SUBMISSION TO THE PRODUCTIVITY COMMISSION

THE AUSTRALIAN PIGMEAT INDUSTRY

DECEMBER 2004

Queensland Government
Department of Primary Industries and Fisheries

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1. Introduction

The Productivity Commission inquiry into the Australian Pigmeat Industry comes at a time when the industry is suffering stress from a range of domestic and international factors. Domestic factors impacting the industry include climatic conditions (drought and high temperatures), summer infertility syndrome, availability of grain and water, price of grain, and consumer preference. International factors causing stress to the pigmeat industry include exchange rates, export demand, price of imports, and trade barriers.

The combination of these factors had resulted in a marked decline in the profitability of the pigmeat industry in recent years. This sharp decline in profitability suggests that the need for Federal Government support for the industry should be considered closely.

2. Queensland Industry - Overview

The Queensland pork industry contributes an estimated $205 million to the State's gross value of agricultural production. The Queensland pork industry represents 22% of the Australian industry and provides employment for approximately 6,400 people.

The production side of the industry, traditionally exposed to cyclical ups and downs of pork prices and feed costs has been increasingly under pressure as the periods of negative cycles have tended to be more lasting. The key indicators for profitability have trended downwards and a large majority of the pig production sector has not adequately been able to counteract this trend through increasing rates of productivity or through changing scale of operation. Not unexpectedly under these conditions producers have continued to leave the industry.

Most production is for the domestic market, with some exported, primarily to Singapore and Japan. National annual exports and imports rose steeply in the last five years with exports currently averaging 51,000 tonnes per annum and imports to 65,000 tonnes per annum, while national production is about 400,000 tonnes[1] per annum.

Queensland has an estimated 74,000 sows in about 439 herds (as a guide, for every sow on a piggery there are approximately 9 other pigs) plus approximately 240 producers who grow weaners under contract (contract growers), see Table1 below. The number of contract grower establishments has increased since about 2000 as a means of expanding established herds. These contract grower sheds have increased the use of low cost, deep litter sheds housing large numbers of grower pigs in one space. Contract growing provides a means for piggeries to reduce capital outlays, maintain herd health, and meet environmental responsibilities by retaining fewer animals on site.

In the last two years the Department of Primary Industries and Fisheries (DPI&F) has issued 14 licenses for new or expanding piggeries, totalling 161,740 pigs. It is believed that these developments have offset a significant number of smaller operators that have left the industry. The industry increasingly concentrates into fewer but larger units to gain efficiencies of scale and in response to difficult economic years, with little change occurring in the State herd size.

[1] APL Pork Trends September 04

Table 1 - Number of Queensland Establishments in 1997 and 2001

Year	Number of establishments	Number of sows and gilts intended for breeding	Number of sows per breeder herd	Number of pigs	Number of pigs per establishment
1997	821	68,293	83	599,900	730
2001	679 (including 240 contract growers)	74,000	168	643,000	946

(ABS Agricultural Census: 1996/7 and 2001/02)

The size of establishments in Queensland, as shown in Table 2 below varies greatly with about half of the piggeries maintaining relatively small numbers of animals, while 128 units each have 1,000 or more pigs (approx 100 or more sows) and together these 29% of breeding herd establishments contain about 88 per cent of the breeder population.

Table 2 - Size of Establishments[2]

Number Breeding sows and gilts (intended for breeding)	1-49	50-99	100-499	500-999	1000 or more	Total
Breeding sows	3,474	5,394	27,332	4,228	34,213	74,641
Establishments	242	69	107	6	15	439
Percent of total establishments	55%	16%	24%	1%	4%	100%

(ABS Agricultural Census: 2001/02)

Pig production is located close to the grain growing areas. The Darling Downs has about 30% of the State's pig herds and produces 55% of the pigs. This is the main grain growing area of Queensland and is close to processors.

The Wide Bay/Burnett district has about 33% of the pig herds and produces 30% of Queensland's pigs. This district is located between the Darling Downs and Central Queensland grain growing areas. In addition, small areas of wheat, barley and oilseeds are grown, but much larger areas of sorghum and maize provide the bulk of locally produced pig feed.

About 5% of the State's pig producers are in Central Queensland, producing some 9% of the State's pigs, with locally grown sorghum contributing to their grain need.

[2] Based on number of breeding sows and gilts intended for breeding

In the last five years the pork processing industry in Queensland has undergone some significant changes, involving processing capacity upgrades, additional export capacity development, ownership changes and moves towards supply chain alliances.

It would seem that the industry in Queensland is progressing towards two major supply chain interests that account for 70-80% of total processing capacity in Queensland. The majority of the processors are generally multi species abattoirs, killing for the local fresh meet trade and generally processing between 1,000 to 3,000 pigs per week. However, some pigs from southern Queensland are transported to a NSW abattoir.

Darling Downs Foods Limited (DDF) has purchased various pig producing properties, arising out of the voluntary administration of Elenium Pty Ltd, and more recently the acquisition of Victorian based Castlemaine Bacon Company (creating a new entity named KR Castlemaine Foods Pty Ltd). The Queensland plant at Toowoomba has a capacity to process 40,000 pigs per week (double shift basis).

Japan Tobacco acquired 100% of Hans Continental Smallgoods, and Hans in turn took up a 40% stake in the Swickers Bacon Factory, located at Kingaroy in the South Burnett. This last move enabled Swickers to expand/redevelop substantially as an export accredited facility, and now has a capacity to process 18,000 pigs per week (double shift). Swickers is a member of the 3600 sow producer Burnett Pork Alliance and has a supply link with the CHM Group (4,000 pigs per week). Hans Continental has recently reported a solid financial performance and has substantially increased its share of the domestic small goods market.

However the supply of pigs has not kept pace with capacity developments and the pig processing industry has operated well below total capacity for a number of years. It seems that there has been a transfer of pigs to Swickers (with new export capacity) at the expense of DDF. Job numbers have decreased at DDF, to approximately 600, while employment levels at Swickers have nearly doubled, although 20 extra workers were reportedly being employed at KR to assist in Christmas product preparation and then in packaging as part of the reorganisation with the merged company.

Based on recent history it would appear that future growth in the industry is dependent upon the development of globally competitive supply chains.

The Queensland pork industry continues to be in a depressed state, brought about by low pig prices over the last 2.5 years, and compounded by high drought-induced feed prices. While pig prices have improved in the past few months, there has been a significant increase in pig producer and agribusiness indebtedness built up over the past few years.

The situation over the last few years has resulted in two large producers going into administration with the resultant sale of these piggeries, one of which is in the process of de-stocking. A number of middle size herds (200 to 800 sows) have reduced their sow numbers, and it is expected that an unknown number of very small herds have closed.

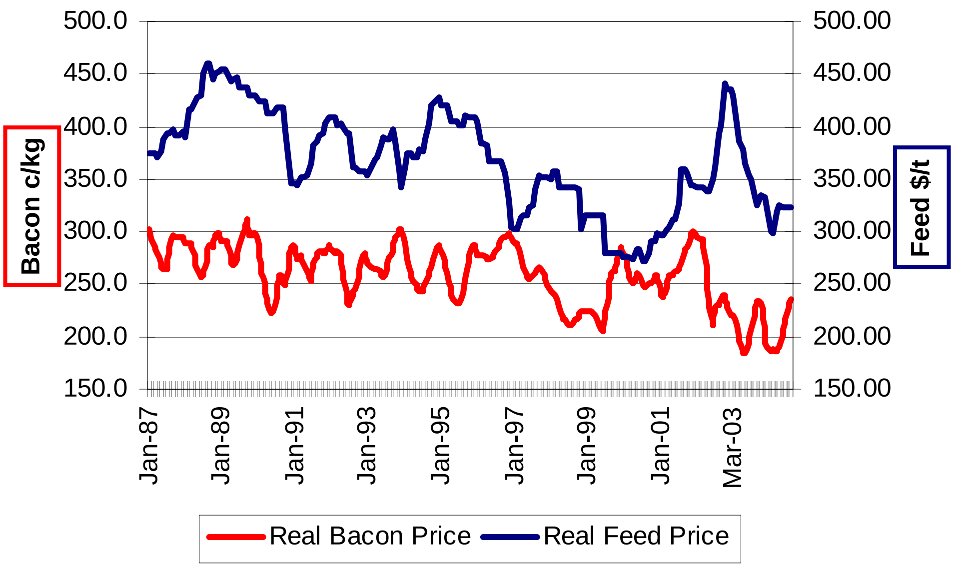
Some family operated herds have reportedly weathered the downturn by increasing cost efficiencies (including relying on family labour) and continuing their supplying small local markets for pork. There are also reports that many family owned herds are postponing decisions on their continuing in the industry until after the high pre-Christmas pig price period has passed, especially those where the operators are considering retirement. Producers concern is that the higher domestic prices will encourage higher levels of imports (which appears to be happening[3]) and thus again reduce their profitability.

3. Industry Prospects

3.1 Profitability

The real pig price (in October 2004 dollars), as shown in Figure 1, has fallen twice to very low levels in the last seven years, and for a longer time than in the past 17 years.

Figure 1 - Bacon and Feed Prices (in October 2004 dollars)[4]



The variability in pig prices is affected by factors including the AUD, producer production decisions (eg increasing herd size and thus slaughter numbers after a period of high profitability from late 1999 to early 2002), seasonal conditions (summer infertility syndrome can reduce numbers for slaughter in the next spring and early summer), processor behaviour to domestic pig prices and their level of purchases of imported pork, and domestic and overseas consumer demand.

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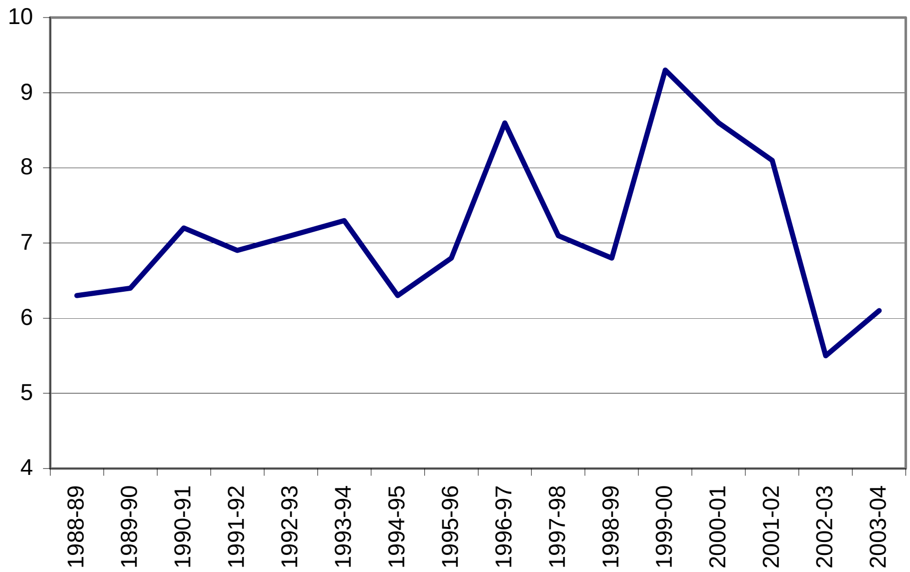
3 APL Pork Trends October 04

4 DPI&F sourced data: Bacon price reflects contract price only and is the average of light and heavy bacon after grading and before levies, inspection fees and pig transport costs. Feed price is for an average grower and finisher diet, does not include delivery or farm specific extra ingredients.

Feed prices have also been high in recent years, due to drought reducing supply, exacerbating the low profitability situation for pig producers especially from mid 2002 to mid 2003.

The ratio of pig carcase sale prices to feed grain prices is an indicator of the relative returns from pig production. Figure 2 below shows that the profitability of the pork industry has varied greatly in recent times, rising from a low in mid-1998, to a record high in December 1999 and then remaining above average (7.1) for the longest time on record. From near mid 2002, profitability fell to a record low in June 2003 due to drought-induced high feed prices and low pig prices due to greater supply on the domestic market (including the effect of the Australian dollar).

Figure 2 - Pig price to feed cost ratio, 1988–89 to 2003–04[5]



3.2 Forecast[6]

Queensland's gross value of pigs sold for slaughter in 2004–05 is forecast to remain the same as the previous year's estimate at $205 million.

An expected decline in the number of pigs slaughtered is underlying the forecast for the gross value of pigs sold for slaughter in 2004–05. Continued low profitability for Queensland's pig producers due to high grain costs, increasing imports and a high Australian dollar in US terms has caused some smaller pig producing enterprises to exit the industry and has halted herd expansion in many of the larger operations. The number of pigs to be slaughtered is forecast to fall by almost 5% in 2004–05.

In 2004–05, the outlook for pig prices is favourable. Gross unit returns to Queensland's pig producers are forecast to increase by 4%, reflecting strong demand from the domestic market.

[5] DPI&F sourced data
[6] Prospects for Queensland Primary Industries 2003-04 to 2004-05, DPI&F, Brisbane

Per capita consumption of pig meat in Australia has been steadily increasing over the last ten years and this trend is expected to continue in 2004–05. This is in response to:

- relatively cheaper retail pig meat prices compared with beef and sheep meat; and
- an extensive advertising campaign to increase pork consumption by Australian Pork Limited (APL).

However, the following factors could place a downward pressure on pig prices in 2004–05:

- the strength of the Australian dollar (assumed to average US70c), which is expected to reduce export competitiveness and limit export growth in 2004–05;
- a possible decline in exports due to:

  - Japan (Queensland's largest export market) increasing its tariffs on imported pork by approximately 25% from 1 August 2004 to 1 March 2005. The tariff rises were implemented when quarterly imports exceeded 19% of the average amount imported for the same period during the previous three years. This is allowed under World Trade Organisation (WTO) rules.
  - The flow-on consequences of competition from Brazil's exports to Singapore, Queensland's second largest export market for pork. While Brazil is supplying frozen product — a segment of the market Australia does not focus on (Australia concentrates on the fresh market) — the increase in frozen product which is sold at lower prices could displace some demand for fresh product for which retail prices are higher.

- a potential increase in imports of manufacturing pork given the recent adoption of the recommendations by Biosecurity Australia to allow imports into Australia from an extended range of countries than were previously permitted.

4. Major issues impacting on the industry

4.1 Imports

In February 2004, the Federal Government released a final Import Risk Analysis (IRA) for importing pork from a number of countries to Australia. The IRA found that pork could be imported provided certain measures were met to minimise the risk of the introduction of disease.

APL was dissatisfied with the IRA process, as it believes it has taken insufficient account of a new disease known as Post Weaning Multi-Systemic Wasting Syndrome. APL has argued that the continuation of Australia's high health status is the principal competitive advantage of the Australian pig industry. It is a marketable commodity; it is this health status that makes Australian pigs and pig products desirable on export markets. With growing global concern for food safety in the wake of increasing disease outbreaks, this high health status becomes even more desirable and an increasing competitive advantage.[7]

On 10 May 2004, Australia opened its borders to pork imports from a more extended range of countries than was previously permitted. This was the result of recommendations from the IRA of Pig Meat. Apart from opening the domestic market

[7] Review of the Generic Import Risk Analysis for Pigmeat, October 2003, APL.

to more countries, the constraints on imports remain much the same as for the past 13 years. That is, imports will only be permitted under strict quarantine conditions that require imported product to be de-boned and cooked prior to release into the Australian market.

Under the previous policy, uncanned, uncooked pig meat could be imported from Canada, Denmark and the south island of New Zealand for processing in Australia. In addition, canned pig meat could be imported from any country.

The new import arrangements have the potential to increase imports of manufacturing pork from countries such as the United States (the third largest exporter of pork) into Australia and therefore place downward pressure on domestic prices. However, imports from other countries will only occur if:

- quarantine requirements are satisfied;
- suppliers can obtain price premiums in the Australian market compared with other markets they supply;
- transport costs are not prohibitive; and
- suppliers can establish supply and marketing channels within Australia.

The quarantine requirements mean that imported pig meat sells into a narrower market segment (manufacturing market) in Australia and therefore does not compete directly with Australian product in the fresh meat market. However, an increase in imports may result in some of the local product destined for the manufacturing market being diverted into the fresh meat market, which could place downward pressure on prices in the fresh meat market.

4.2 Exports

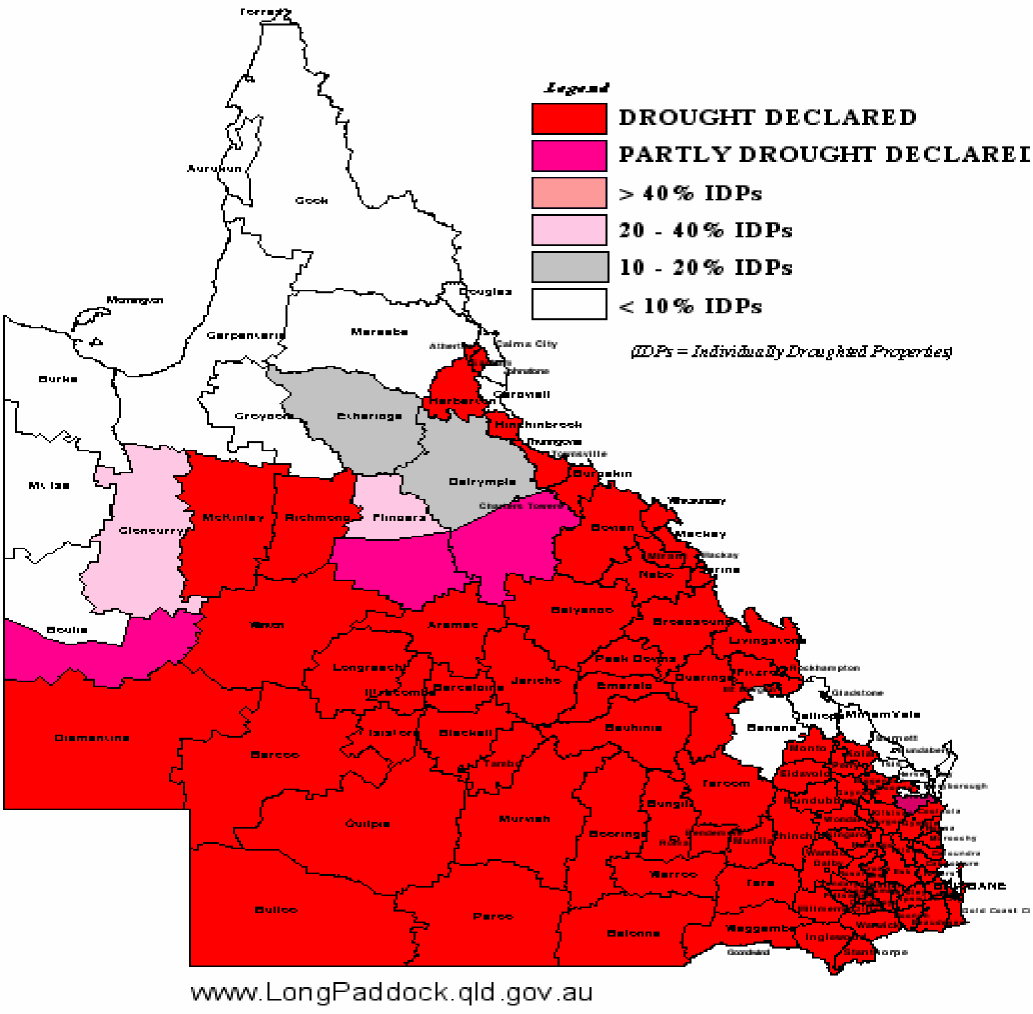
The Queensland pork industry is moving from an almost exclusive domestic focus to a growing export industry. For example, in the period to the mid 90s, exports from Australia were in the range 5,000 tonnes to 9,000 tonnes per year. However, since 1998, exports from Australia have increased significantly, rising to 64,520 tonnes in 2002 valued at $270.3 million. The major markets for Australian pork are Singapore and Japan, where exports during 2002 to Singapore totaled 30,771 tonnes (valued at $121.1 million) and exports to Japan amounted to 14,989 tonnes (value of $101.7 million).

Export opportunities for the Australian industry arose out of health problems in pig herds in Malaysia (Nipah Virus) and Foot & Mouth Disease in the U.K., Europe, Taiwan and Korea. However, while Australia has been able to capture export opportunities, to develop the industry, further investment will be required to increase the supply base to meet the anticipated demand.

4.3 Drought (including feed grain price and supply)

As at 31 January 2004 there were 95 shires and 4 part shires drought declared under State processes, which represents 66.5% of the land area of the State, as shown in Figure 3 below. At that time there are also 140 Individually Droughted Properties (IDPs) in a further 15 shires. These drought declarations were made in the period October 2000 to August 2003.

Figure 3 - Areas Drought Declared at 31 January 2004



At no time since the introduction of State drought declaration process in the 1960's had such a large percentage of the land area of the State been drought declared for such a long period.

On 24 March 2004 the Commonwealth Government acknowledged the impact severe drought was having on the pork industry, as a result of high prices, with the declaration of Exceptional Circumstances (EC) for all Queensland pork producers not previously covered by an EC declaration.

The most significant drought impact on the pork industry is the increase in grain prices. Feed grain (which makes up about 80% of the diet) and ingredients is the major cost within a piggery, accounting for 50-60% of the total cost of production. Feed grain prices had been the highest on record during the 2001-2004 drought, and feed input costs had risen to represent more than 80% of the cost of production and pushed most producers into loss positions.

The widespread nature of drought in Queensland meant that feed grain prices were high throughout. The drought was unusually severe in that not only did feed prices rise through competition for supply there were serious problems in securing the quantities of feed needed to maintain normal levels of production.

Drought normally causes feed grain prices to rise in Australia, so pork producers are impacted by drought irrespective of the location of their piggery. When feed was sourced from beyond regular suppliers, freight costs were an added cost burden to producers.

In 2004, a survey[8] of primary producers in Queensland was undertaken to collect data on the drought management practices used by producers during the 2001-04 drought, the effect of drought on the income of producers, and how much current government programs were being used, and to assess the attitudes of producers to government drought assistance. The survey results were representative of all classes of primary producers across all regions of the State. Although the number of responses from intensive livestock producers was comparatively small it is the believed that the views expressed are representative.

In response to the question about their preparedness for drought 71% of intensive livestock producers indicated that they were very well prepared or moderately prepared for drought. The strategies mainly adopted were forward fodder contract, fodder storage facilities, and improved water supplies.

Respondents were also asked whether the drought had resulted in an increase or decrease in their farm profits. For intensive livestock producers 78.9 percent said they had experienced a moderate or very large decrease in farm profits. The reasons given by intensive livestock producers for this decrease included sold stock earlier than otherwise and used fodder that had been stored.

The survey results clearly indicate that the majority of intensive livestock producers had implemented risk management strategies to prepare for drought, but the severity of the drought had greatly reduced the effectiveness of these strategies.

The rises in feed cost since 2000, due to drought, have been the single greatest short-term impediment to the growth of the pigmeat industry in Queensland.

Grain for feeding livestock is a spin-off from grain production for human use (including export), and the intensive livestock industries have been investigating the supply of grain for their industries.

The pigmeat industry acknowledged the need to take steps to prepare for future droughts and, for that reason, APL has been working closely with the Australian Quarantine & Inspection Service to improve arrangements for the import and handling/processing of feed grain. Grain imports would allow them to create a buffer to prevent the dramatic price increases for domestic feed grain brought about by the drought.

The Commonwealth Government should consider either improving the grain import protocol or assisting in the establishment of grain treatment facilities for imported grain. At present, imported grain cannot be transported out of metropolitan areas unless/until it has been heat treated and/or processed. When combined with the transport costs from the metropolitan area, this is having a significant impact on prices of feed grain delivered to producers.

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[8] Managing the Drought, Queensland primary producers' strategies 2001-2004, DPI&F, Brisbane

4.4 Water

A distinguishing feature of the 2001-2004 drought has been the impact on water supplies particularly in south eastern Queensland. This situation has highlighted the difficulties that primary producers face when competing for scarce water resources.

Recent research[9] by the Bureau of Meteorology indicates that in the last 30 years there has been a significant negative trend in annual rainfall in many parts of Queensland. All of Queensland's pigmeat producing regions are located within this area.

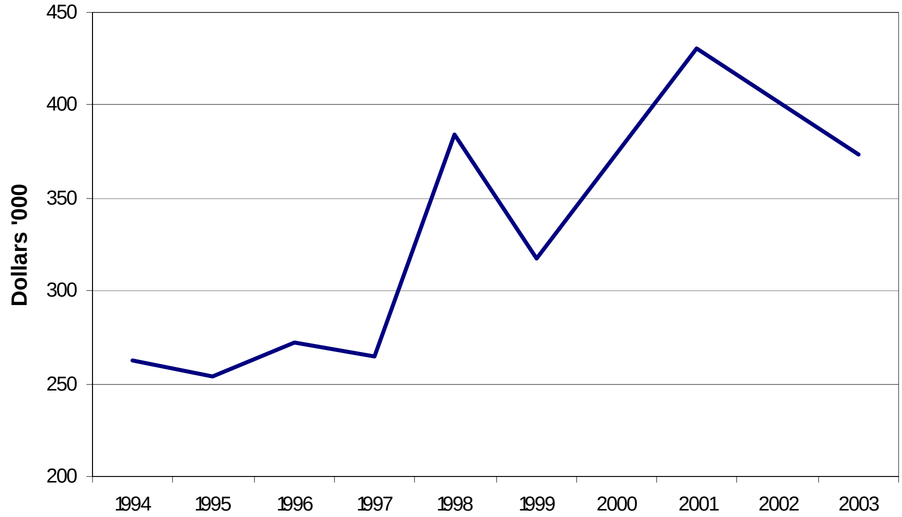
A lack of availability of good quality water in the future is a potentially limiting factor for both the development of new pigmeat enterprises and the sustainability of existing enterprises.

In terms of availability of water for new piggeries, there appears to be greater potential in the South Burnett region with new or improved infrastructure planned to provide additional water along Barambah Creek, and the Burnett River.

4.5 Debt

QRAA (formerly the Queensland Rural Adjustment Authority) undertakes a periodic survey of rural debt in Queensland. Data from the 2004 survey[10] displayed in Figure 4 shows an upward trend in the amount of average debt held by producers in the intensive livestock industries (excluding dairy) in the period 1994 to 2003. The survey also shows that the 83% of these producers were either considered viable under most circumstances or potentially viable in the long term.

Figure 4 - Average Debt in Intensive Industries (excluding dairy) 1994 – 2003



[9] http://www.bom.gov.au/silo/products/cli_chg/index.shtml

[10] Rural Debt in Queensland Survey 2004, QRAA, Brisbane

The reasons for the upward trend in average debt level were not considered in the QRAA survey, however possible explanations include:

- rationalisation through changes in size of enterprise over this period;
- cash flow difficulties as a result of drought.

However, if the upward tend in average debt was to continue post drought then this would indicate either further change in number of establishments and/or change in the profitability of establishments.

5. Queensland Government Support for the Pigmeat Industry

The Queensland Government is working proactively with the pork industry. Support is provided to assist the Queensland pork industry in the key areas of industry development, market development and biosecurity.

DPI&F industry development programs include nutrition, market development, skills enhancement, financial counselling, water freight subsidies, partial funding of Exceptional Circumstance assistance business support, and provision of decision support tools such as the PrimePulse software and SmartDATA analysis service, the AUSPIG pig production model, the MEDLI effluent disposal using land irrigation model, and the PIGBAL effluent treatment design tool. There is also a large input into research and extension in the area of environmental management, and regulation of new piggery developments and environmental monitoring to ensure sustainability and assist in market access.

DPI&F biosecurity programs include animal health (managing the risks presented by disease) and animal welfare (to maximise market access and community confidence in pork products).

The Minister for Primary Industries and Fisheries has established an Intensive Livestock Systems Unit to streamline the environmental assessment and approval process for new piggeries or existing piggeries seeking to expand in Queensland.

The Department of State Development and Innovation (DSDI) facilitated the formation of supply chain group, the South Burnett Pork Alliance.

Over the last 4 years, DSDI has provided more than $3 million in direct grants to the pork industry assisting the industry to improve production processes, value add and improve supply management.

An Investment Mission visited the UK, Denmark and the Netherlands in March 2002 resulting in a visit by a UK Pig Industry Delegation visit to Queensland in June 2002.

The Minister for Primary Industries and Fisheries led an Investment Mission to Japan and Taiwan, which resulted in a Taiwanese Pig Industry Investment Delegation visit to Queensland in May 2002 to look at the potential to invest in pig production.

DSD&I has worked closely with SunWater, shire councils and real estate agents in the Burnett region to identify localities and locate properties in those areas, which may be suitable for the establishment of new piggeries. Details of properties were provided to the various shire councils to identify sites, which met the Council’s criteria as being suitable for intensive livestock production.