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Dr Neil Byron
Commissioner
Australian Pigmeat Industry Inquiry
Productivity Commission
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Dear Dr Byron

Queensland Pork Producers Inc (QPPI) welcomes the opportunity to have input into the Productivity Commission Inquiry into the Australian Pigmeat Industry. Thank you for the opportunity to participate in the Inquiry and for the visit to Queensland on Monday 13 September from yourself and your colleagues.

QPPI is the organisation which represents the interests and needs of pork producers in Queensland through the delivery of effective services and leadership. The Queensland pork industry provides a significant financial and employment contribution to the State.

Industry profitability over the last two years has become a significant issue due to the increasing volumes of pigmeat imports and the corresponding downward pressure they have placed upon domestic pig prices. In addition to these depressed pigmeat prices, the drought caused the cost of feed grain to rise to the highest levels on record, thus further decreasing financial returns to producers.

Please find attached our submission to the Inquiry, should you require any further information please do not hesitate to contact me on (07) 3837 4727.

Yours sincerely

Paul Taylor
President

Queensland Pork Producers Inc

Submission to the Productivity Commission
Australian Pigmeat Industry Inquiry

Structure and regional distribution of the industry

Queensland Pork Producers Inc (QPPI) is the organisation which represents the interests and needs of pork producers in Queensland through the delivery of effective services and leadership. The pork industry provides a significant contribution to rural and regional areas, particularly through general economic multipliers and employment. In terms of economic benefits, the industry provides $200 million gross value of production as well as $434 million in total value added to the Queensland economy. Whilst in terms of employment the industry provides direct and indirect employment for 6300 people across the production, processing, retail sales and food service sectors (Source: Western Research Institute, 2002).

The Queensland pork industry is widely recognised as having a comparative advantage in pig production and supply, due to all year round access to competitively priced grains and other feed inputs (in non drought years), as well as having environmental factors well suited to intensive pig production. The industry is well serviced by major pig processing facilities, feed mills, other input suppliers and it has proximity to major domestic and export market channels as well as to the major grain production regions of Queensland and Northern New South Wales.

Pork production in Queensland is dominated by individually owned farrow-to-finish operations which have both breeder and grower herds conducting continuous production on the one site. However, there is a growing trend towards the formation of alliances or links between sectors both horizontally and vertically to match the competitive advantage possessed by each party as well as to meet consumer demands for product consistency and quality. The key production areas of the Queensland industry are the Darling Downs, Burnett and to a lesser extent the regions of Central and North Queensland.

According to the QPPI database there are 230 pork producers in Queensland and a further 60 contract growers, whilst the total number of sows is approximately 65 000. Contract growing has become an important part of the industry because it enables larger producers to develop economies of scale and have pigs grown out under a specified system through a strict control of costs. The number of producers in Queensland has reduced over the past two years, with some moving across to contract growing whilst others have left the industry completely. This change in the dynamics of the industry has placed significant financial pressure upon the ability of QPPI to achieve its stated goals and objectives.

QPPI believes the following trends are shaping the future structure of the Queensland pork industry.

1. Corruption of international markets due to high levels of artificial market support in the European and North American pork industry and the development of bilateral trade agreements/alliances as well as the formation of regional trading blocs.
2. Declining international costs of production within the United States (US), Canadian and South American pork supply chains.
3. Further competition for feed grains due to the significant growth in intensive livestock industries (beef feedlots, chicken meat production, dairy production) within Queensland

and Northern New South Wales, particularly if a grain based ethanol industry is developed in Queensland.

4. Further globalisation of food markets through the consolidation of the food retail sector in global markets coupled with increasing dominance by a small number of US and European conglomerates. At the same time, domestic retailers are adopting tighter supply chain management practices.
5. The emergence of the ethically conscious consumer has increased consumer demand for proof of integrity of safe, clean food production systems. This is leading to greater demand for strict food safety and traceability procedures. Community sensitivity to issues such as animal welfare, environmental impacts and resource-use efficiency has also increased.
6. Development of the discerning consumer has driven eating preferences in terms of convenience, health benefit, taste and "experience". Consumers have reduced the time given to meal preparation due to increased time demands for work and leisure activities. Increased price competition between meat categories has caused retailers and processors to increase their methods of differentiation.

Risk management will become a major focus for pork producers with many of them entering into contracts, particularly in terms of outputs. However the coordination and facilitation of risk management activities on both the input and output side of pig production will present significant challenges which must be overcome. There are several different forms of pig price contracts, however most operate between an upper and lower bound (ie: cap and collar) or with a guaranteed minimum price. Contracts are also used for inputs to the production enterprise, in a specific attempt to manage the risk associated with feed grain prices.

Traditionally the industry has experienced peaks and troughs in terms of pig prices. However since the significant increase in unrestricted subsidised pigmeat imports, domestic pig prices have been depressed and the troughs have become longer and more severe.

Up until two years ago, there was significant uptake of new technology within the Queensland pork industry as numerous innovative production and natural resource management practices were introduced and adopted. However due to pigmeat imports and drought induced financial pressures over the last two years, the uptake of technology and industry growth opportunities have both reduced.

In recent years, the implementation of environmental licensing processes as well as the application of environmental regulations has impeded the expansion of existing and/or development of new piggeries in Queensland. The main environmental regulatory impedients to the development of the industry have included a complex licensing process, variations in interpretation by relevant Government agencies, a non-transparent and inconsistent development approval process, an inadequate appeals process as well as limited differentiation of information on environmental licensing for new and existing piggeries. Issues have also occurred due to a lack of guidelines to assist with the preparation of licensing applications, limited recognition for industry innovation in environmental management as well as limited use of science-based information on key environmental areas. QPPI together with relevant Queensland Government Departments and Australian Pork Limited have worked hard to overcome these issues to the point where they are no longer viewed as significantly constraining the development of the industry.

In Queensland, implementation of the Council of Australian Governments water reform is guided by the *Water Act 2000* (Water Act). Under the Water Act, the State Government can regulate water courses, lakes and springs, underground water and overland flow. The Water Act allows the Government to regulate the allocation and management of water through catchment wide Water Resource Plans followed by Resource Operations Plans. As this water reform is implemented across key pork production catchments, issues regarding access, allocation and pricing are expected to impact adversely upon the development and hence profitability of the industry.

Considerable work has been undertaken into the current and projected feed grain demand and supply in Queensland and Northern New South Wales. One of the key findings of this work was that grain production is highly variable with the likelihood of a grain supply demand deficit to occur in 30 percent of years (Source: APSRU, 2003). With current forecasts indicating a shortage for existing consumers (mainly intensive animal industries), additional demand for feed grain from the ethanol industry will only further contribute to this deficit.

The provision by the Federal Government of an excise subsidy of 38 cents per litre to the developing ethanol industry equates in real terms to an indirect subsidy on the industry's grain inputs of $152 per tonne (Source: Macarthur Agribusiness, 2003). QPPI is concerned this subsidy will adversely affect the pork industry because it will provide a distinct advantage to the ethanol plants as they compete directly for grain.

Trends and factors influencing demand and supply

Consumption

Pigmeat prices, the price of substitute products such as chicken, beef and fish as well as consumer trends are some of the main determinants of pigmeat consumption. Under current food labelling regulations, consumers are faced with significant challenges when trying to identify products either 100% Australian grown or processed foods that are made with 100% Australian grown produce because consumers are unable to make country of origin distinctions at the point of sale. For example the label "Made in Australia" allows for large amounts of imported raw materials to be sold in processed pork products under the guise of being of Australian origin, therefore significant reform is required to country of origin labelling.

Through the Australian HomeGrown initiative, the strong emotional bond identified through research which exists between Australian consumers and farmers who grow their food will be used to inform consumers about whether or not the produce and food products they are buying are genuinely made with 100% Australian homegrown produce.

As mentioned previously, the growing importance consumers are placing upon production systems (ie: safe, clean and ethical) as well as eating preferences (convenience, health benefit, taste) is also influencing pigmeat consumption.

Production

The costs of key inputs as well as a combination of internal and external factors are the major factors which influence the production of pigmeat. Risk management through the development of contractual arrangements and the emergence of buying groups and supply chain alliances are becoming more common. Internal factors which impact upon production include advances in technology and their subsequent uptake. The difficult financial circumstances experienced by producers has partly limited their ability to adopt new technologies. From an external perspective, the main factors which influence production include the pigmeat imports, the exchange rate and global trade relations.

Imports

Volumes of pigmeat imports have increased significantly over the last six years as evidenced by the following figures. For the 12 month period ending August 1998 pigmeat imports were 37 175 tonnes compared to the 12 month period ending August 2004 where imports equalled 64 123 tonnes, an increase of 72% (Source: Australian Bureau of Statistics). At this point in time Canada and Denmark and the two major countries which export subsidised pigmeat into Australia. However under the recently completed import risk analysis for pigmeat, major pigmeat exporting countries such as the United States of America (USA) will be able to export pigmeat to Australia. QPPI is concerned that due to the recently signed free trade agreement with the USA, Australia's quarantine requirements could be compromised through American participation on certain quarantine committees.

Domestic prices of fresh pigmeat are closely linked with the price of imports of frozen pigmeat for manufacturing. Pork imported into Australia is a major input into the production of smallgoods and only 60% of smallgoods are actually produced from Australian ingredients. Even though imports are currently limited to raw material for supply to smallgoods manufacturers, unrestricted subsidised imported pork has become a critical element, which in turn directly determines the prices received by Australian pork producers. The strong correlation between the price of imported frozen pigmeat for manufacturing and the domestic price of fresh pigmeat clearly demonstrates that pigmeat imports cause severe economic harm to the domestic pork industry and consequently a strong case exists for the imposition of safeguard measures.

Exports

Significant gains have been made over the last four years regarding pigmeat exports, particularly to Singapore and Japan. Australia's high health status, proximity to these markets and industry competitiveness across the production and processing sectors appear to be the main reasons for the growth in pigmeat exports. These exports have stalled during the last two years due to the high exchange rate and competition from subsidised frozen pigmeat. For the 12 month period ending August 2002 pigmeat exports were 60 912 tonnes compared to the 12 month period ending August 2004 where exports equalled 51 864 tonnes, a decrease of 17%.

Impact and effectiveness of programs

Government Programs

From a Federal Government perspective, programs which impact upon the Queensland pork industry include FarmBis, Exceptional Circumstances (EC) drought assistance, FarmHelp, Farm Management Deposits, Dairy Regional Assistance Program, research and development funding as well as the Pork Industry Restructure Strategy which contained the National Pork Industry Development Program.

Queensland Government programs, which impact upon the pork industry, include drought assistance and industry specific programs such as business analysis tools and environmental spreadsheets. In April 2001,the Queensland Government launched the *"Queensland Pig Industry Development Strategy"* which identified the investment, growth and export opportunities and potential for the Queensland pork industry. The strategy outlined twelve elements, which would build the industry's supply base as well as create jobs and boost the economy of regional Queensland. Whilst QPPI is supportive of a strategy which aims to develop the pork industry in a sustainable manner, the outcomes from the strategy to date have been very limited.

Opportunities to Improve Government Programs

Significant inadequacies in State and Federal drought policy were once again clearly illustrated during the 2002/03 drought when attempting to apply this policy to modern continuous agricultural production systems such as pork production. These inadequacies are due to the location specific nature of drought assistance, the use of inappropriate criteria, difficulties with the criteria for individual producers as well as the application process required. In terms of EC, there has been a reasonable uptake of assistance (income support payments and interest rate subsidies on existing loans), however the eligibility requirements have excluded larger producers and contract growers, mainly because of their business structure.

Queensland Government drought programs such as the Drought Relief Assistance Scheme are virtually irrelevant because they exclude pork producers and provide preferential treatment to other industries. The recent introduction of the Drought Carry-on Finance Scheme which provides new loans at “reduced rates” has had limited uptake by pork producers primarily because of producer reluctance to borrow further money. It would be of much greater benefit if the assistance provided through these schemes enabled the servicing of existing debt levels. The application of State drought programs to the pork industry is particularly difficult due to the outdated policy approach, which fails to recognise the impacts of drought upon the industry.

Industry Programs

There are industry programs designed to address research and development, quality assurance, natural resource management and marketing issues which producers have been encouraged to actively participate in. In November 2003, QPPI launched a manual titled *Piggery Developments: A Guide to Important Planning and Environmental Issues*. This manual was the first of its kind to be developed in Australia, as it provided pork producers and Local Governments with information on planning and environmental requirements regarding piggery developments. Producer uptake of industry developed environmental workshops has not reached expected targets due to poor industry profitability over the last two years.

Profitability

Industry profitability, particularly over the last two years has become a significant issue due to the increasing volumes of pigmeat imports and the corresponding downward pressure they have placed upon domestic pig prices. In addition to these depressed pigmeat prices, the drought caused feed costs to rise to the highest levels on record, thus further decreasing financial returns to producers. A clear indication of the industry’s lack of profitability over the last twelve months is outlined by figures obtained from a 450 sow multi-site pork production enterprise in Queensland. These figures show that between July 2003 and June 2004, the average cost of production for this operation was $2.26 whilst their average price received per kilogram was $2.14. Over the last two years, many producers have experienced their most difficult period ever, with significant financial losses occurring due to a combination of low pig prices and high grain prices. One long established medium sized piggery has reported that during the 2002/03 financial year, increased grain prices added an additional $140,000 in costs. This producer expects the current 2003/04 financial year will see their business run at a $60,000 loss due to reduced market prices which have been impacted by the benchmark prices set by imported pigmeat. Even though this producer has implemented new industry technology and innovation to their piggery to ensure it meets current welfare, environmental and workplace health and safety standards so that the business remains competitive and viable, continuing damage from imports are significantly threatening the future of this business. The direct and indirect employment generated by this piggery is also under severe threat.

The major costs involved with pork production are feed costs (67.4%), overhead costs (11.2%) labour costs (10%) and herd costs (7.4%), (Source: Australian Pig Annual, 2003). It is therefore clear that any event which significantly impacts upon feed costs will have a direct and significant impact upon the profitability of pork producers. The general increase in costs across all parts of the pork production (including both fixed and variable costs) has also contributed to reduced profitability.

The other key determinant of industry profitability is the cyclical nature of pig prices and the corresponding impact of unrestricted subsidised pigmeat imports upon domestic prices, which has placed producers in an extremely precarious financial position.

Impact of Drought on Profitability

Events such as the drought of 2002/03 have a significant financial impact upon pork producers and hence upon the Queensland pork industry. In so far as drought normally causes feed grain prices to rise (but within the constraint of linkages to export parity), pork producers are impacted by drought irrespective of the location of their piggery. This is due to their heavy reliance upon grain and other annually produced feeds as critical inputs into their business. It is important to remember that during a drought event, piggery production and profit are decoupled from one another because there is an inverse relationship between production and profitability. The location of the Queensland pork industry is in part due to the desire to minimise such risks by being close to supplies of both winter and summer grain crops because it is unusual that both crops would fail in any one year.

Pork producers are normally able to manage the usual swings in pork prices, the effects of imports, and other "competitive issues" in the market place. However it was the extreme duration of high grain prices (30+ months, and record high prices for most feeds for 6+ months) and the corresponding downturn in income which was just too long and deep for normal risk management strategies to work. The first two years of feed price “pressure” were manageable, but onwards from early 2002, further steep rises in feed prices placed exceptional financial pressure on producers remaining in business. Producers were also forced to secure grain from far more distant regions than usual, therefore adding further costs to already high feed costs. For some producers severe losses occurred as feed costs soared to around 80% of sale proceeds, forcing them into further draw down of equity. The major financial implications upon producers from the 2002/03 drought were;

- Dramatic increases in variable costs due to rising feed costs
- Deterioration in cash profit/loss
- Erosion of equity

Apart from higher feed costs, drought also impacts upon the Queensland pork industry due to the creation of difficulties in terms of supply chain relationships, water pricing and availability as well as employment. Drought can cause difficulties with supply chain relationships due to problems with the fulfillment of contracts and or the development of quality issues in terms of both inputs and outputs. The 2002/03 drought presented significant challenges for pork producers due to increased water pricing and reduced water allocations to supplemented systems (eg: irrigation scheme, pipeline, town water or regulated water course). Water availability from unsupplemented systems such as unregulated watercourses, farm dams and creeks also caused significant problems for producers due to reliability of supply.

In late 2003, QPPI in conjunction with Queensland Farmers’ Federation undertook a survey of pork producers in Queensland which examined how drought had impacted upon employment. This survey found that:

- 54% of respondents indicated drought impacted on employment; and
- 30% of respondents had to let staff go as a result of the drought.

Of real concern to the industry is that during drought it is very difficult to retain skilled labour due to financial constraints and usually once they leave the business they will not return, thus leaving a skill shortage within the industry.

Measures to enhance competitiveness

There are Government and industry measures, which if undertaken could enhance the competitiveness of the industry. The Australian pork industry restructure plan focuses upon several key strategies which will lead to a globally competitive industry. These strategies include:

- Increase fresh pork sales through consumer education and product innovation;
- Increase carcase weight in order to reduce costs throughout the supply chain;
- Reduce feed costs through the establishment of Pork Cooperative Research Centre (CRC) as well as encourage improved feed buying practices;
- Create new pricing systems, including long term contract pricing;
- Undertake animal health initiatives to reduce costs and meet consumer demands;
- Build consumer loyalty for 100% Australian smallgoods;
- Implement trade measures to address market distortion.

If implemented correctly, the above strategies will also address the six trends outlined earlier, which are shaping the future structure of the Queensland pork industry. Corruption of international markets and the associated levels of market support will be addressed through trade measures. The establishment of the Pork CRC will help reduce the domestic cost of production and address increasing competition for feed grains through the encouragement of a dedicated feed grain industry as well as through further research into feed grain varieties. The creation of new pricing systems, particularly long-term contracts will assist with the management of a consolidated food retail sector. Whilst the consumer trends of clean, safe production systems and eating preferences in terms of health, benefit and taste will be managed through greater consumer education and product innovation.

Conclusion

The impact of falling pigmeat import prices and increasing import volumes combined with excessive inputs costs (particularly feed grain) has placed extreme financial pressure upon pork producers and the entire pork industry.

The implementation of the strategies contained in the pork industry restructure plan will lead to the required changes to the dynamics of the industry. These strategies must be undertaken in a coordinated and consultative manner and they must be accompanied by Government assistance. Through the immediate introduction of safeguard measures such as quotas or tariffs on pigmeat imports, an opportunity will be provided for the necessary adjustment and realignment of the supply chain to occur.

QPPI also believes a complete review of all Government programs (both State and Federal) is required in order to ensure pork producers are not excluded from these programs due to eligibility criteria which do not take into account the uniqueness of the industry.