WINDRIDGE FARMS

Submission in Response to Productivity Commission Draft Report

The Productivity Commission report is very disappointing. The Commission relies heavily on assumptions, which are not adequately tested. It ignores the short term to focus only on the long term inappropriately for an industry with high cashflow, which can fail in the short term despite good long-term prospects. Reasoning and recommendations are inconsistent, and not enough effort has been made to consider alternative tools to solve even the recognised problems.

Productivity Commission Assumptions

1. The Commission assumes the cost of a safeguard on pigmeat will outweigh the benefits. This treatment is not assumed for other industries – such as the wheat industry where the Commission suggests analysis of the costs and benefits should be undertaken. In this report the costs and benefits are briefly outlined and rejected. There is no attempt at analysis or quantification.
   - One point critical to the Commission's assumption and conclusion is that consumers do actually receive lower prices as a result of imports. This is not assessed in the draft report (there is only brief reference to retail prices following pig prices based on an increase in retail prices at the same time as higher pig prices in one year). If this is not true, for example if large retailers maintain retail prices in spite of lower input prices then the only part of the supply chain to benefit from imports are the secondary manufacturers and the large supermarket chains. We believe this is the case the majority of the time.
   - Another critical part to this assumption is that safeguard protection or other assistance to the industry will prevent the industry restructuring. This is not necessarily correct, particularly if the assistance or safeguard is temporary. Given the industries history of dramatic restructuring and the existing industry driven plans for restructure in the future it is not reasonable to assume a complete halt to restructuring as a result of any government assistance, especially if this was temporary.
   - The Commission also states imports have grown relatively consistently since 1990 (p XXIV). Figure 2.15 of the Report shows the September 2003 import volume is about 60% of the March 2003 volume. Figure 2.14 shows a dramatic increase in import growth in 1999 then an 18 month long 20% fall in imports during 2000-2001 and a significant year long slowing of import growth in 2002-2003. These changes are not insignificant and actually give a picture of significant instability.

2. The Commission assumes that any changes made by the government to feed, imports, or any other policies will be insignificant. This is not correct. Government policy already significantly affects costs in several of these areas as is noted in the draft report. Correction of these policies could thus have significant impact. The cumulative impact also needs to be considered. Small improvements in several areas would have an overall significant impact. Dismissing all possibilities in such a manner shows a complete lack of respect for the industry, those it supports and the Productivity Commission process.
   - Feed is 60% of a piggeries cost. For every kilogram of meat produced 4 kilograms of feed are needed. Thus any small change in feed costs has a significant effect on pig producers profitability. Removing the monopoly in the wheat industry would significantly impact on grain prices, feed costs and piggery profitability. Alternatively compensating those who bear the cost of this government granted monopoly (such as

the pig industry) could achieve the same ends and is justifiable. Basic economic theories on this point always included compensation.

- Labour costs are also a large proportion of piggery costs. Changes to government policy in this area could significantly affect piggery profitability. One small example allowing self-insurance for workers compensation would save our business $130,000 per year. This is not insignificant! Another small example providing workers compensation for trainees would increase our ability to employ and train new staff improving our productivity. Simplifying our award (federal) would allow us to achieve many productivity improvements and better reward our better performing staff. Removing the ridiculous burden of unfair dismissals (our lawyers advise us to settle these no matter how good our case is because no emloyer ever wins in court) would also improve workforce productivity. More capable staff and resulting improvements in productivity could generate for example, half a pig more per litter, ie 5,100 additional pigs equating to about $400,000 net income per year for our business. Again this is not insignificant.

- Reducing barriers to new markets could also have highly significant impacts on the industry and should be strongly recommended as action to be undertaken by government. Increasing the number of export markets available provides diversification, which is sorely needed as a risk management strategy for the industry as a whole. Individual producers and processors, or even the industry as a whole do not have the resources to negotiate alone with other countries governments to reduce barriers such as tariffs and gate prices. In addition occasional rapid changes in supply and demand as a result of disease outbreaks can mean a small market can become a highly significant one very quickly – if access is possible. Singapore is an obvious example of this. It was very fortunate that the import and quarantine procedures had just been negotiated prior to the outbreak of nipah virus.

- A safeguard on imports could stabilise prices for a few years giving us the time and enough funds to implement our strategic plans lowering our cost of production by 15c/kg thus significantly improving our ability to compete. We cannot implement these plans in the current environment.

3. The Commission assumes there are limited tools available to assist the industry. There does not appear to be a proper assessment of a variety of tools in the report. There are many examples which even an untrained farmer can come up with:
   - a temporary safeguard on imports,
   - compensation to domestic grain users for domestic grain prices being above export parity during drought,
   - legislated requirement for domestic grain prices to be no higher than export parity during a drought
   - tax incentives for feed storage (similar to water storage),
   - tax incentives for productivity enhancing investments,
   - self insurance for workers compensation,
   - workers compensation funded by government for trainees.
   - simplification of awards to improve flexibility and thus productivity

- removal or improvement of unfair dismissal laws – employer never wins, this would improve productivity as well as encourage additional employment.
- payroll tax exemptions for regional employers or for those competing with subsidised imports or for the pig industry due to its unique situation.
- regulation of supermarket pricing so that when pig prices drop, retail prices drop too.
- Education of grain farmers on advantages of some of feed crops, eg, lupins less harsh to environment compared to canola and can fill the same place in crop rotation.
- Government funding of grains industry research focussed on better feedgrain production. Currently little effort is directed in this area by the grains industry. Better yields and nutritional qualities of feed grain varieties suitable for Australia would increase their profitability to grain producers and also pig producers.

Any of these tools are justifiable when considering the steeply sloped playing field of the pig industry with regulated input markets, subsidised competitors, and restricted markets.

4. The Commission assumes general assistance programs are appropriate and that the pig industry situation is similar to that of other agricultural industries. This is not entirely correct. Extensive agricultural operations are significantly different to intensive operations.

   - Extensive agriculture is generally characterised by low cashflow, as compared to intensive agriculture leading to the industry adage – it takes 20 years to go broke in wool and 20 weeks to go broke in pigs.
   - The capital required for investment (initial and for improvements) in the pig industry is also much higher than most other agricultural industries.
   - In almost all cases the lead-time is also greater due to more complicated development application processes.
   - Most extensive agricultural industries have much greater flexibility in choosing the time of sale of product.
   - Very few other intensive or extensive agricultural industries have had extraordinary rate of growth of imports in recent years resulting in destablised prices.
   - There is no other agricultural industry with such a dramatic history of restructuring nor with a well defined and thought out plan for restructuring in the immediate future.

   The combination of these features mean the pig industry is in a unique position which justifies government action. In addition these features and the structure of most general programs around extensive agriculture often excludes the pig industry. For example, drought assistance has been largely unavailable to pig producers. Many general programs seem to exclude those in company structures, which means the most professionally setup businesses are excluded, this is not reasonable.

Focus on Long Term ignoring Short Term Situation

The Commission focusses on the long term at the expense of the short to medium term. Although current prices are not unreasonable the threat of higher and unstable levels of imports and price wars between importing countries means that pigmeat producing businesses, such as Windridge, cannot take the necessary steps in the short term to improve their long term competitiveness.

WINDRIDGE FARMS

As stated in our previous submission, we have a strategic plan, which we believe will result in a 15c/kg lower cost of production. We need time and funds to implement this plan. It includes building new sheds, renovating old ones, and implementing new technologies. The total investment is approximately $20 million. We expect to fund this largely out of cashflow as our borrowings are already significant. However we also need support from our banks to be able to continue. There is significant lead time due to planning and development application requirements, building times, time taken to build up the pig herd and grow pigs out to larger sizes.

As pig production is a high input and thus high cashflow business, when prices do fall below costs, we need significant financial reserves to maintain our business. The recent dramatically increased level of uncertainty has resulted in a need for us to build much larger reserves, which impedes our ability to continue with our strategic plan. In addition we bear the risk of going bankrupt in the short term although our long term prospects are good. We note that we are aware of highly efficient pig production businesses with excellent marketing who have gone out of business in the last few years due solely to short term cash requirements not being able to be met. These businesses were not the expected least efficient ones leaving the industry.

A safeguard on imports could stabilise prices for a few years giving us the time and enough funds to implement our strategic plan and significantly improve our ability to compete. We cannot implement our plans in the current environment.

I note this is relevant to draft finding 6.1. This situation is a significant impediment to restructuring. Short term lack of profitability and extreme uncertainty caused by the rapid increase of imports and change of government policy on quarantine is preventing Windridge from making the necessary but significant investments to reduce costs and improve productivity for the long term. We understand this situation is common across the industry. The impact of this impediment to restructuring should not be lightly dismissed by the Commmission.

Unique Position of the Pig Industry – Corrupt Markets

The Productivity Commission does not make any note of the rather extraordinary situation of the pig industry in Australia. Our two major costs, grain and labour, are regulated, our competitors are subsidised (the Danish to a level of 22% according to the draft report- is this not a clear source of comparative advantage?) and a significant proportion of our export markets are protected.

The report fails to point out that subsidisation and restrictive trade practices while decreasing in Australia are currently increasing in the Countries we compete with particularly for pig meat.

Lack of Recommendations on Threatened Comparative Advantage

The Commission notes that our clean green image and disease free status is one of our key comparative advantages but does not comment on the fact that there is a high risk of losing this advantage due to the recent quarantine changes. The CSIRO predicted this change will result in an exotic disease incursion within 10 years. Surely the Commission cannot fulfill its terms of reference (see points 2 to 5 under Part 1 and Part 2) without some recommendation on maintenance of our most important comparative advantage?

Conclusion
The lack of in depth analysis in the report is disappointing and indicates either inadequate time or a foregone conclusion. The lack of a link from the facts brought up in the report to the conclusions is frustrating. If the facts are as stated there are many opportunities for government action. The Commission's terms of reference require description of these but the report merely describes theoretically a few standard options. Some ideas have been mentioned above, there are no doubt many more, which the Commissions well-trained and innovative staff could come up with.

The draft report is vague, recommendations are weakly worded, critical assumptions are not tested, some evidence is ignored. Understanding of the industry appears limited. If the final report is not significantly improved this inquiry will be seen as a complete waste of taxpayers funds as well as an insult to the industry.