|  |  |
| --- | --- |
|  |  |

Overview

# Overview

In this report the Commission assesses whether ‘safeguard’ measures are warranted under World Trade Organization (WTO) rules for Australian producers of processed tomato products. WTO members can take safeguard action when a surge in imports can be demonstrated to have caused, or threatens to cause, serious injury to a domestic industry.

The Commission completed an Accelerated Report which assessed the case for imposing provisional measures before the inquiry was finalised. It found that the requirements for the imposition of provisional safeguards were not met. Since the release of the Accelerated Report, the Commission has further developed its analysis in light of updated data on imports and exports, submissions received from interested parties, and evidence presented at a public hearing.

## Background to the inquiry

Over the past decade, the Australian processed fruit and vegetable industry has undergone substantial change. Several large manufacturers, including Heinz, Simplot, McCain Foods, National Foods (Berri juices), Rosella Group and Windsor Farm Foods have consolidated or closed processing facilities.

SPC Ardmona has been signalling for some time that it faces challenges in maintaining profitability, production and sales levels of its processed fruit and tomato products. It stated in its initial submission to the inquiry that if current trends continue, it will ‘put the viability of the tomato operations under threat’. Specifically, it stated that the continued loss of market share would reduce the value of its Ardmona brand, and that ‘the current and prospective returns to the business do not justify additional capital investment which is required to make the operations competitive’.

In April 2013 these concerns were formally conveyed to the Australian Government in separate written requests for safeguard measures for processed fruit and tomato products. Subsequently, the Australian Government directed the Productivity Commission to undertake the two safeguards inquiries.

### SPC Ardmona also requested other forms of assistance

As well as its requests for safeguard measures, SPC Ardmona requested investigations into whether processed tomato products from Italy and processed peach products from South Africa have been sold in Australia at ‘dumped’ prices. The Anti‑Dumping Commission has made a preliminary determination that some Italian producers of processed tomato products were selling to Australia at ‘dumped’ prices with the dumping margins ranging from negligible to 9.1 per cent. Anti‑dumping duties can be applied by the Minister following the Anti‑Dumping Commission’s final recommendation (due by 30 January 2014). In the interim, from 1 November 2013, the Australian Customs and Border Protection Service has applied ‘securities’ to imports of processed tomatoes made by Italian producers found to have non‑negligible dumping margins. The Commission understands that one of the Italian producers found to have a negligible dumping margin (not subject to provisional dumping securities) is a major supplier of private label products to Australian supermarkets.

As well as seeking measures to reduce the impact of import competition, SPC Ardmona asked the Australian and Victorian Governments for $50 million to upgrade its Shepparton processing facility. At the time of writing this report, a decision on direct financial assistance has not been announced.

### What is a safeguard action?

Safeguard action is temporary, emergency action that may be taken by a member country of the WTO where an increase in imports causes or threatens to cause serious injury to a domestic industry. Measures can take the form of an increased tariff, a tariff–quota or a quota. Any measures, initially, may only be put in place for a maximum of four years and must be liberalised progressively in order to promote industry adjustment to import competition.

Safeguard measures are invoked relatively infrequently. As at October 2013, there were 31 definitive safeguard measures in place across 12 WTO member countries. All of those countries classify themselves as developing countries.

WTO rules set out several criteria that must be met before safeguard measures can be implemented (box 1).

|  |
| --- |
| Box 1 When can safeguard measures be applied? |
| Safeguard measures to assist a domestic industry can only be applied if a number of criteria have been satisfied.   1. Imports must have increased in absolute terms or relative to domestic production. The increase in imports must be the result of unexpected and unforeseen developments and be ‘recent enough, sudden enough, sharp enough and significant enough’. 2. The industry must be suffering serious injury, or such injury must be threatened. In assessing injury, factors such as changes in market share, sales, production, productivity, capacity utilisation, profits and losses and employment must be examined. 3. Increased imports must be shown to have caused, or threaten to cause, serious injury. The impact of other factors must be separately identified and assessed. When factors other than increased imports are causing injury to the domestic industry, such injury shall not be attributed to increased imports.   Safeguard measures normally can apply for up to four years (including any provisional measures), and possibly up to eight years. Measures can only be applied to the extent necessary to prevent or remedy serious injury caused by increased imports and to facilitate adjustment. |
|  |
|  |

#### Anti‑dumping is different to safeguards

SPC Ardmona and other interested parties questioned the Productivity Commission’s finding that provisional safeguard measures were not warranted, given that the Anti‑Dumping Commission found evidence of dumping. Anti‑dumping measures are distinct from safeguard measures, and different tests are applied for the two types of trade remedies. There are two key differences.

* Anti‑dumping measures are imposed to remedy injury caused by import *prices* that are considered to be below the ‘normal’ value of the product, whereas safeguards are imposed to remedy injury caused by a surge in import *volumes*.
* The injury threshold is different. Anti‑dumping duties can be imposed if ‘dumped’ imports are causing or threatening to cause ‘material’ injury to the domestic industry. For safeguards, the test is ‘serious’ injury, which is consistently interpreted as being a more demanding test.

As the two systems are intended to deal with different circumstances, and apply different tests to determine whether measures are warranted, there should be no expectation that a finding that measures are warranted under one system would lead to a similar finding under the other system. Conversely, a finding that measures are not warranted under one system would not automatically lead to the same finding under the other system.

### The scope of the inquiry

The Australian Government has directed the Commission to assess whether safeguard action is warranted against imports of processed tomato products falling within tariff subheading 2002.10.00.60 of the Australian Customs Tariff. The products under reference include prepared or preserved tomatoes in packs not exceeding 1.14 litres. The most common products falling within the classification are retail‑sized cans of whole, chopped, diced or crushed tomatoes.

SPC Ardmona is the only significant domestic producer of processed tomato products that are like or directly competitive with the imported products under reference — the company effectively constitutes the domestic industry (box 2). It manufactures products under its own brands and for supermarket private labels.

|  |
| --- |
| Box 2 The Australian tomato processing industry |
| The Australian tomato processing industry includes the manufacture of tomato pastes, sauces and other products, as well as canned tomatoes. Growers are concentrated in northern Victoria and southern New South Wales. They grow tomato varieties that are suitable for processing, and which differ from tomatoes grown for fresh markets.  The industry is small by world standards, and has consolidated over the past several decades. The number of growers has fallen from 95 in 1993 to 12 in 2013, and the number of processing companies has fallen from at least 14 in 2000‑01 to three (SPC Ardmona, Kagome Australia and Billabong Produce).  Virtually all processing tomatoes grown in Australia are harvested and purchased by Kagome Australia. Kagome mainly produces tomato paste and passata for other food manufacturers. It also supplies raw and diced tomatoes to SPC Ardmona. SPC Ardmona’s processing involves washing, grading, dicing and canning the tomatoes.  Billabong Produce is a small producer located in Jerilderie in New South Wales which grows its own tomatoes. It supplies tomato passata to retail markets, and large cans of diced tomatoes to the food service sector and SPC Ardmona. In 2013, Billabong processed around 4 per cent of the total harvest. |
|  |
|  |

## Have imports increased?

Under WTO rules, safeguard measures can only be imposed if there is clear evidence that imports have increased *either* in absolute terms or relative to domestic production. While a timeframe for the increase in imports is not specified in the Agreement on Safeguards, a rule of thumb that has arisen from the case law is to focus on the last five years for which data are available, and to assess both the trend rate of increase and absolute quantities of imports. The Commission has considered the past five years, but has also looked at earlier data to help it to understand trends in imports of the relevant products.

### Absolute import volumes

In the five years to June 2008, annual imports increased significantly — from about 21 kilotonnes to about 41 kilotonnes (equivalent to a compound annual growth rate of about 18 per cent). However, over the subsequent period under investigation, the rate of import growth was significantly slower (figure 1). Over the five years to June 2013, annual imports increased from about 41 kilotonnes to about 46 kilotonnes (equivalent to a compound annual growth rate of about 3 per cent). In the Commission’s view, this does not meet the standard of a ‘recent, sudden, sharp and significant’ increase in imports, as required under WTO rules.

Figure 1 There has been no recent surge in imports

|  |
| --- |
| This figure shows the volume of imports from July 2003 to September 2013. Volumes are presented as monthly data, moving annual totals and trend lines. Monthly data are variable and range from around 1 kilotonne to around 6.5 kilotonnes. Moving annual totals rise and fall, following the patterns of the monthly data. Over time they increase from around 17 kilotonnes in the year to July 2003 to around 47 kilotonnes in the year to September 2013. The trend lines indicate that imports increased over the ten year period, with the rate of increase slower from July 2008 to September 2013 than for July 2003 to June 2008. |

### Imports relative to domestic production

To assess whether imports have increased relative to domestic production, the Commission calculated the ratio of imports to domestic production (in tonnes) over the period 2009–2013. To preserve the confidentiality of the production data that were supplied by SPC Ardmona, the ratio is presented as an index. Between 2009 and 2013, the ratio increased by about 70 per cent (figure 2). This meets the standard of a ‘recent, sudden, sharp and significant’ increase in imports relative to domestic production.

Figure 2 Ratio of imports to production

|  |
| --- |
| This figure shows the ratio of imports to domestic production for 2009 to 2013 (in calendar and financial years), including a trend line for the financial year ratio. All values are indexed relative to 2009. The ratio was highest in 2010-11. Over the period, the ratio increased by around 70 per cent. |

Although it constitutes sufficient evidence that imports have increased relative to domestic production, this ratio is not a robust indicator of the impact of import competition. It is sensitive to changes in domestic production levels, and to the initial levels of imports and domestic production. In the case of processed tomatoes, the increase in the ratio is explained mainly by the fact that in the first year of the period under investigation, domestic production (the denominator) was already low relative to imports (the numerator). Where this is the case, the ratio will be highly sensitive to changes in domestic production. Although the Commission cannot disclose the confidential production figures, data from Coles, Woolworths and Metcash supermarkets show that the market share of the domestic industry in those supermarkets was about 30 per cent in 2009. The relative levels of domestic production and imports were broadly consistent with this.

Over the five years from 2009 to 2013 domestic production decreased by about 33 per cent. Floods significantly reduced the supply of tomatoes in 2011. Over the same period, imports increased by about 11 per cent. The net effect was that the ratio of imports to domestic production increased by about 70 per cent. About three quarters of the increase in the ratio can be attributed to the reduction in domestic production.

## Is the industry suffering serious injury?

There is compelling evidence that SPC Ardmona’s tomato processing operations have suffered serious injury in recent years. A number of indicators of the injury were identified. Sales of its processed tomato products have decreased, as has its market share across Coles, Woolworths and Metcash supermarkets (figure 3).

Figure 3 Australian processed tomatoes have lost market share

Coles, Woolworths and Metcash supermarkets

|  |
| --- |
| This figure shows the market share and sales volumes of processed tomato products in Coles, Woolworths and Metcash supermarkets, by source (Australian produced or imported) from January 2008 to April 2013. The left panel shows market share by month. The market share of imports increased from around 70 to 80 per cent, while the market share of Australian produced products fell from around 30 to 20 per cent. The right panel shows moving annual totals by month, with the first data point for December 2008. Sales of Australian produced products gradually decreased and sales of imported products gradually increased, while total sales have been relatively steady over the period. |

Confidential evidence indicates that domestic production fell by 33 per cent over the period 2009–2013 (figure 4). Lower production has led to a loss of economies of scale, increasing the cost of producing each can of tomatoes (the increased unit cost of production was driven mainly by increased per‑unit finance charges and indirect expenditures). As a result, the profitability of SPC Ardmona’s tomato processing operations has fallen significantly. The data also indicate that employment in the industry has decreased — the number of labour hours used in tomato processing fell by 47 per cent over the period.

Figure 4 SPC Ardmona’s production has fallen significantly

|  |
| --- |
| This figure shows annual SPC Ardmona production of processed tomato products, with a trend line, from 2009 to 2013. There are no numbers on the vertical axis for confidentiality reasons. Production trended down over the period, with a significant decrease in 2011 due to floods. |

## Has injury been caused by a recent surge in imports?

The Agreement on Safeguards does not specify strict tests for how to evaluate the causes of the injury to the domestic industry. However, WTO law requires that there should be at least, a ‘coincidence of trends’ between the injury and any increase in imports. There has not been a surge in absolute import volumes during the period under investigation. However, the Commission did identify several other trends that coincide with the period of injury and help to explain the reduction in domestic production and consequent increase in the ratio of imports to domestic production.

### The injury coincided with increasing supermarket price competition

SPC Ardmona’s branded processed tomato products are sold at a higher retail price than private label products (including imported products and private label products that are manufactured by SPC Ardmona) and imported branded products. Over the period under investigation, there has been a large and increasing gap between the supermarket unit values of SPC Ardmona branded products and of private label products (figure 5). Initially, the supermarket unit value of imported branded products was only slightly lower than the SPC Ardmona unit value. However, by 2010 the gap was beginning to widen. The increasing gap coincided with decreasing supermarket sales of SPC Ardmona branded products.

Some of the increase in the gap was caused by increased supermarket unit values of SPC Ardmona products. The rest is due to decreased unit values of imports.

Figure 5 The gap in unit values has widened and SPC Ardmona sales have decreased

|  |
| --- |
| This figure shows moving annual averages of unit values (in dollars per kilogram) and the moving annual total of monthly sales in Coles, Woolworths and Metcash supermarkets. There are four series: SPC Ardmona branded products, branded imports, Australian produced private label products and imported private label products. Both panels cover the period from January 2008 to April 2013, with the first data points for December 2008. The left panel shows average unit values. Average unit values for SPC Ardmona branded products increased over the period, while average unit values for branded imports decreased. Average unit values for private label products (Australian produced and imported) increased during 2009 then were relatively steady over the remainder of the period. The right panel shows sales. Sales of Australian produced products decreased and sales of imported products increased. |

### The increased price pressure was not caused by changes in the world market

The key mechanism through which an increase in imports can cause injury to the domestic industry is by driving down market prices. This could happen if a decrease in the world price leads to an increase in imports.

Most processed tomatoes that are imported into Australia are sourced from Italy. The import price of these products, expressed in Euros, has not changed significantly over the past five years (figure 6). This, along with the fact that there was no surge in import volumes, shows that the reduction in the supermarket retail price of processed tomato products was not caused by a significant change in the world market price for processed tomato products.

Some of the increase in the supermarket price gap can be attributed to the appreciation of the Australian dollar. Although the unit value of processed tomatoes did not change significantly when expressed in Euros, the appreciation of the Australian dollar from 2009 led to a significant decrease in the price of processed tomato imports to Australia. Unit values decreased from an average of about $1.40 per kilogram in 2009, to an average of less than $1 per kilogram in 2013. The lower import price gave supermarkets the option to reduce the prices they charge for processed tomatoes.

Figure 6 The appreciating dollar reduced import prices

|  |
| --- |
| This figure shows the moving annual average unit value (in FOB terms) of imported processed tomato products, in Australian dollars per kilo and Euros per kilo, by month. The figure covers the period January 2008 to September 2013, with the first data point for December 2008. In Australian dollars, the unit value rose during December 2009, peaking around $1.40 per kilogram, then decreased steadily over the remainder of the period to around 90 cents per kilogram. The unit value was relatively constant in Euros, at around 70 Euro cents per kilogram. |

### Supermarket private label strategies increased price pressure on SPC Ardmona

Supermarkets have sold private label products for many decades. In recent years competitive developments such as the entry of ALDI into the Australian market in 2001, and the turnaround plan implemented by Coles from 2008 have driven increased use of these products, and increased supermarket price competition. There have also been changes in the way private label products are promoted. Previously, private label products tended to be viewed as low cost and lower quality than branded products. More recently, supermarkets have begun to offer ‘tiers’ of private label products, and they have increased their promotion of these ‘tiers’ during the period under investigation. Some consumers have come to regard some ‘premium private label’ products as close substitutes for branded products.

This strategic decision by supermarkets to increase their offering of private label products has affected the ability of manufacturers like SPC Ardmona to charge premium prices for their own label products without losing market share. Consumers benefit from the increased choice and reduced prices, but private label competition has the potential to reduce the profitability of producers of higher‑priced branded products.

### Floods reduced Australian processed tomato production

Flooding around the tomato growing areas of Victoria in the 2010‑11 growing year reduced the quantity of processing tomatoes harvested by approximately two‑thirds, and SPC Ardmona’s production decreased significantly. This coincided with increased sales of imported private label products in Coles, Woolworths and Metcash supermarkets, and lower sales of Australian branded and private label products and of imported branded products.

Sales of domestic private label products have not recovered to their pre‑flood levels. It is clear that the floods caused significant injury to the domestic industry, and that the injury has persisted as domestically produced products have failed, as yet, to regain market share even after production levels recovered in the following years.

### Exports have decreased over time

Exports of Australian processed tomatoes have decreased significantly over the past five years, coinciding with the appreciation of the Australian dollar (figure 7). This has likely caused injury to SPC Ardmona through decreased production volumes, sales, revenues and profits. However, the extent of any injury caused by reduced exports is likely to have been small, because exports have constituted a relatively small proportion of SPC Ardmona’s total sales.

Figure 7 Exports of processed tomatoes have collapsed

|  |
| --- |
| This figure shows the volume of exports of processed tomato products from July 2004 to September 2013 as a moving annual total of monthly exports. In volume terms, exports peaked in financial year 2005 06 and have fallen steadily since, with the lowest volumes occurring in 2012 13. |

## Have the criteria for safeguards been met?

In this report, the Commission has concluded that the WTO requirements for the imposition of definitive safeguard measures have not been met. While absolute imports have not increased in a sudden, sharp or significant manner during the period under investigation, domestic production has fallen significantly. This has caused an increase in the ratio of imports to domestic production that passes the test in the Agreement on Safeguards.

The domestic processed tomato industry is suffering serious injury. However, the injury was caused by other factors, including domestic competitive pressures emanating from decisions made by supermarkets, the appreciation of the Australian dollar and floods in the tomato growing regions of Victoria.

The Commission has concluded that for the products under reference, definitive safeguard measures are not warranted.