisions are met, then the provisional safeguard measures have to be removed and trading partners whose imports were restricted by the provisional safeguards are entitled to secure compensation.

2.4 Action by the Productivity Commission

APL is aware that the terms of reference for this Inquiry do not include determination of whether or not a case exists to impose safeguards under the provisions of the WTO. It is enjoined to assess the international competitiveness of the industry and to consider what government measures would be warranted to make the industry competitive.

This submission points out the serious impact imports have had on the industry. APL will advise the Commission of the industry's objectives for

restructuring and its strategies to achieve that. Those proposals will not include provisions for permanent protection by raising tariffs.

APL wishes to point out however that the circumstances facing the industry are critical and time urgent. Urgent action is required to prevent an unstructured shake out in the industry and to provide a stable environment in which restructuring can proceed in an orderly way.

APL has demonstrated that a case exists to impose immediately provisional safeguards and that this is an appropriate measure. It recommends to the Commission that it propose to the Government as soon as is practicable that an appropriate authority immediately impose provisional safeguards for 200 days to restrain imports of pig meat to avert the critical situation facing the industry and to enable a proper assessment of the competitiveness of the industry to be made and to enable an orderly process of restructuring to be developed and implemented.

APL sees nothing in the mandate given to the Commission which prevents it from making such a recommendation to the Government without prejudice to its terms of reference. Its terms of reference are to consider the competitiveness of the industry and measures relevant to achieving that. Safeguard measures do not create competitiveness. This is recognized in WTO rules. They do not permit ordinary (as opposed to provisional) safeguards to be imposed without evidence that other measures are in place to restructure domestic industry.

The case to put to the Government to warrant imposition of temporary safeguards can be summarized as follows:

- There has been a marked and substantial increase in imports of like or directly competitive products from Canada and Denmark, namely boneless legs and middles;
- There is clear evidence of the causal link between increased levels of import penetration from Canada and Denmark in the domestic industry and adverse conditions being experienced in production, profits and capacity utilization in the industry;
- There is "clear evidence" that the domestic industry is suffering serious injury, as detailed in Part 2 of this submission;
- The domestic industry faces the "threat" of further serious injury – a seasonal spike in imports is anticipated in the last quarter of 2004 and there is potential for additional import competition flowing from further loosening of quarantine controls in light of the final Import Risk Assessment on imports of pig meat;
- There are now "critical circumstances where delay would cause damage that is difficult to repair."

APL will also be submitting a further submission contending that an Inquiry for the imposition of full or normal safeguard measures is warranted and therefore a recommendation from the PC inquiry that a safeguard investigation is warranted.

3. Structure and regional distribution of the industry

3.1 The Australian pork industry

There are currently an estimated 2,323 pork producers in Australia[8] producing some 5 million pigs annually. APL's members own approximately 75 percent of the Australian pig production. The estimated Gross Value of Production (GVP) for pig production is $891m[9] for the period 2002/03, an 8 percent decrease from the previous year. Pork represents 2.2 percent of total Australian farm production.

The Australian pork industry provides a significant positive impact to local, regional, state and national economies through substantial income generation and employment. The total value produced by the industry is approximately $2.6 billion. It generates over $1.1 billion in household income. In 2002, the pork industry directly generated approximately 6,000 full time jobs with a further 33,863 jobs generated indirectly in other sectors of the national economy[10]. The specific economic impacts at a national, state and regional level are documented below in Table 3.

Table 3. Socio-Economic Impact of the Pork Value Chain

	Output ($m)	Value Added ($m)	Household Income ($m)	Employment
Australia	6,199.90	2,576.00	1,109.78	33,863
States				
New South Wales	1,498.14	625.22	266.05	7,916
Victoria	1,359.76	550.05	242.38	7,732
Queensland	1,188.37	434.28	201.37	6,312
South Australia	539.65	219.53	85.70	3,121
Western Australia	469.24	183.47	78.16	2,380
Tasmania	87.39	35.07	16.09	488
Regions				
Central NSW	372.05	129.52	49.93	2,011
Southeast Qld	601.02	192.56	80.68	3,257
Southern NSW – Northern Victoria	615.20	212.25	88.80	3,348

Source: 'Socio-Economic Impacts of the Australian Pork Industry', Western Research Institute; 17 December 2002

[8] ABS Agricultural Survey 2003 Figures

[9] ABARE - pork livestock slaughtering GVP - for 2002/2003 period

[10] 'Socio-Economic Impacts of the Australian Pork Industry', Western Research Institute; 17 December 2002

3.1.1 Australian Pork Limited

Australian Pork Limited (APL) is the national representative body for Australian pig producers. It is a producer-owned not-for-profit company combining marketing, export development, research and innovation and strategic policy development to assist in securing a profitable and sustainable future for the Australian pork industry. The framework for APL was established under the Pig Industry Act 2001. Operating and reporting guidelines are provided for in the funding agreement with the Commonwealth of Australia.

APL's primary funding is derived from statutory pig slaughter levies collected under the *Primary Industry (Excise) Levies Act 1999*. The levy amounts to $2.435 per cacase levy at slaughter, of which APL receives only $2.35, consisting of $1.65 for marketing activities and 70 cents for research and development. The remaining 8.5cents is for the Pig Monitoring Residue Program, which is received and managed solely by the National Residue Survey. Due to the increasing costs of running this program and in recognition of the difficult financial circumstances facing producers, APL has absorbed these additional costs rather than recommend an increase in the residue levy. For the financial year ending 2005, this amounted to $100,000. Additional research-specific funds are also received from the Commonwealth Government.

3.2 The geographical make-up of the Australian pork industry

Australian pig numbers fell by 10 percent to 2.7 million at 30 June 2003, with falls in all states except Queensland and Tasmania[11]. The number of herds fell by 12 percent to 2,900 at 30 June 2003, with a decline in numbers of herds in all states. New South Wales and Queensland account for over half the industry breeding sows[12].

Australia pig production is located Australia-wide reflecting transport costs and also historical factors such as storage, technology, grain producing areas and demand for fresh product by consumers (Chart 15 below). This spatial distribution has probable implications for realisation of scale economies and specialisation in pig production and processing.

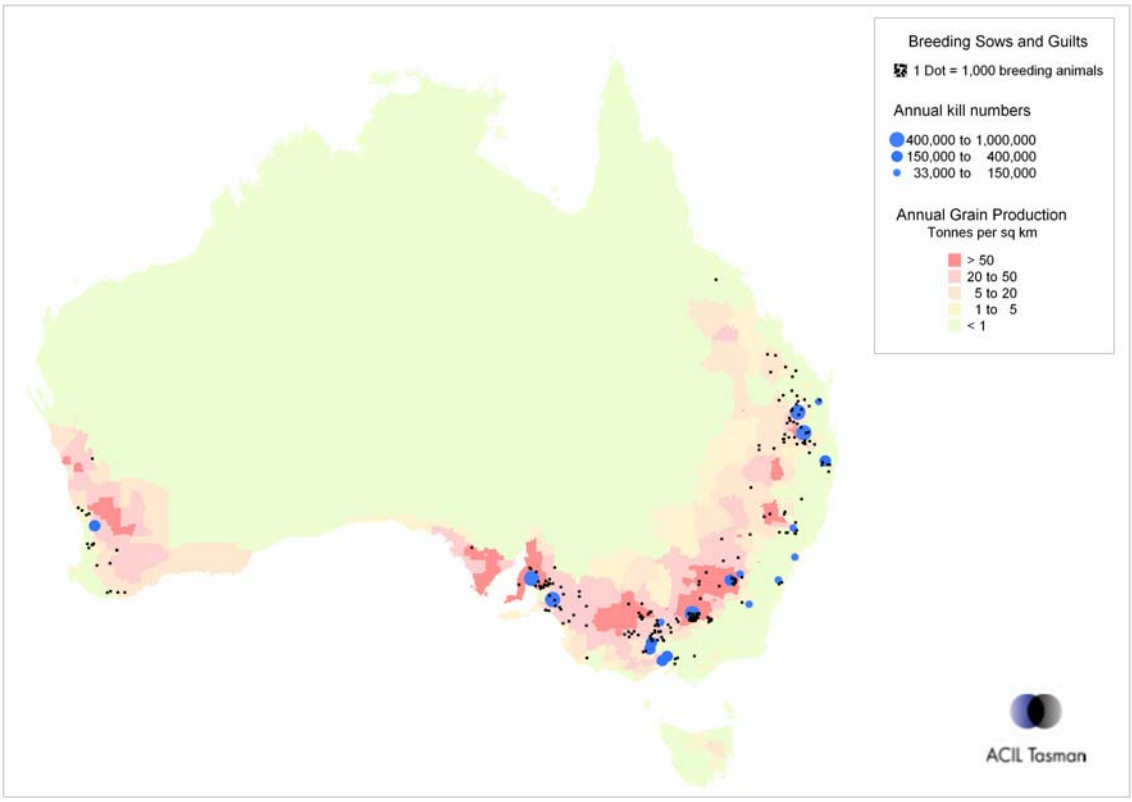
The pig industry, closely associated with dairy industry locations in the past, is now largely located in the grain growing regions. Grain growing areas of Australia are found in two relatively narrow inland belts; the eastern

[11] Australian Bureau of Statistics – Year Book Australia, 7121.0 Agriculture Commodities, Australia

[12] Australian Bureau of Statistics – Year Book Australia, 7121.0 Agriculture Commodities, Australia

Australian grain belt, which stretches through central Queensland, New South, Wales, Victoria and South Australia, and the Western Australian grain belt, which is in an area bordered by Geraldton in the north, Albany to the south and Esperance to the east[13].

Chart 1 Distribution of pig producers, pig processing and grain production: Australia 2001



Note: 'Total grain' refers to wheat, barley, sorghum and triticale only.
Dots representing breeding animals distributed randomly around the SLA where the animals are from.
Annual kill numbers from 20 Abattoirs with the highest kill numbers. Abattoir location assumed to be the midpoint of Abattoir's postcode area.
Data source: AGSTATS 2003 – data from 2001 Agricultural Census. SLA boundaries from CData 2001

[13] Feed Grains - Future supply and demand in Australia, ABARE E Report 03.21, Prepared for the Grains Research and Development Corporation, Amhed Hafi and Peter Connell, November 2003

Intensive farming, environmental concerns, and nutritional research showing increased productivity through grain feeds, is largely behind the move towards the grain based diets and the separation from the dairy sector into the grain belts. In 2003, 29 percent of sows were located in NSW, 21 percent in Queensland, 23 percent in Victoria, 15 percent in South Australia and 12 percent in Western Australia. In New South Wales, the pig industry is heavily concentrated in the south of the state; in Queensland it is concentrated in the Darling Downs; while in Victoria it is more dispersed around the north[14].

Table 4. Distribution of Pig Farms by State

State	Herds	Sows	Total Sows (%)
New South Wales	708	101,436	29%
Queensland	401	75,661	21%
Victoria	416	79,473	23%
Sth Australia	457	52,003	15%
Western Australia	281	41,145	12%
Tasmania	58	2,448	1%
Northern Territory	3	374	0.001%
Total	**2,639**	**355,401**	**100%**

Source: ABS Agricultural Survey 2003

3.3 Shift to specialist pork production

According to the Australian Bureau of Statistics, approximately 40 percent of producers are specialists deriving most of their income from pig production. While the industry is now characterised by a large number of specialist producers, large herd sizes and advanced husbandry practices, there remains much diversity in the size of producer units, degree of specialisation and business organisation[15]. The industry comprises a spread of small to large family operations and large corporate enterprises with vertically integrated operations[16].

As noted by ABARE in their 2004 study into the Australian pork industry, even though many small producers have left the industry, there continues to be a large number of such producers accounting for a relatively low

[14] Feed Grains - Future supply and demand in Australia, ABARE E Report 03.21, Prepared for the Grains Research and Development Corporation, Amhed Hafi and Peter Connell, November 2003

[15] Economic Assessment of the Effects of Pig Meat Imports on the Australian Industry; ABARE; May 2004

[16] Economic Assessment of the Effects of Pig Meat Imports on the Australian Industry; ABARE; May 2004

percentage of the total sow herd. The majority of farms are small to medium sized family owned operations, with an average herd size for such operations of 130 sows. More than 80 percent of producers have less than 100 sows and account for around 25 percent of the total herd. At the other end of the scale, 1 percent of producers have more than 1000 sows and account for 34 percent of the total herd. There is a move towards vertically aligned larger scale operations, reflecting a global trend towards vertical integration and alignment.

3.4 Nature of global trade

Australian producers operate in a globally competitive pork market. International trade in pork products primarily occurs in the form of specific cuts as opposed to whole carcases, however trade in these cuts has price implications for the whole of the pig. Over two thirds of the imported pork sold in Australia comes in the form of legs (supplied principally from Canada) and middles (overwhelmingly supplied from Denmark). As the processed market and the fresh market are inextricably linked, any artificial downward pressure placed on pork product supplied into the processed sector in turn has a similar price lowering effect on the Australian fresh pork sector. Subsequently, whilst Danish middle cuts may only compete directly with Australian middle cuts, the price distortion impact of EU support measures flows through to the Australian fresh market. The ABARE report details research from the OECD, which shows that EU producers receive 26 percent of their earnings from the government, mostly in the form of market price support.

Legs are valued at low levels around the world because more value is gained from the other cuts of the carcase. Relative to demand, there is an ongoing global oversupply of legs cuts, however Australia is one of the few markets that has strong demand for this cut. Consequently, Australia is viewed by the Canadians (and the USA) as being a valued leg market. The industry, therefore, needs to match the value structures of its global competitors in order to compete with imported leg meat.

This issue will be addressed by APL in detail in a subsequent submission encompassing strategies that focus on improving competitiveness across the supply chain as detailed in the draft industry restructure plan.

3.5 World market position of the Australian pork industry / production statistics
On the world stage, the Australian pork industry is relatively small. Production of 395,000 tonnes ranked Australia 36th in the world in 2002 (Table 5). This accounts for only 0.4 percent of total world production. However, 1992 to 2002 saw the Australian industry increase 18 percent in total meat production compared to the global average of 31 percent.

Table 5. World Pig Meat Production 1992 and 1999 – 2002 (000's tonnes)

Country	1992	1999	2000	2001	2002
Australia	335.8	369.9	362.9	365.2	395.0
Total Asia / Pacific	34061.8	48324.0	48660.2	50436.1	52740.7
Rest of World	38854.9	41577.6	40873.3	40854.2	41445.0
Total World	72916.8	89901.5	89533.5	91290.3	94185.7

Source: FAO, RAP PUBLICATION: 2003/10, Selected Indicators of Food and Agriculture Development in Asia-Pacific Region 1992-2002, October 2003

In more recent years, the Australian pork industry has seen the emergence of a few large processing companies dominating the market place and supplying the greater proportion of all pig meat sold in the country. Along with this emergence, and more intensive farming and efficient pig production practices, there has been a rise in pig meat production steadily since the mid 1970s, when production dipped to a low of 174,000 tonnes. In 2002/03 pig meat production increased 6 percent to 420,000 tonnes, more than double its low point in 1976[17].

4. Key factors influencing the profitability of the industry: an overview.

Note a more detailed analysis regarding to what extent these factors are short or long term will be addressed in APL's submission on industry competitiveness.

[17] Australian Bureau of Statistics – Year Book Australia, Agriculture, Meat production and slaughtering.

4.1 Volatility in grain and pork prices

It is a key axiom of pork production worldwide that profitability of pig farming is intrinsically linked to the pig feed: pork price ratio. An historic "rule of thumb" is that this ratio should be 1:8 or less for pig farming to be profitable. However, the required ratio for profitability has been narrowed somewhat in recent years due to improvements in pig genetics and husbandry techniques.

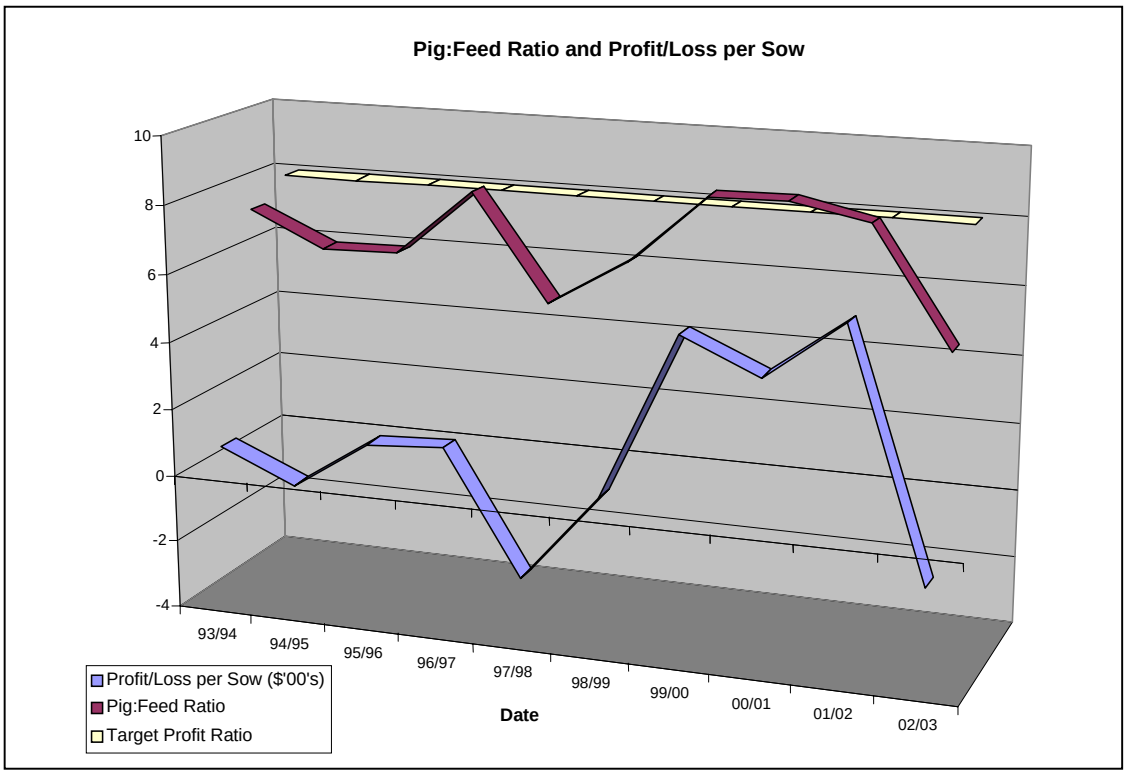
The Queensland Department of Primary Industry has maintained a rolling index of the pig feed: pork price ratio in Australia since 1987. Trends in this ratio over the last 10 years are shown in Table 6 and the accompanying Chart 15, alongside farm profit and loss data from PigStats.

Table 6. Profitability and Pig:Feed Ratio 1993-2003*

Year	Profit/Loss per Sow($)	Pig:Feed Ratio
1993/94	81.00	7.4
1994/95	14.00	6.4
1995/96	134.00	6.5
1996/97	147.00	8.4
1997/98	-216.00	5.3
1998/99	47.00	6.7
1999/00	536.00	8.7
2000/01	437.00	8.8
2001/02	608.00	8.3
2002/03	105.00	4.9

*(*From PigStats and Queensland DPI data)*

Chart 15. Pig:Feed Ratio and Profit/Loss per Sow



From this data it may be seen that:

- There have been massive swings in profitability over the last 10 years.
- During this period, there have been only three years (2000, 2001 and 2002) where profitability has approached what could be regarded as adequate levels for long term business sustainability. One of those three years was due principally to the FMD outbreak in Europe resulting in reduced Danish imports (as detailed in section 4.2).
- In evaluating these figures, it also needs to be noted that more recent financial survey work indicates that the PigStats data underestimates current asset values and financing costs.

4.2 Causes of volatility

In order to understand the underlying causes of these swings of profitability, a review of the recent history of the industry identifies a number of key external events that have driven these financial trends.

In 1990, revision of import regulations resulted in imports of pig meat being able to enter the Australian market for the first time. Then the drought of 1994/95 saw a large scale exit of producers from the industry. Producer numbers dropped by over 1000 from 1994 to 3,615 producers in 1995 [18]. Imports of pig meat also saw a dramatic rise in this period with 1995 recording a 92 percent increase over the previous year. The shortfall in production encouraged processors to import more product and imports escalated further in 1997 and 1998. This led to a collapse of Australian pig prices in 1997/98.

A combination of Government assistance and opportunities opening up in Asian markets due to local pig disease outbreaks saw a rapid export-driven return to profitability in the Australian industry from late 1999 until 2002. This came to an abrupt end in early 2003, following on from average pig feed prices having increased by 52 percent for the second half of 2002 as compared to the average for the second half of 2001 due to drought conditions and unfavorable movements in the exchange rate occurred. At the same time, domestic pork prices fell due to high volumes of low cost imported meat entering the market and export prices and volumes were also constrained by high exchange rates.

Therefore, for sustainability of the Australian pork industry, three key factors are apparent:

1. More control over market prices is required;
2. Costs of production need to be reduced and if possible stabilised; and
3. Efficiency needs to be optimised.

4.3 Pork price and pig price dynamics

Australian pork producers are now operating in a much more complex marketing environment than they have done historically, prior to the 1990s, when the industry was solely domestically focused and protected from imports.

The main focus of the industry has been, and still is, the production of bacon-weight pigs for further processing and therefore is a key driver on industry prices. The fresh pork market in Australia is relatively underdeveloped and

[18] Australian Pig Industry Handbook – Pig Stats 2002, Australian Pork Limited

traditionally is supplied by a comparatively small number of specialist producers, who typically sell their pigs at lighter weights to meet the specific requirements of retail butchers. However, this has started to shift, particularly over the last 18 months, as a result of price competitiveness and marketing efforts having successfully shifted consumer attitudes towards what were previously deterred purchase decisions. Baconer weight pigs remain a key driver, but it should be noted that production has shifted marginally towards fresh over the last few years.

Feedback to APL indicates the largest boning rooms are now only transferring 40 percent to the processed sector. Whilst APL continues to target growth in the fresh sector, and hence by implication production, the industry still views supply to the processed sector as an important part of our production base.

Since 1999, fresh chilled pork from heavier weight pigs has also been exported in large volumes to Singapore and to some extent to Japan. Initially the Singapore market was primarily focused on meeting basic volume requirements, following the suspension of live pig imports from Malaysia previously the primary source of supply. However, that market has now become more discerning and competitive, resulting in reduced demand for volume and a higher need for market specialisation from suppliers.

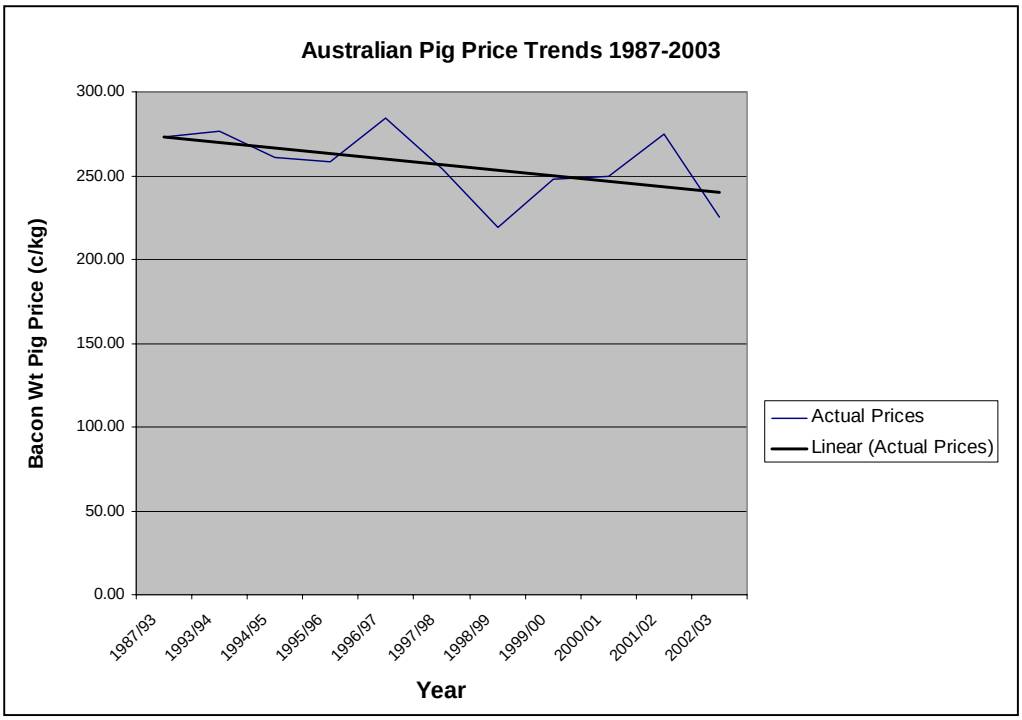
Feedback from processing companies to APL indicates that most of the meat "displaced" by imports in the manufacturing sector has actually been sold into fresh meat sectors causing an oversupply and hence falls in wholesale prices. As the manufacturing sector is able to use frozen pork for many of its product lines and there are increasing volumes of low cost frozen product available from other countries, this results in Australian grown fresh bacon weight pigs having to compete directly on price with frozen imports. This has had the combined effect of driving down both consumer prices for processed pork products and farm gate prices for Australian grown bacon weight pigs. It is important to note that the smallgoods sector has not increased by the volume of the increase in imports. This meat has had to be sold somewhere (and/or stored as frozen) and companies have indicated the majority of the displaced meat has had to be sold on the traditional fresh wholesale market. This has been reflected in the fresh consumption figures whereby there has been a 10.9 percent increase for the 12 month period up to July 2004, as compared to July 2003.

The impact of these factors on pig prices is shown in Table 7 and the accompanying chart.

Table 7. Bacon Weight Pig Price Trends 1987-2003
(Figures are in real dollars, based on Queensland DPI & PigStats data)

Year	Av. Bacon Wt Pig Price c/kg
1987/93	272.89
1993/94	276.09
1994/95	261.25
1995/96	258.65
1996/97	284.27
1997/98	253.93
1998/99	219.20
1999/00	247.58
2000/01	249.69
2001/02	274.58
2002/03	224.91

Chart 16. Australia Pig Price Trend 1987-2003

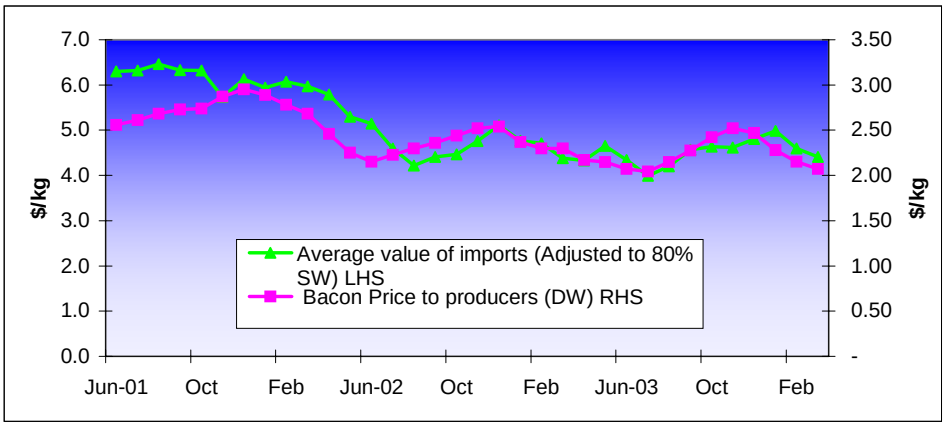


A clear conclusion from these figures is that there has been a persistent downward trend in market prices for bacon weight pigs at the farm gate level, with real pig prices now typically around 30 cents per kg less than they were 10 years ago. This is a price decrease in real terms of over 10 percent.

4.4 International prices[19]

As Australian pork producers compete in a global market, the fortunes of producers are influenced, if not determined by, world trends that influence supply and demand of both pork and the key input, feed grain. In broad terms, Australian pig prices have tended to mirror import prices (Chart 17).

Chart 17. Australian pig meat prices: Imports and local prices 2001 to 2004



Source: APL

Recent PIC Australia and APL research has pointed to longer term, *albeit weak*, correlation between Australian pig prices and US and Canada pig prices, especially the latter. Specifically, Australian prices appear to lag local US and Canada pig prices by 6 months with a price correlation of the price of 0.59 and 0.72, respectively (Chart 18). The key factors appear to be:

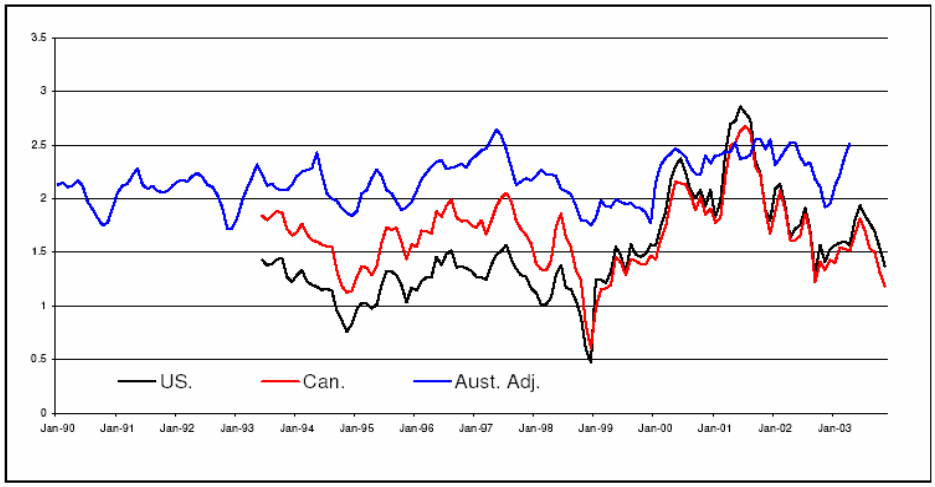
- seasonality of both North American and Australian pork prices. Both prices peak in their respective summers (therefore six month time lag); and
- a two month shipping time ex North America, hence the time for changes in local North American prices to be reflected in Australian import values.

APL is strongly of the view that the relationship between Australian prices and the US prices is a correlation and not cause and effect. This was emphasized in the Joint Industry Government Working Group meeting and in discussions with ABARE that **Australia should not use the correlation as a predictive tool.** APL believes that the reason for the correlation is that demand is higher in summer in both countries and coincides with supply restrictions, due largely to summer infertility in the previous year. Therefore, **price swings in each country are related to the fact that they are in different**

[19] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

hemispheres and hence seasonal conditions, not because there are directly linked.

Chart 18. Pig price correlations: US, Canada and Australia

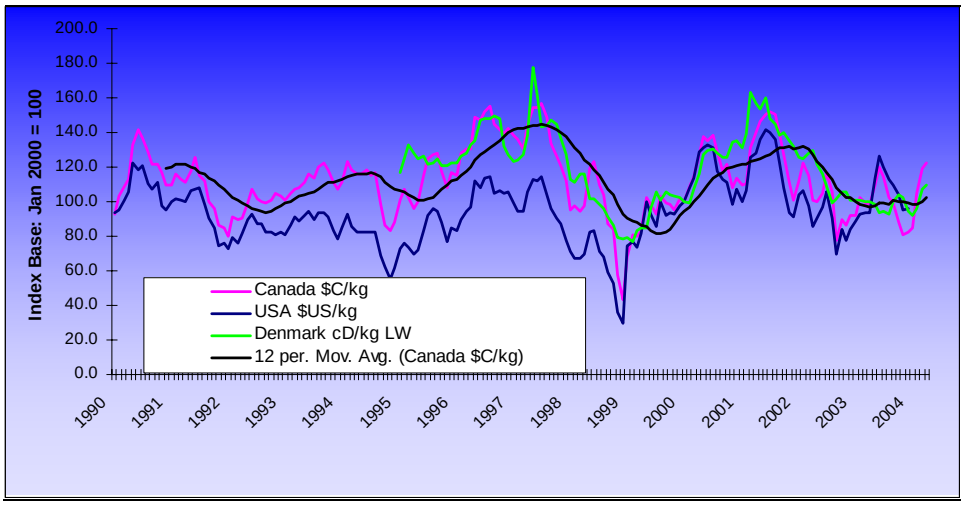


Note: Australian prices adjusted for exchange rate changes and lagged 6 months
Data source: PIC Australia and APL

Analysis of pig meat prices in Canada, the USA and Denmark suggest that prices move in concert with a cycle of around three years (Chart 19) often referred to as the classic hog cycle. There are indications that the current upward price cycle shift may continue until late 2005 or early 2006[20]. However, whilst the recent turn around in Canada and Denmark is significant, it is worth noting that a similar rise occurred in the USA and Canada in mid 2003 and had dissipated by year end[21].

[20] Whole Hog - Issue 102; 02/02/04
[21] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

Chart 19. Global pig price cycle 1990-2004 (index base January 2000)



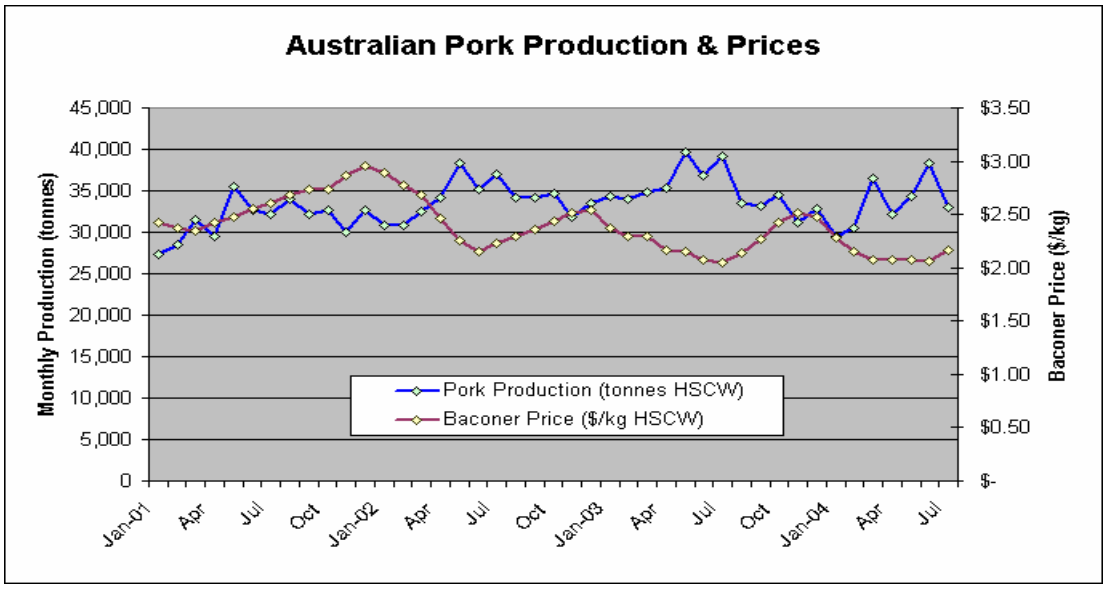
Notes: Canada: Canadian marketing Board, Ontario http://www.agr.gc.ca/misb/aisd/redmeat
Denmark StaBank Denmark http://www.statbank.dk/statbank5a/SelectVarVal/saveselections.asp
Source: ACIL Tasman

4.5 Australian production and prices[22]

As well as the influence of international prices, local prices have been reinforced by variations in Australian production in response to the price cycle (Chart 20). Overall prices have fallen as production generated from the previous upturn in prices was marketed. Prices to producers have trended down over the last four years as demonstrated below.

[22] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

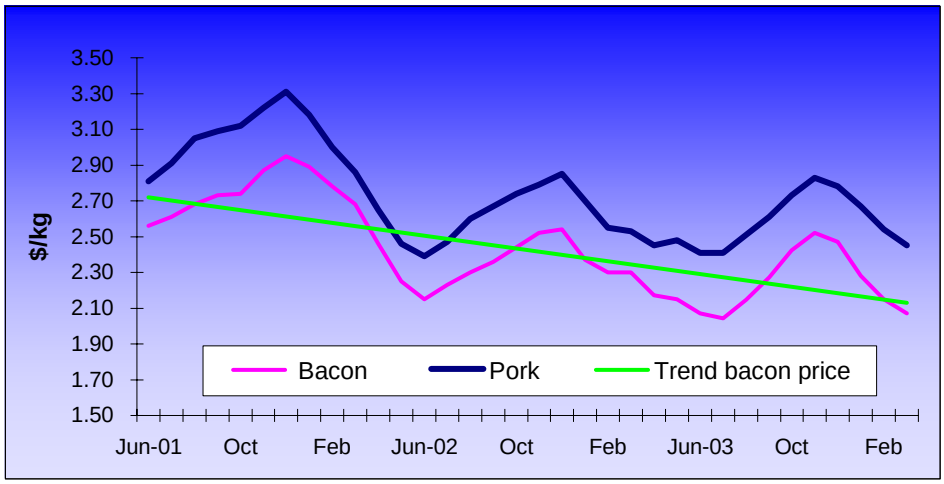
Chart 20. Australian pork production and prices: 2001 to 2004



Source: APL

Most importantly, over time prices to producers for pigs have broadly followed prices for baconers (Chart 21). Therefore, the impact of imports on the pricing of baconers has important ramifications for the fresh pork market due to their interrelationship, as was discussed in Section 2.d and Section 3.4.

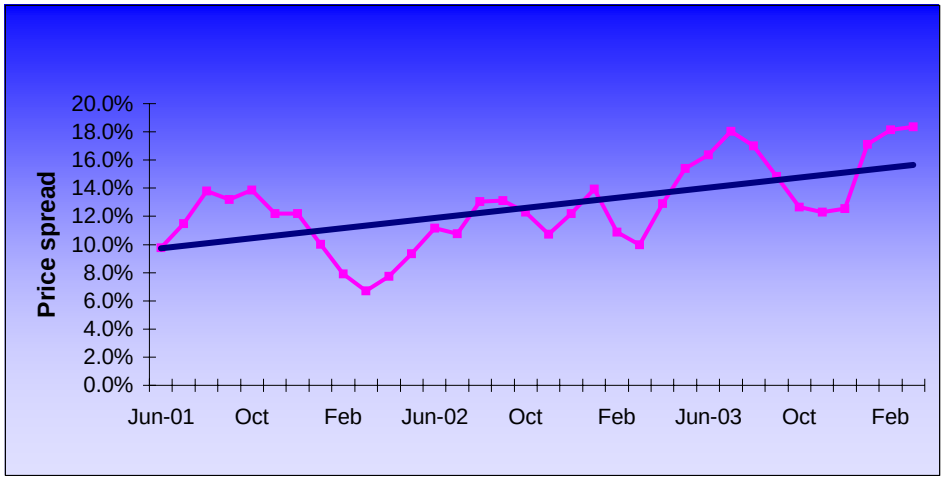
Chart 21. Australian pig meat prices: Porker and baconer 2001 to 2004



Data source: APL

The porker/baconer relativity has fluctuated and generally trended upwards (Chart 22). It averaged 14 percent during calendar year 2003. **This improvement has not, however, resulted in a tangible shift towards porker production relative to baconers**. As overall pig numbers decline, parts of the baconer pig are increasingly being used in the fresh markets.

Chart 22. Australian porker prices relative to baconer prices 2001 to 2004

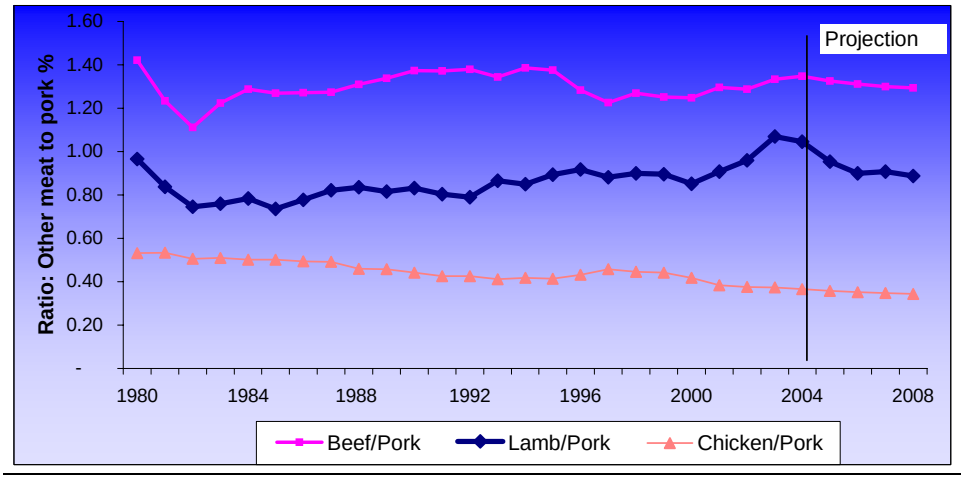


Data source: APL

4.6 Other meat prices

In the medium term, other meat prices are projected by ABARE to fall relative to pork (Chart 23). This reflects an easing in beef and lamb prices as producers' market animals from an expanded post drought situation and as international beef prices fall. International beef and lamb prices determine local prices for these red meats.

Chart 23. Australia: Relative meat prices 1980 to 2008 (projected)



Data source: ABARE

Typically, it is in periods of lower prices that producers propose and support increased promotional expenditure. The prospect of lower beef and lamb prices is therefore likely to lead MLA to expand red meat promotion. Such promotion could be expected to impact pork demand.

Taken together, both these factors suggest that per capita pork consumption could come under pressure; therefore future estimates of per capita consumption should tend to the conservative, or at least recognise that increases in consumption may well come at the expense of lower prices.

4.7 Grain prices[23]

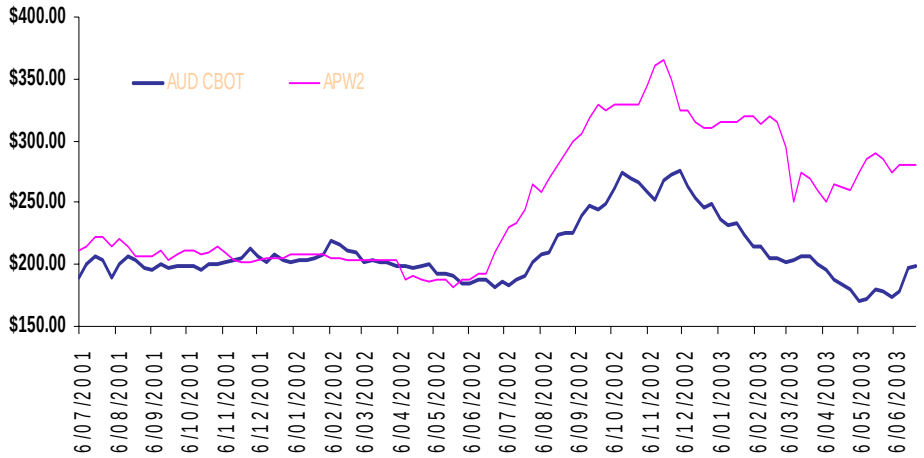
Under non-drought circumstances, Australian grain prices are determined by the export parity (international prices expressed in $A terms) price for Australian wheat since:

- Australia is typically a net exporter of wheat.
- The opportunity cost of selling wheat on the domestic market is export parity; hence domestic prices gravitate to export parity.
- Other feed grain prices are broadly benchmarked off wheat, with the relativities determined by quality attributes, such as energy and protein levels; although some feed grain prices are determined by respective export prices.
- In turn, inland grain prices are determined by the export parity price less transport and storage costs to port from the respective grain supply source.

However, the years 2002 and 2003 witnessed major variations to this situation. International prices rose during 2002, in part due to extensive drought conditions in Eastern Australia, which led to reduced Australian wheat (and other grain) supply. In addition, the level of total domestic demand for grain within Australia increased, (bolstered by demand for drought feeding of sheep and cattle), relative to available supplies, driving domestic prices to well above export parity (Chart 24). Grain prices rose to historical highs but were alleviated in late 2002 with imports of wheat. (See Section 4.8 for more detail) .

[23] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

Chart 24. Australian wheat prices — local and export parity 2001 to 2003



Source: Graincorp

The USDA world agricultural outlook suggests that there is some upside for prices in 2004 compared to 2003. The outlook for US wheat is for a significant decline in production. World consumption is expected to exceed production for the fifth year in a row. However, the implications for world prices are offset by larger beginning stocks and larger exportable supplies out of Europe (the EU -25, Ukraine and Russia).

ABARE has projected that grain prices (nominal terms) will fall in 2004/05 Table 8) as compared to 2002-03. By 2006/07, grain (and therefore feed) prices for pig producers are estimated to be some 7 percent less than those prevailing in 2003/04 and around 20 percent less than those prevailing in 2002/03.

Table 8. Grain prices: ABARE projections

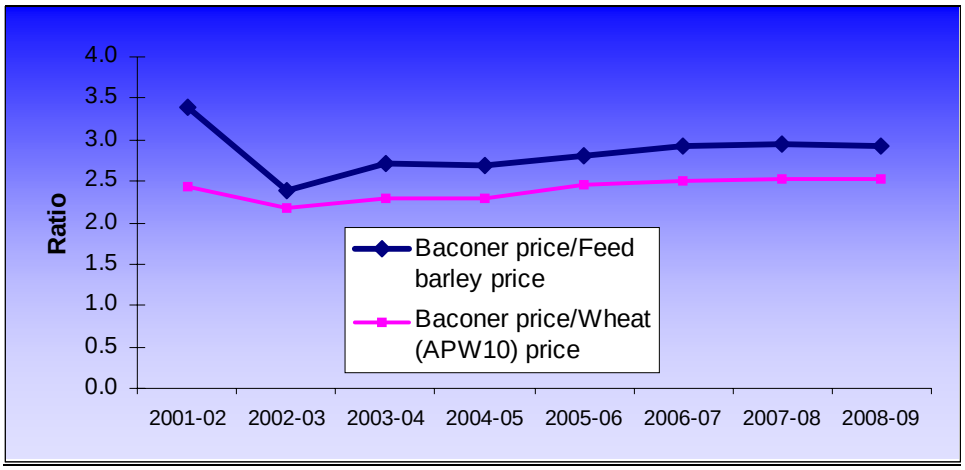
		2002-03	2003-04	2004-05	2005-06	2006-07
Wheat APW10	$/tonne	253	224	212	204	208
Feed barley	$/tonne	230	190	181	179	177
Grain sorghum	$/tonne	205	183	175	173	174

Note: Wheat estimated net pool return
Source: ABARE, Australian Commodities, March 2003

Conditions in 2004 have been sufficient to ensure that winter cereal crop production volumes will likely be enough to ensure an exportable surplus and avoid a return to the high domestic gain prices that prevailed during 2002-03.

ABARE projections of grain (as represented by APW10 wheat, net pool return and feed barley) **suggest that pig profitability** (represented by the ratio of pig prices to grain prices) **will improve by 2005-06 but it still fall well short of the profitability levels seen in 2001-02 (Chart 25).**

Chart 25. Australia: Pig price/grain price ratio 2001 and projected to 2009



Notes. Assumes feed conversion ratio of 3.34:1 and a dressing %age of 75%
Data source: APL and ABARE

For 2004/05 there is no reason to be optimistic that grain prices will fall; equally there is no specific reason to be pessimistic. AWB expects the Estimated Pool Return (ERP) for 2004/05 to be down $6/tonne (on the current ERP for the 2003/04 pool of $226/tonne), but historically the early ERPs have underestimated final pool returns by $19.40/tonne and even more in recent years. **Market analysts have described the current international market as volatile; tight wheat stocks are making the market jumpy to new information on either the supply or demand side.**

4.8 Feed costs

Over the five years 1999-2003 [24], feed costs have accounted on average for 55 percent of total pig farm expenses. The two key components of feed costs are feed grain prices and protein prices. Protein prices have been relatively stable over the period. However, feed grain prices have been highly volatile, due to such factors as the drought effects, the Australian Government quarantine regulations for grain imports, lack of a dedicated feed grain market and limitations on using alternative feedstuffs. Feed price trends are shown in Table 9 and the accompanying figure.

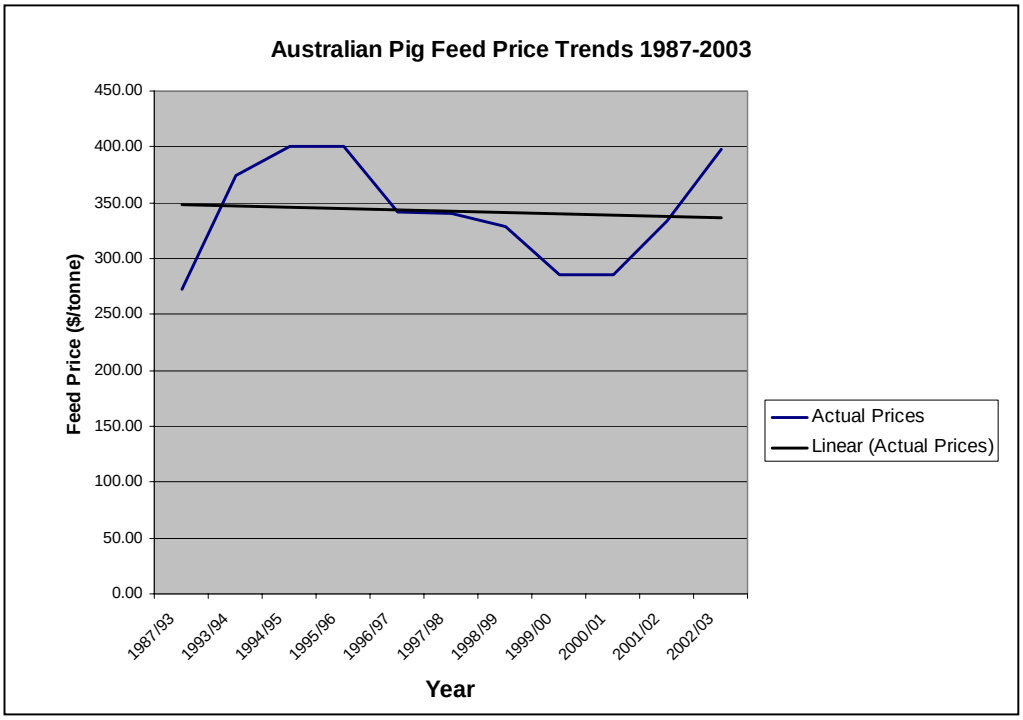
[24] Based on APL financial models derived from PigStats and other industry data

Table 9. Pig Feed Prices and Trends 1987-2003

(Figures are in real dollars based on Queensland DPI Data)

Year	Av. Pig Feed Price ($/tonne)
1987/93	272.89
1993/94	374.69
1994/95	400.63
1995/96	400.68
1996/97	342.25
1997/98	339.96
1998/99	328.45
1999/00	285.94
2000/01	285.50
2001/02	333.57
2002/03	397.53

Chart 26. Australian Pig Feed Price Trends 1987-2003



From this data it can be seen that there have been massive fluctuations in feed prices over the period 1993-2003.

Statistical analysis of the full data set on which this summary is based showed over the 10 year period:

- The mean feed price was $348 per tonne with a standard deviation of $44.
- The range of prices was $271-$440 per tonne
- The lowest price was 22 percent below the mean and the highest was 26 percent above the mean; in other words it may be expected under current market conditions that **forward planning scenarios for farm budgets need to be able to accommodate a feed price variation of around +/- 20 percent around the mean.**

Given that feed prices comprise on average around 55 percent of total pig production costs that equates to +/- 11 percent of total farm expenditure at risk from feed price variations.

As a rule of thumb, this supports the idea that **Australian pig farms operating in the current environment need to be able to generate around $500 net profit per sow on total revenue of around $3,000 per sow to be able to withstand such fluctuations in price of their key input cost. Over the 2002/03[25] period, there was an average net loss of $104.81 per sow, whilst for the 2001/02 period there was an average net profit of $608[26] per sow.**

In addition, sound risk management provisions would also require farmers to have available contingency finance to continue funding their farming operations in the event of drought conditions extending over two consecutive seasons. **Droughts are the key driver of high feed prices and the feed price impacts of such an occurrence are unlikely to be able to be accommodated from working capital, even with what might be regarded as otherwise sustainable profit margins.**

Furthermore, any policy measures that can be usefully adopted to reduce the volatility of feed grain prices will clearly be of enormous benefit to the overall sustainability of the industry.

Finally, it is interesting to note that the trend line for feed prices over the 10 year period shows a reduction in the average price by around $10 per tonne (3 percent). However, *taking into account the variance from year to year, this should not in our view be relied on in any predictive sense.*

[25] Australian Pig Annual 2003
[26] Pig Stats 2002

4.9 Pork prices and feed grain ratio[27]
(confidential information)

4.10 Impact of the Single Desk

With over 80 percent of wheat produced destined for export, the AWB has the ability to dominate all aspects of grain traded in domestic and export markets. As the only exporter, AWB can acquire most of the grain available.

[27] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

When one company holds most of the grain, they are in a monopoly position to charge what they like – particularly when grain supply is short and quarantine restrictions make grain imports costly. **There may be many domestic buyers but they are all effectively forced to trade at the price set by the AWB. The export monopoly kills price competition on the domestic market and the effect is most pronounced in times of grain shortage.**

The impact from a single desk selling structure has varying consequences over time. If it has been a good growing season, typically there is a plentiful supply of grain in Australia, and domestic prices are close to that of world prices. **However, during times of shortage, primarily influenced in Australia by drought conditions, Australian domestic grain prices have risen significantly above the world price**. With quarantine restrictions stating that any imported grain must be treated before use, along with transport and storage costs, this effectively creates a mechanism causing imported grain prices to be higher than the export price.

4.11 Increasing feed grain requirements

A key area of concern for the Australian pork industry is the question whether sufficient supplies of domestic supplied feed grain will be available to meet the future requirements of the industry. Total feed grain usage by the intensive industries has been increasing steadily since 1992/93, when 5.77 million tonnes were used, almost doubling to 10.92 million tonnes in 2002/03. (During the drought, national feed grain demand has been trending lower as higher feed grain prices and lower returns from dairy and pig products ration reduce demand). The pig industry's usage of grain has increased from 1.57 million tonnes in 1992/93 to over 2.13 million tonnes in 2002/03. This comprises approximately 2,000 kilo tonnes of grain (predominantly wheat, barley and sorghum) and 120 kilo tonnes of oilseed meals[28].

Total feed grain availability is projected to increase slightly from 21.5 million tonnes in 2003/04 to 21.8 million tonnes in 2007/08. This small increase in projected production is the result of the small fall in the projected area under grain being more than offset by a projected increase in crop yields over the period. On the demand side, the largest increases in livestock numbers over the period to 2007/08 are projected in the cattle feedlot category (up 29 percent), poultry meat production (up 15 percent) and pork production (up 16 percent)[29].

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[28] Fact Sheet – Feed Grain Issues, APL

[29] Feed Grains - Future supply and demand in Australia, ABARE (Report # 03.21), Prepared for the Grains Research and Development Corporation, Amhed Hafi and Peter Connell, November 2003

In 2003 the Australian Government announced subsidies for ethanol producers comprising excise subsidies, capital grants of up to $10 million per ethanol plant established, and assistance measures such as start up assistance for individual projects and test marketing of ethanol. **However, analysis shows that the Government ethanol policy will further distort the feed grain market and bring about increased pressure on scarce feed resources both from prices and supply bases. These subsidies will adversely affect intensive livestock producers as the proposed ethanol plants would compete directly with the intensive livestock industries for grain. The excise subsidy of 38 cents per litre equates in real terms to an indirect subsidy on the industry's grain inputs of $152 per tonne**[30]. The effect of these subsidies will be to create an artificial shortage, which will be accentuated in drought years.

A recent analysis of feed grain supply in the northern region [31] showed that there is highly variable grain production with the likelihood of a grain supply demand deficit in this region to occur in 30 percent of years. There is a limited supply of feed grain relative to domestic demand in eastern Australia (particularly in the northern NSW and QLD) in most years. Current forecasts indicate a growing shortage for existing customers; therefore any additional demand from ethanol producers will only increase the vulnerability of such production to droughts etc.

4.11.1 APL actions to address feed shortages

The issue of accessing feed ingredients at world competitive prices is a key strategic priority for APL. Specific targets include:

- Achieving parity with world feed price for Australian grain by June 30 2005;
- Bringing about protocols leading to cost-effective imported whole grain on-farm by June 2005; and
- Identification of feed grain risk management services and tools for further development and/or promotion to producers.

In order to achieve security of feed grain, APL has undertaken a number of initiatives and collaborates with other grain end user industries. APL and Meat and Livestock Australia have funded a project with CSIRO to investigate devitalising imported whole grain using a new fumigation technology. CSIRO has identified a new gaseous fumigant, which shows high potential to be an effective treatment for the devitalisation of whole grains, weed seeds and the pathogens and insects of quarantine concern, in

[30] Development of Regional Fuel Ethanol Industries Based on Grain Feedstock and Possible Effects on the Lot Feeding and Pork Industries"; Macarthur Agribusiness; 2003

[31] The reliability of Supply of Feed Grains in the Northern region, APSRU, 2003

imported feed grain. If this treatment is proven successful (final results are not expected until late 2005), then it would result in a shelf ready fumigation product that could be used for grain imports in future droughts, and may enable the industry to engage in long term grain supply arrangements off shore to minimise risk.

In a separate project APL, along with MLA, Dairy Australia and Australian Wool Innovation, have completed a broad ranging feasibility study into the options available to livestock end users to address the impact of recurrent feedstuff supply shortages[32]. The study provides analysis of the real options available to the industry, along with their costs and benefits. The reports recommendations will be discussed in more detail in subsequent APL submissions to the inquiry.

Another recent initiative aiming to achieve feed grain security has involved the establishment of the Livestock Feed Grain Users Group (LFGUG). The group, made up of industry bodies, including Australian Pork Limited, the Australian Egg Industry Association, Australian Lot Feeders Association, the Australian Chicken Meat Federation, and Australian Dairy Farmers was established to address supply shortages, the associated high cost of feed grain, and improve relationships with the grains industry. In 2004, the LFGUG provided a joint submission and made a presentation to the Wheat Marketing Review, which assessed AWBI's performance as the commercial manager of the single desk. In this submission, the LFGUG requested that the WEA widen its consultation process and be compelled to consult with feed grain user industries. The Group aims to be the single point of contact on feed grain issues and is intent on strengthening relationships with the grain industry. A long term strategy for the LFGUG has been drafted by APL for the consideration of the participating industries. The issues covered focus on the single desk, security of supply and pricing, and Government drought assistance.

4.12 Potential supply chain inefficiencies

(Confidential information removed)

[32] 'Review options to reduce Feedstuff variability in Australia'; Macarthur Agribusiness & Rural Action Pty Ltd; November 2003.

(Confidential information removed)

(Confidential information removed)

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(Confidential information removed)

4.13 Recent profitability and industry margins[33]

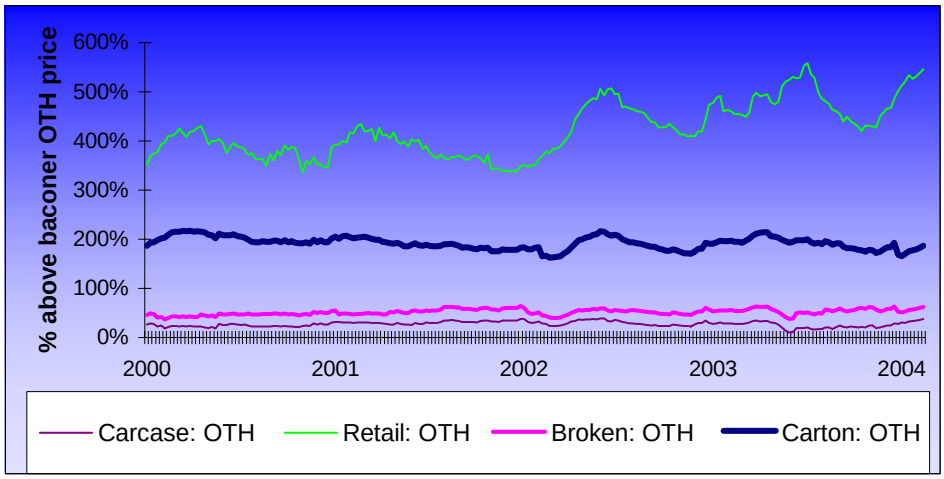
Measured as the gross price difference to relative producer prices (dressed weight), industry margins between the farm gate and retail have remained relatively constant, except for the retail margin, which has widened over time (Chart 29). Also, most marked is the variation in the average retail margin, but this margin appears to reflect the weighting of retail cuts and, particularly during 2003, the variation in one cut, pork fillet (Chart 30).

The relatively constant margin between over the hook (OTH or carcase) and retail suggests that profitability within the chain will be driven principally by throughput rather than a significant variation in the margin itself.

The trend lines for retail continues upwards while the prices received by producers remain comparatively flat; implying chain intermediaries are making increased profits.

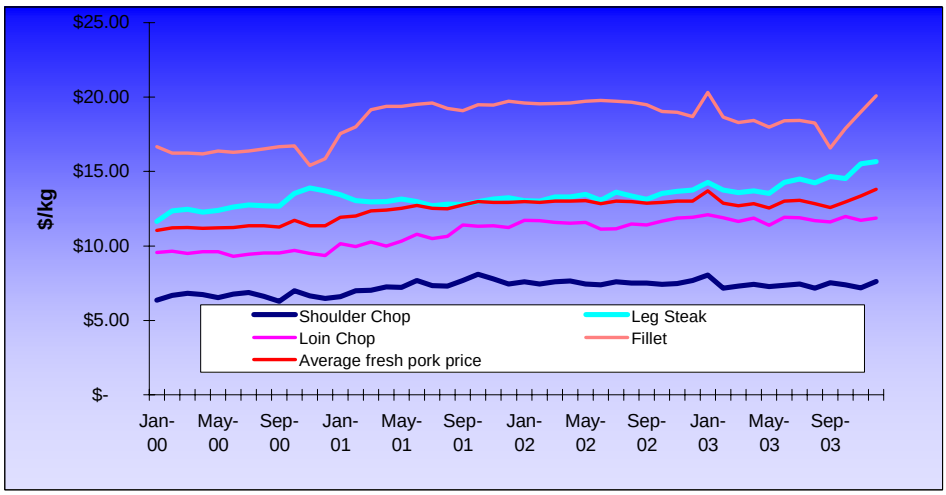
[33] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

Chart 29. Industry margins (gross): Markup relative to producer DW price 2000 to 2004



Note: All prices reflect unweighted averages of selected cuts.
Data source: APL

Chart 30. Retail pork prices 2000 to 2004



Note: Average is the unweighted average of the selected cuts
Data source: APL

While retail alliances with major producers, abattoirs and boning rooms have developed, the highly competitive nature of the supply chain means that there is little publicly available pricing information. Similarly, there is also little publicly available information in respect of the net margins (profitability) along the supply chain.

4.14 Other key on-farm production costs

Labour costs are the second biggest contributor to on-farm production costs, accounting for approximately 14 percent of total expenditure. Clearly, any

means to reduce labour inputs and also create labour market flexibility would be of benefit to the industry's overall competitiveness.

Other key costs relate to pig productivity issues. Three key indicators of animal productivity in pig production systems are:

- Numbers of pigs weaned per sow per year
- Live-weight (kg) of pig meat sold per sow per year
- Herd feed conversion – total weight of all feed used divided by the total live-weight produced.

According to these indicators there is a large range of variation in productivity between farms in the industry (Table 10).

Table 10. Pig Productivity Indicators

Indicator	**Range**	**Average (weighted means)**
Pigs weaned/sow/year	14.6 – 23.9	19.7
Liveweight sold/sow/year	1,047 – 2,324	1,637
Herd feed conversion ratio	2.97 – 4.02	3.34

Source: PigStats 2002

Clearly, there is much scope for overall improvement in on-farm animal productivity in the Australian industry, which in turn would have a financial impact on farm financial performance. APL's draft industry restructure plan recognizes the improvements required in key production areas, such as optimizing herd feed conversion efficiency, enhanced animal health and reproductive capacity, increased carcase weights and improved genetics. Further analysis and recommendations, including a comparative analysis of Australian costs of production with international benchmarking, will be provided in APL's next submission addressing competitiveness.

On the other hand these improvements also need to be balanced against the need for quality stockmanship to achieve both optimum productivity and ensure society's expectations for animal welfare are met.

Producers have indicated in recent consultations that recruiting and retaining suitable staff is an ongoing challenge[34], which will to some extent work against the possibility of labour cost savings.

[34] APL Animal Welfare Producer Consultations April/May 2004.

5. Trends and factors influencing demand and supply, including imports and exports

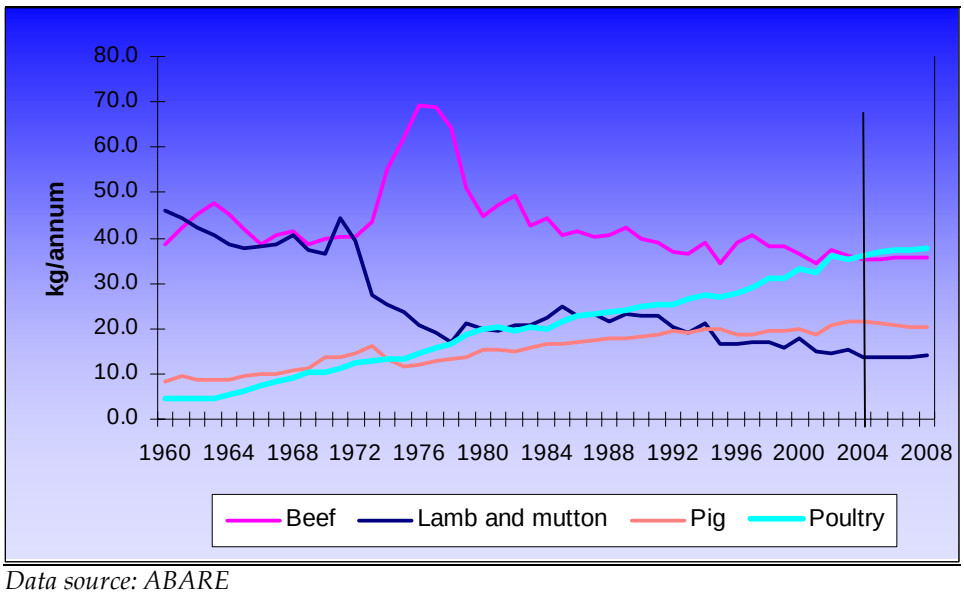
5.1 Consumption

The Australian domestic meat market is highly competitive and is characterised by various meats competing for a share of the consumer's expenditure. Australian consumption of main meats (beef, poultry, mutton, lamb and pork) varies each year across the different shares. These variations are typically the result of each meat's changing price and its price against competing meats. Domestic consumption in pork has largely been rising steadily throughout the 1990s and has resulted typically from the decline in pig prices, and the advent of greater imports driving the retail sector further down. Since January 1991, per capita total consumption of pork products has grown by 27 percent to current levels for the year ending July 2004 of 22.35 kg.

5.1.1 Gains in pork consumption[35]

Longer term per capita pork consumption continues to trend up (Chart 31), with increased consumption particularly evident during 2003.

Chart 31. Australia: Per capita meat consumption 1960 to 2004 and to 2008 (projected)



Data source: ABARE

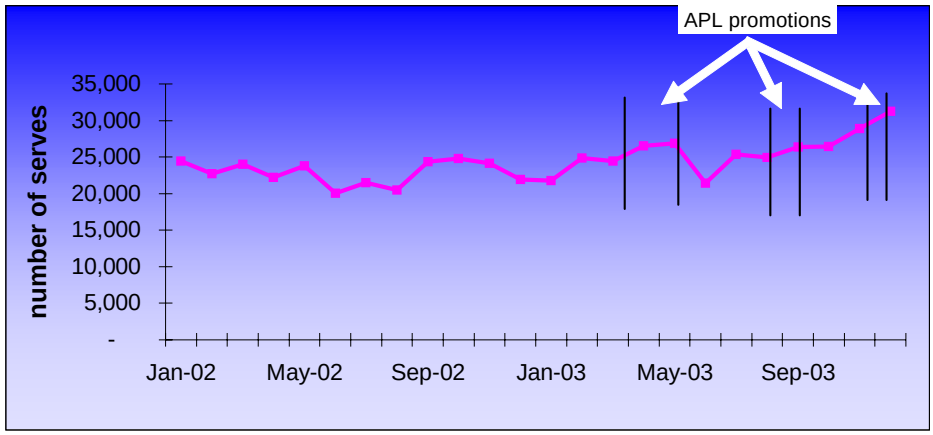
During 2002 and early 2003, fresh pork consumption (measured as serves purchased at retail) was relatively static. In the period October to December 2003 period, total sales (and the relative share of meat consumption) rose

[35] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

sharply, to be around 15 percent higher than a year earlier (Chart 32). Reasons for this rise are:

- The impact of the drought on other livestock industries leading to a significant rise in red meat prices (see section 5.13); and
- During 2003, APL's investment in promotion intensified. Subsequent consumer research on APL's promotional activities showed significant increases in awareness (which research concluded translated into a 7 percent increase in pork consumption, see Chart 32).

Chart 32. Australia: Fresh pork consumption 2002 to 2003



Data source: APL

5.1.2 APL fresh pork and retail consumption goals

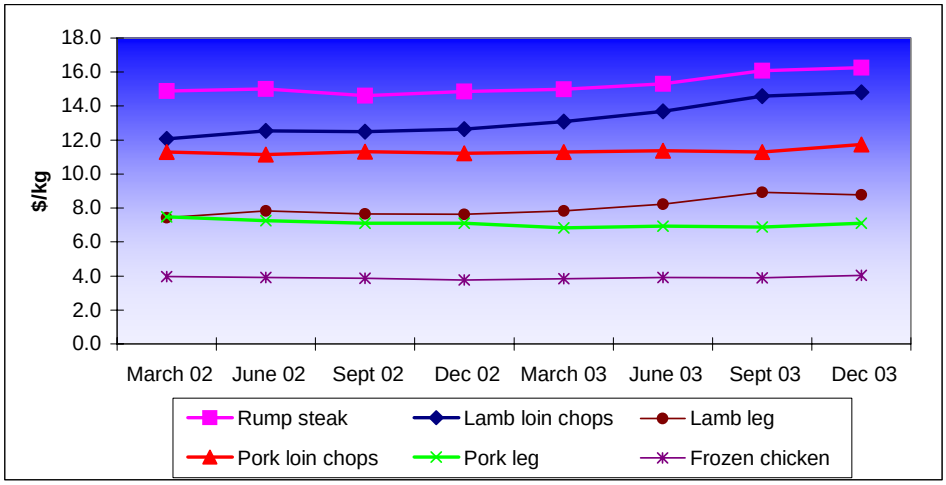
APL aims to increase consumption of all pork products to 25kg/capita as compared to the current rate of 22.35kg/capita. APL aims to increase fresh pork consumption per capita to 12.5kg/capita by 2007 as against consumption levels of 9.3 percent kg/capita in June 2004. Promotional efforts are specifically focused on improving entrenched consumer attitudes and perceptions towards pork that impact on the propensity to purchase. A major APL marketing objective is to modernise key consumer perceptions for Pork such as "Great Flavour", "Easy to Cook" and "Healthy" to achieve improved consumer motivation for increased consumption of pork. Particular emphasis is also being placed on increasing consumption of 'everyday cuts', such as mince, stir fried and diced cuts, that are very popular with consumers, but not high selling items for pork. Related to this is the objective of making consumers seeing pork as a meal solution.

An enhanced longer term positive attitude towards pork has been reported, whereby survey respondents were found to be more likely to agree as to the promoted attributes of pork after the promotional campaigns conducted between March and September 2003.

5.1.3 Other meat prices

Historically relative prices of different meats have been important in influencing consumption patterns. Lamb and beef prices relative to pork rose over the course of 2003 and 2004, essentially due to the drought and rebuilding of stock, suggesting a positive price environment for pork (Chart 33)[36]. Also, the absence of significant promotional activities by the red meat industries is likely to have benefited pork consumption.

Chart 33. Australian: retail meat prices 2002 to 2003

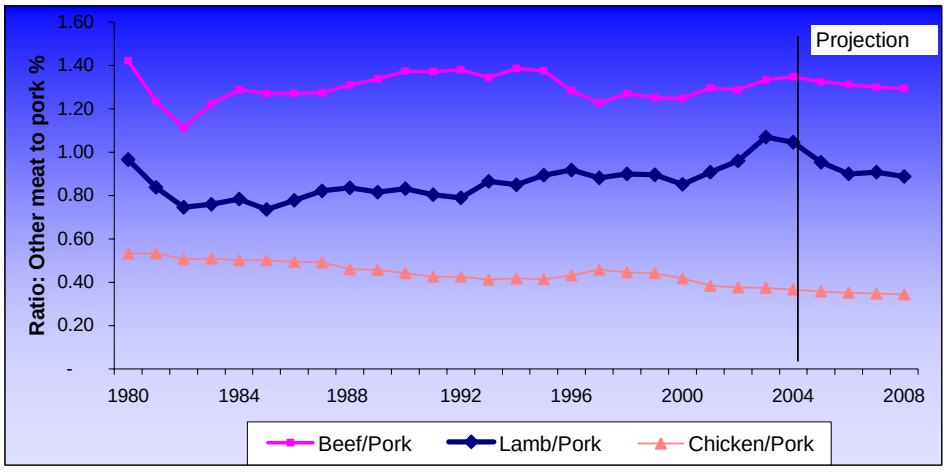


Data source: APL, ABS statistics

In the medium term other meat prices have been projected by ABARE to fall relative to pork (Chart 34). This reflects an easing in beef and lamb prices as producers' market animals from an expanded post drought situation and as international beef prices fall. International beef and lamb prices determine local prices for beef and lamb.

[36] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

Chart 34. Australia: Relative meat prices: 1980 to 2008 (projected)



Data source: ABARE

Typically it is in periods of lower prices that producers propose and support increased promotional expenditure. Therefore, the prospect of lower beef and lamb prices is likely to lead MLA to expand red meat promotion. Such promotion could be expected to adversely affect pork demand.

Taken together, both these factors suggest that per capita pork consumption could come under pressure and thus present another reason to be relatively conservative as to future increases in per capita consumption, or at least recognise that increases in consumption may well come at the expense of lower prices.

5.2 Imports

Import restrictions on pork were revised in 1990. Before this time, the only form of pig meat imports allowed were canned hams. With the revision of the quarantine regulations in 1990, imports of frozen and uncooked pig meat from Canada were permitted. In 1992, import regulations were strengthened requiring all imported frozen pig meat to be boned prior to shipment. The imported meat was to be used for further processing within Australia.

Over the last decade a steady rise in imports occurred, predominately from Canada and Denmark. This resulted from the price squeeze during the 1994/95 drought crises and a reduction in overall pig producers over this period as the industry rationalised. Low import prices in 1996 encouraged processors to import legs of pork in 1997. These import volumes grew further in 1997 and 1998, leading to a collapse in the Australian pig prices, driven by high levels of carry-over stocks and increased production[37]. Total imports of

[37] Australian Pig Industry Handbook – Pig Stats 2002, Australian Pork Limited

pig meat have increased dramatically over the past two years. The 12 month moving total (MMT) to July 2002 indicated 45,042 tonnes imported as compared to July 2004 with 61, 834 (MMT). This was an increase of 37 percent in two years[38].

Since the FMD impact in Europe in 2001, the impact of imports from Denmark has increasingly been felt. Since this time, Denmark has steadily improved its share of the Australian import market and for the current calendar year, as at August 2004, accounted for nearly 44 percent of all imported meat. Canada currently has a 53 percent share and the remainder of imports are primarily in the form of canned ham from the US.

Table 11 below indicates some of the events over those times, which led to an increase of pork imports. Key amongst these were:

- **2003: 21 percent increase** - Appreciation of the Australian dollar relative to the Canadian dollar and Danish kroner
- **1999: 156 percent increase** - Nipah virus causes export focus requiring domestic processors to source pork from overseas markets.
- **1997: 60 percent increase** - Low import prices in 1996 encouraged processors to import legs of pork in 1997

Table 11. Pig Meat import growth from 1990

Year	Import Tonnes (MAT)	% Change	Reason Change
2003	55,527	21%	Industry suffering high prices for feed grains due to drought. Appreciation of the Australian dollar relative to both the Canadian dollar and Danish kroner major factor in increased import volumes from both of these countries.
2002	45,920	42%	Increased supply as European imports re-enter the market.
2001	32,262	-10%	Reduced supply due to FMD impact ex Europe
2000	35,987	48%	—
1999	24,268	156%	Nipah virus sees exports increase significantly. Processors look to overseas markets to meet supply shortfall.

[38] Australian Bureau of Statistics – Year Book Australia, Agriculture, Meat production

1998	9,490	-14%	Australian pork industry largely a domestic focused industry.
1997	11,037	60%	Low import prices in 1996 encouraged processors to import legs of pork in 1997
1996	6,923	42%	—
1995	4,884	92%	Industry suffering high prices for feed grains due to drought
1994	2,540	-26%	The drought of 1994/1995 saw producer numbers drop by over 1000, from 4,683 producers in 1994 to 3,615 producers in 1995.
1993	3,422	-22%	—
1992	4,368	34%	Import regulations strengthened requiring all imported frozen pig meat to be boned prior to shipment. The imported meat is used for further processing in Australia.
1991	3,269	75%	—
1990	1,867		Import restrictions on pork were revised in 1990. Before this time, the only form of pig meat imports allowed were canned hams. With the revision of the quarantine regulations in 1990, imports of frozen and uncooked pig meat from Canada were permitted.

Source: Australian Pork Limited, 2004

5.3 Exports[39]

The following discussion on exports is a broad overview of the key issues and opportunities that will be explored in more detail in subsequent submissions.

The industry's export markets are now valued at over $177 million per year compared to $24 million in 1997. Demand from overseas markets for Australian pork has increased substantially over the past four years, from just 2.6 percent of Australian pork production in 1997 to approximately 16.5 percent in 2004. Exports peaked at 21.5 percent of production in January

[39] Australian Pork Industry: Microeconomic Analysis; ACIL Tasman; June 2004

2002. Australia's key markets are in Asia, with Singapore and Japan providing export income of $77 million and $54 million per year respectively[40] (Table 12). Of major significance is the fact that both of these markets place a particularly high level of importance on food safety and animal heath issues, as highlighted by Japan's response to recent BSE outbreaks in Canada and the USA, involving temporary bans on imports of beef from those countries.

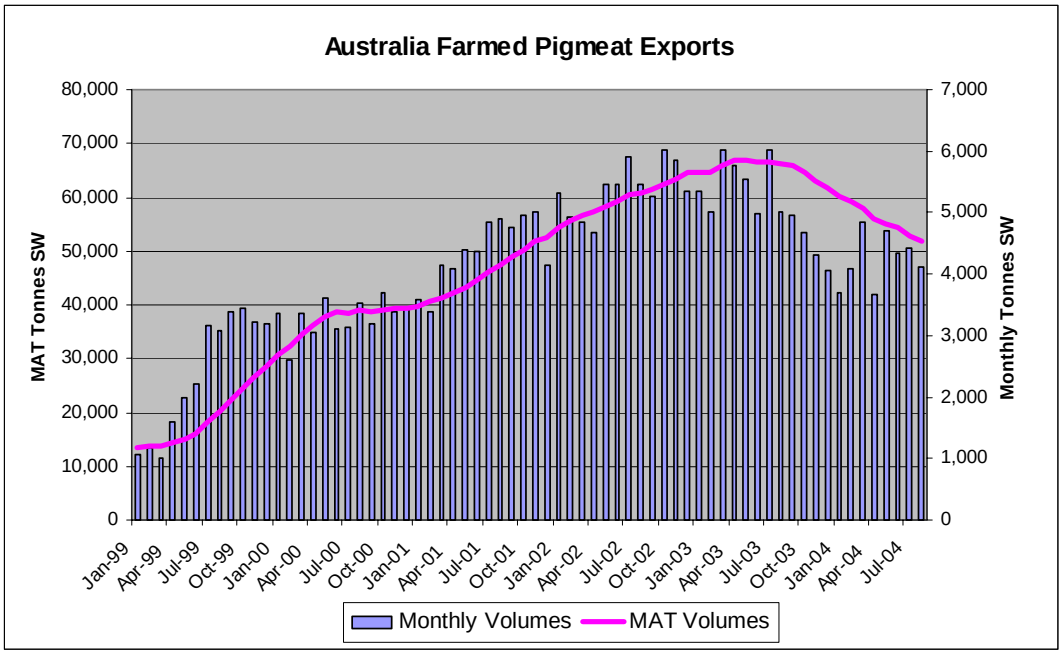
The Australian pork industry is in the enviable position of having a national pig herd with a 'world's best' health status, which underpins pork exports and is vital to the competitiveness and growth of the industry. In a report commissioned by the Commonwealth Government 2001, 'Charter of Strategic Imperatives for the Australian pork industry', it is acknowledged that the industry's key competitive advantages are its comparative freedom from disease, proximity to Asia, and capability to export fresh chilled pork to these Asian markets and as such "it should be fiercely protected". It is this health status that makes Australian pigs and pig products desirable. With growing global consumer concern for food safety in the wake of increasing disease outbreaks, this highly regarded health status becomes even more desirable and an increasing competitive advantage.

The industry's competitive advantage, its clean green image, is under further threat from the newly established pork import protocols, which fail to reduce the level of risk posed by the disease Post Weaning Multisystemic Wasting Syndrome (PMWS) to an acceptably low level. The industry's costs of production are also under threat should this exotic disease take hold in Australia, since eradication is not technically feasible and control measures difficult to implement; animal health costs would increase significantly and production decline, due to productivity losses and mortalities.

A higher $A makes imports more competitive and at the same time makes exporting less competitive. Export volumes fell by 23 percent or a $93.3million fall in value through 2003 through to August 2004 (Chart 35). Since 2002 Australian exchange rate changes have meant that pig and pork suppliers have faced reduced export competitiveness (into Singapore and Japan). These exchange rate movements have favoured suppliers from key international pork markets such as the US and South America.

[40] ABS August 2004

Chart 35. Australian pork exports: 1999 to 2004



While Australia's recognised disease free status has been important in accessing and developing new markets, price competitiveness remains of key importance in holding and expanding export sales. While the recent depreciation of the $A has helped competitiveness, Australian exporters remain much less competitive than three years ago.

5.3.1 Japan

Australia's pork exports to Japan in August 2004 were 36 percent lower than August 2003 levels. The strong AUD has unfortunately cancelled out much of the margin gains from the positive pork price trends experienced in Japan in recent months, and the increasing price of Australian pigs has made it more difficult to source heavy weight pigs to meet the specifications of the Japanese market.

A key difficulty for producers involves the poor returns they receive for those portions of the carcase not exported to Japan, such as the leg and to a lesser extend the shoulder and belly (Table 13). At the same time as the exchange rate reduced the profit/return from the market (Yen prices stayed high for the cuts sold to Japan), the returns for the non-Japan cuts faced increased competition and price pressure on the Australian markets from imports i.e. legs and bellies. Therefore, the overall profitability of the pig grown for the Japanese market was reduced, due both to the lower return from Japan for a

portion of the animal and lower returns from Australia for a large portion of the remainder of the carcase.

Table 12.. Australian Exports to Japan

Pork Cut	Percentage of total pork exports to Japan in August
Loins	25.9%
Bellies	23.2%
Shoulders	14.2%
Collar Butts	11.9%
Sow meat	9.0%
Manufactured pork*	5.9%
Leg cuts	4.4%
Tenderloins	3.8%

**Further processed pork*

Source: DAFF

5.3.2 Singapore

Moving Annual Total (MAT) pork exports to Singapore are now 30 percent below year ago volumes, with monthly tonnages averaging just over 1,900 tonnes during the last 12 months.

The Singapore Agri-Food & Veterinary Authority (AVA) has now declared the Malaysian provinces of Johor and Malacca as bird-flu free zones. The AVA ban on poultry and egg imports from these areas will therefore cease, effective from 30th September 2004 and potentially impact on pork consumption and subsequently Australian pork exports. The Malaysian poultry ban, resulting from the Avian Flu outbreaks, has seen Singapore consumers hit by rising poultry and egg prices, therefore increasing demand for pork supplied by countries such as Australia.

5.3.3 Shift from Export to Domestic Focus

Australian pork exports in August 2004 were 18 percent below previous year volumes with exporters reluctant to increase export volumes while domestic pig prices experience such growth. Prices of Australian baconer weight pigs increased by 16 percent between July and August 2004 effectively increasing the input costs for exporters. Some exporters have also been tempted by the strength of the domestic market, which many suggest is currently a more lucrative alternative to an export trade pressured by a strong AUD. For those organisations continuing to supply pork export markets, medium to long-term gains are instead the major attraction.

As part of the Pork Market Improvement Project (PMIP), the global Performance Study seeks to ultimately expand the breadth of Australia's export markets so that it does not rely principally on two key export market sectors. It is envisaged further details regarding this study including APL's revised export strategy will be provided to the inquiry in APL's final submission.

6. Conclusion & recommendations

The analyses in APL's submission clearly establishes the causal link between imports and the damage caused; there is direct correlation between rises in imports and falls in domestic prices. Low prices in turn are causing financial loss and declining rates of return on investment. Imports *alone* are causing serious injury to the Australian pork industry as a consequence of Australia complying with WTO obligations and that this, in turn, is adversely impacting on the competitiveness of the industry.

If the rate of imports continues at existing levels, or increases, as is likely, the consequences for the industry will be severe. The increase in import levels is due to the seasonal pattern of trade in pig meat, the global market conditions which are assumed to favour continuing availability of supply from countries exporting to Australia, and the likely further relaxation of quarantine import controls,. APL anticipates further financial losses across the industry, bankruptcies and loss of livelihoods among small producers.

The increase in imports anticipated before the end of 2004 is likely to cause significant disruption among pig producers and result in greater hardship and more dramatic changes in market share than would be the case in a planned program of restructuring. This would be damage that could not be repaired.

Clearly, a case exists for provisional safeguards and APL wishes to secure immediate relief through *temporary protection*, while orderly restructuring can be undertaken (as provided for in WTO rules). Once provisional safeguards are imposed, a formal inquiry, as required under WTO rules, can be established to justify imposition of continuing safeguards. On the assumption that the Commission will consider the option of recommending maintenance of temporary import protection while a restructuring program is implemented, APL will follow this submission with a full case for imposition of safeguard measures.

Recommendation: APL requests that the Commission makes a recommendation for the imposition of provisional safeguards.

The Australian pork industry faces several ongoing challenges to improving profitability, which must be addressed if the whole of the supply chain is to match the value structures of its global competitors in order to successfully compete with imported product. Every stage of the pig meat value chain is under considerable profitability pressure.

A significant challenge facing the industry is security of feed supply at world competitive prices. Feed grain prices have been highly volatile in recent years, due to drought, the Australian Government quarantine regulations for the importation of grain, the lack of a dedicated feed grain market and limitations to the use of alternative feedstuffs. APL's analysis shows that under current market conditions, forward planning scenarios for farm budgets need to be able to accommodate a feed price variation of +/- 20 percent around the mean. That equates to +/- 11 percent of total farm expenditure at risk from feed price variations.

Drought is a key driver of high feed prices and the resulting feed price impacts are unlikely to be able to be accommodated from working capital, even with what might be regarded as otherwise sustainable profit margins. In addition, the single desk wheat marketing arrangement, the result of public policy, creates an export monopoly that kills price competition on the domestic market and the effect is most pronounced in times of grain shortage. These shortages are likely to be compounded by the Government ethanol policy which will further distort the feed grain market and bring about increased pressure on scarce feed resources both from price and supply bases.

Recommendation: APL requests that the Commission identify Government measures and considers industry measures (as detailed in APL's draft industry restructure plan) that can be adopted to reduce feed price volatility and enhance feed competitiveness.

Recent industry history has highlighted massive swings in profitability creating an exceedingly high level of financial uncertainty due to the extremely volatile nature of feed input costs and also the downward impact of imported product on prices received. Most of the meat "displaced" by imports in the manufacturing sector is sold into fresh meat sectors, causing an oversupply and hence falls in wholesale fresh prices. However while imports have continued to grow, the smallgoods sector has not increased by the volume of the increase in imports.

The manufacturing sector can use frozen pork for many of its product lines and there are increasing volumes of low cost frozen product available from other countries. This results in Australian fresh bacon weight pigs, grown for further processing and the key driver for industry prices, having to compete directly on price with frozen imports. This has had the combined effect of driving down both consumer prices for processed pork products and farm gate prices for Australian grown bacon weight pigs.

Therefore, the impact of imports on pricing of baconers has important ramifications for the fresh pork market due to their inter-relationships. There has been a notable persistent downward trend over the last 10 years in market prices for bacon weight pigs at the farm gate level, whereby there has been price decrease in real terms of over 10 percent.

Recommendation: APL recommends the Commission identify the measures required, taking into account the strategies detailed in APL's draft industry restructure plan, to provide greater transparency of market pricing and reduce price volatility.

A significant issue that has emerged from APL's initial overview of the supply chain is the need to capture greater competitiveness and efficiency through abattoirs, smallgoods manufacturers and boning rooms and the means by which this can be achieved. Since APL is essentially an information service provider and does not trade in pigs, its ability to drive change in the supply chain is limited. The impetus for such change essentially relies on market forces, but given the urgent need to capture supply chain efficiencies and become globally competitive, and without relief from imports, industry would be looking to government to provide assistance in expediting realignment of the supply chain.

Recommendation: APL recommends the Commission highlight the need for Government to provide assistance, to expedite the realignment of the supply chain

In regards to trends and factors influencing demand and supply, changing consumer preferences, resulting from factors such as relative pricing and marketing, and also differing levels imports and exports have all played a significant role. Domestic consumption in pork throughout the 1990s rose steadily, largely the result of declining pig prices and increased imports driving the retail sector further down. However, as consumption has increased, industry margins between the farm gate and retail have remained relatively constant, and the retail margin has widened over time. The trend lines for retail continue upwards while the prices received by producers

remain comparatively flat; implying supply chain intermediaries are making increased profits. Future increases in pork consumption may well come at the expense of lower prices.

On the export front, while the recent depreciation of the Australian dollar has helped competitiveness, Australian exporters remain much less competitive than three years ago. While Australia's recognised disease free status has been important in accessing and developing new markets, price competitiveness is critical in holding and expanding export sales. The industry's competitive advantage, its clean green image, as well as its costs of production are under further threat from the newly established pork import protocols. These protocols fail to reduce the level of risk posed by the disease PMWS to an acceptably low level.

Recommendation: APL recommends that the Commission identify the necessary Government, taking into account APL's draft industry restructure plan, that are required to establish a globally competitive supply chain and appropriate measures to safeguard the industry's competitive advantage – its 'world best" herd health status.

In the view of APL, the five month timeframe set for this inquiry is inadequate to satisfy the terms of reference. APL is similarly constrained by the timetable. It does not provide adequate time to prepare a submission covering all issues raised in the terms of reference or the questions raised by the Commission in it's Issues Paper.

Recommendation: APL requests that the Commission seeks an extension of the term of the inquiry as soon as possible.

APL wishes to advise the Commission that this is the first of four submissions our organisation will be making to the Pig Meat Inquiry. The second submission will address details concerning the competitiveness of the industry, including a draft of the industry restructure plan and will be forwarded in late October. APL asks that the Commission note the restructure plan is still in draft form and will not be finalised until early February 2005.

APL's third submission will analyse the impact and effectiveness of existing and recent government and industry programs and will be provided to the Commission in mid November. The final submission will be tabled at the Sydney public hearing in early December. This will provide updated information on the specific initiatives APL intends to pursue as part of the industry restructure and will identify government measures to enhance the competitiveness of the industry.

Annex 1 - Summary of legal requirements for "serious injury" to the domestic industry

a. The WTO Agreement on Safeguards and "serious injury"

The concept of serious injury

The concept of serious injury is found in the WTO Agreement on Safeguards. The Agreement[41] is intended to provide a respite against imports. It essentially allows for the temporary re-imposition of trade barriers provided certain conditions are met. A key element is that there is injury or damage to the domestic industry which is legally termed "serious injury".

Safeguard measures and serious injury

The Agreement on Safeguards contains detailed provisions which govern the concept of serious injury. Articles 2 and 4 of the Agreement define the concept and set out the legal standards that must be met in order to establish that the domestic industry is suffering from serious injury.

Article 2 notes that the existence of serious injury due to increased imports is a necessary requirement for the imposition of safeguard measures. Article 2.1 states:

> *"A member may apply a safeguard measure to a products only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territories in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten serious injury to the domestic industry that produced like or directly competitive products."*

Article 4 further defines serious injury or threat thereof. It sets out criteria for determining whether increased imports have caused or are threatening to cause serious injury to a domestic industry under the terms of the Agreement. These provisions are elaborated below.

b. Legal requirements for a determination of serious injury due to imports

In summary, in order to establish that the domestic industry is suffering serious injury, the WTO Agreement on Safeguards mandates the following be demonstrated:

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[41] in conjunction with Article XIX of the GATT

- That the domestic industry is suffering serious injury; and
- That the injury is due to increase imports of a 'like or directly competitive product."

This requires a determination of the following:

- Like or directly competitive products;
- The domestic industry;
- An increase in imports;
- The existence of serious injury;
- The existence of a causal connection between serious injury and increased imports.

Like or directly competitive products

Articles 2 and 4 mandate that injury must be suffered by a domestic industry (or producers) that produces "like or directly competitive" products, to imports.

What must be established is what products are like or directly competitive to imports. There is no precise definition articulated in the Agreement. It appears to have been accorded a wide rather than narrow interpretation in WTO disputes cases. WTO disputes cases have focused on the "like or directly competitive" relationship between the products in determining such products[42]. This submission does not attempt to provide a legal definition.

The Agreement does not require that the impact of imports on both like and directly competitive products be assessed, but that injury caused by imports affects producers of like or directly competitive products. It is possible that injury could be established for the producer of one or another, rather than both classes of product.

The domestic industry

Article 4 of the Agreement states that the domestic industry "shall be understood to mean the producers as a whole of the like or directly competitive products operating within the territory of a member, or whose collective output is the like or directly competitive product constitutes a major proportion of the total domestic production of those products."

The term extends solely to producers of the "like or directly competitive product", and therefore focuses on producers of a specific group of products. It

[42] WTO, United States – *Safeguard measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, Report of the Appellate Body, WT/DS177/AB/R and WT/DS178/AB/R, 1 May 2001.

requires first, identification of products that are like or directly competitive with the imported product (see above) and second, identification of producers of this product[43]. The domestic industry may constitute either the total of producers of such products in Australia, or producers whose output of such products, when measured collectively constitutes a large proportion of the total production of such products in Australia.

This must be considered in light of the structure and pattern of ownership of the pig meat industry in Australia.

Increase in imports

Articles 2 and 4 mandate that the increase in imports must cause or threaten to cause serious injury to the domestic industry. Article 2 refers to imports "being imported in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or to threaten serious injury". Article 4, in referring to the economic factors to be considered for determining injury, notes that the "rate and amount of the increase in imports of the products concerned, in absolute and relative terms" must be examined.

What must be demonstrated is that there has been an increase in imports (of like or directly competitive product) in both absolute and relative terms. In recent WTO cases, the WTO Appellate Body has stated that this requires more than merely a mathematical or technical determination such that there must be such increased quantities so as to cause or threaten to cause serious injury to the domestic industry. This requires that the increase in imports must have been recent enough, strong enough and sudden enough, both quantitatively and qualitatively, to cause or threaten to cause serious injury[44]. There is thus not a requirement for an increase of a specific magnitude or amount. Rather the important thing to be considered is the impact of the increase, once established, in causing serious injury. (See next section below).

There is also no reference period over which imports must be shown to have increased, although some WTO jurisprudence notes that it is necessary to examine "recent imports" and not just those in a preceding period.[45]

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[43] WTO, United States – *Safeguard measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, Report of the Appellate Body, WT/DS177/AB/R and WT/DS178/AB/R, 1 May 2001.
[44] See WTO, *Argentina – Safeguard measures on imports of footwear*, Report of the Appellate Body, WT/DS121/AB/R, 14 December 1999.
[45] See WTO, *Argentina – Safeguard measures on imports of footwear*, Report of the Appellate Body, WT/DS121/AB/R, 14 December 1999.

Serious injury

Article 4.1 states that serious injury is understood to mean "a significant overall impairment in the position of the domestic industry". Threat of serious injury is defined as "serious injury that is clearly imminent", in accordance with the former.

The word injury is qualified by the adjective serious, which according to recent WTO jurisprudence "underscores the extent and degree of significant overall impairment that the domestic industry must be suffering or about to suffer, for the standard to be met[46].

The meaning of the term "position of the industry" is not addressed in the Agreement. The importance of this term can be shown if it is compared with the term "condition". The condition of anything is measurable against how it was before. Becoming unprofitable after being profitable is an obvious change in condition. The word "position" means in relation to other thing. The position of something is impaired if it means that its standing in relation to other things has altered. The terms in Article 4 include references to shares in the domestic market and the level of sales and production (see below). In assessing the effect on the position of the industry therefore, its standing relative to competing imports has to be taken into account. Evidently profitability and capacity utilization are obvious indicators.

Although there is no complete "test" for determining whether imports have caused or are threatening to cause serious injury to the domestic industry, Article 4.2 sets out the relevant economic criteria that must be considered. It states that in determining this, what must be evaluated is "all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the products concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses and employment." Article 4 further states that a determination of the existence of threat of serious injury is to be "based on facts and not merely on allegation, conjecture or remote possibility".

Clearly a wide range of economic factors, including those enumerated in Article 4, must be examined in order to make a determination of serious injury.

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[46] WTO, United States – *Safeguard measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, Report of the Appellate Body, WT/DS177/AB/R and WT/DS178/AB/R, 1 May 2001.

WTO disputes cases have affirmed that all listed factors must be evaluated at a minimum, as well as other factors relevant to the industry concerned.[47]

According to Article 4, this requires an assessment of the following:

- the rate and amount of the increase in imports over the injury period, in absolute and relative terms;
- the share of the domestic market taken by the increase in imports;
- the effects of imports on prices in the domestic market; and
- changes in the levels of sales, production, profitability etc.

Whether or not injury is established thus depends on the economic case to support such a determination. What is required is an adequate explanation as to how the facts as a whole support the determination made.[48] What is important is the significant overall impairment of the industry – it is not necessary that all evaluated factors point to injury as long as the overall picture is consistent with significant impairment[49].

Injury due to increased imports – causal connection

Article 4.2 of the Agreement states that a determination of serious injury shall not be made unless it can be demonstrated on the basis of objective evidence, "the existence of a causal link between increased imports of the product concerned and serious injury or threat thereof". When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports."

The causal linkage between increases in imports and serious injury to the industry is established when increases in imports can be shown to have a critical impact in causing serious damage to industry. WTO jurisprudence has affirmed that the relationship between movement in imports (such as volume and market share) and movement in injury factors is central to a causation analysis.[50] WTO cases have also referred to the causal link as "denoting a relationship of cause and effect such that increases in imports contribute to, bring about, or are producing or inducing the serious injury."[51]

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[47] See WTO, *Argentina – Safeguard measures on imports of footwear*, Report of the Appellate Body, WT/DS121/AB/R, 14 December 1999.
[48] WTO, Korea – *Definitive safeguard measures on imports of certain dairy products*, Report of the Panel, WT/DS98/R, 21 June 1999.
[49] *Ibid*.
[50] See WTO, *Argentina – Safeguard measures on imports of footwear*, Report of the Appellate Body, WT/DS121/AB/R, 14 December 1999
[51] WTO, United States – *Safeguard measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, Report of the Appellate Body, WT/DS177/AB/R and WT/DS178/AB/R, 1 May 2001

Serious injury is established when injury spread across a significant breadth of producers, according to the Agreement, either that a 'major proportion of producers" or the "whole of producers". There has to be an impairment of the position of the industry which those producers constitute.

It has been contended that the quantitative impact of the injury caused by imports needs to be established against the quantitative impact of injury caused by domestic factors. The Agreement stipulates that injury caused at the same time by domestic factors cannot be counted towards the injury caused by imports. It therefore is necessary to assess other factors that may affect the industry and negate them as the cause of injury. This could include:

- The performance of the economy generally;
- Exports;
- Weather conditions, such as drought;
- Changes in consumer preferences;
- Productivity; and
- The impact of changes in the price of substitutes.

Notably, not much can be gained by trying to assess the relative impact of one source of injury over another. All that has to be demonstrated is that the increase in imports has "caused or threatened to cause" serious injury. The impact can be cumulative. It is the effect of the increase, not the size of the increase which is the material factor.

Further, it is not necessary that increases in imports be the sole factor causing serious injury. WTO disputes cases have affirmed that the causal link between increased imports and serious injury may exist, even though other factors are also contributing at the same time to the situation of the domestic industry. What is important is separating or distinguishing the effects caused by the different factors in bringing about the injury.[52]

At any time in any industry, "domestic" factors can be regarded as causing injury. If imports clearly act as an independent factor and can be identified as such, then the cause of the increased level of imports can clearly be established.

[52] WTO, United States – *Safeguard measures on imports of fresh, chilled or frozen lamb meat from New Zealand and Australia*, Report of the Appellate Body, WT/DS177/AB/R and WT/DS178/AB/R, 1 May 2001.

Annex 2- Summary of WTO requirements for the imposition of provisional safeguards

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a. The WTO Agreement on Safeguards and provisional safeguard measures

The WTO Agreement on Safeguards permits governments to impose immediately, provisional controls on imports, (termed provisional safeguards), if imports threaten the viability of domestic industries. This is conditional upon verifying that WTO conditions for such restrictions are met in a preliminary determination by a government authority, and upon demonstrating that further requirements under the Agreement on Safeguards are met within a specified time period.

b. The legal requirements for the imposition of provisional safeguards

The WTO Agreement on Safeguards

Article 6 of the Agreement on Safeguards states:

> *In critical circumstances where delay would cause damage which it would be difficult to repair, a Member may take a provisional safeguard measure pursuant to a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury. The duration of a provisional measure shall not exceed 200 days, during which period the pertinent requirements of Article 2 through 7 and 12 shall be met. Such measures should take the form of tariff increases to be promptly refunded if the subsequent investigation referred to in paragraph 2 of article 4 does not determine that increased imports have caused or threatened to cause serious injury to a domestic industry….*

Unlike normal or full scale safeguard measures, not all of the above must be demonstrated *before* the provisional safeguard measure is imposed. What is required is a "preliminary determination" which provides "clear evidence" of serious injury, or threat of serious injury, and which establishes that there are "crucial circumstances where delay would cause damage that is difficult to repair."

Accordingly, before imposing a provisional safeguard measure, the Agreement requires that there be "clear evidence" of:

- "Critical circumstances where delay would damage which is difficult to repair;"
- Increased imports of a "like" or directly competitive" product;

- "Serious" injury to the domestic industry or the threat of it;
- Serious injury and threat of serious injury caused by the increase.

The Agreement itself sets our further provisions governing each concept, some of which have already been addressed in the submission (serious injury for example).

Clear evidence

The Agreement on Safeguards does not define 'clear evidence." WTO jurisprudence offers no further guidance. The ordinary meaning of the phrase would suggest that there must be indications, signs and facts that are distinct, intelligible and unambiguous.

Critical circumstances where delay would cause damage that is difficult to repair

The Agreement on Safeguards does not provide further guidance as to what constitute "critical circumstances". The ordinary meaning of the word "critical" means that of the nature of a crisis. It implies a time of acute hardship or danger. Increasing levels of debt, falling returns and financial hardship in combination with likely relaxed quarantine controls as well as likely future increases in imports could constitute circumstances that are "critical."

The Agreement also does not further define the meaning of the phrase "damage that is difficult to repair". The phrase "difficult to repair" implies that damage must be hard to restore or set right again, such as to restore the industry to a good condition. It must not be easily fixed or remedied. Commercial problems such as bankruptcies, withheld investment as well as disruption to sales and marketing arrangements would be hard to recover.

The "critical circumstances" that exist must be such that delay will cause the damage (which is difficult to repair). It therefore must be demonstrated, by means of clear evidence, that a delay in addressing increasing levels of imports will result in damage to the industry noted above.

Increased imports of a like or directly competitive product

This is addressed at Annex 1.

Serious injury to the domestic industry or the threat of it

This is addressed at Annex 1.

Serious injury and threat of serious injury caused by the increased imports

This is addressed at Annex 1.

Relationship with GATT Article XIX

It is now established that GATT Article XIX and the WTO Agreement on Safeguards together set out the rules under the WTO for the imposition of safeguard measures. The WTO has noted that Article XIX has been has been clarified and reinforced by the Agreement on Safeguards and that in order to give legal effect to both the GATT and the Agreement, the provisions of each apply cumulatively.

Article XIX:1(a) states:

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

Whilst it is clear that Article XIX must be complied with for the imposition of a full or normal safeguard measure, it is not clear whether the requirements of the GATT Article XIX must be met before a provisional safeguard measure is imposed.

There is also little guidance on what is required of a member in order to determine the above conditions are met. The WTO has ruled in several safeguards cases that in order to comply with this Article, a member must demonstrate, as matter of fact, that as a result of obligations incurred under the GATT, it finds itself confronted with developments it had not foreseen when it incurred that obligation. There must be a "logical connection" between the unforeseen developments and the increase in imports (in the sense the unforeseen developments have led to the increase in imports). "Unforeseen developments" have been interpreted by WTO disputes bodies as developments that were unexpected at the time the obligation under the GATT was negotiated.

c. The procedural requirements for the imposition of provisional safeguard measures

Article 6 specifies that safeguard measures can be applied provisionally subject to a "preliminary determination" that the criteria specified under the

Agreement are met. The Agreement on Safeguards does not provide further guidance as to what constitutes a preliminary determination. Presumably it can take the form of a decision taken by a government authority, such as a Minister.

There is a further requirement that within 200 days of imposing the provisional measures an independent review is conducted which verifies the measures are justified. This requires an investigation by a competent authority that the "pertinent requirements" of Articles 2 through to 17 of the Agreement have been met. This requires establishing, to the requisite standards of the agreement that imports have caused or threatened to cause serious injury to the domestic industry (See Annex 1).

In the event that the review finds the measure are not warranted, the tariff protection must be removed and refunded to the affected importers.