

SUBMISSION BY THE AUSTRALIAN MEAT INDUSTRY
COUNCIL

TO

**PRODUCTIVITY COMMISSION INQUIRY INTO
THE PIG MEAT INDUSTRY**

OCTOBER 2004

INTRODUCTION

The Productivity Commission (PC) is conducting an inquiry into Australia's pig meat industry. In announcing the inquiry, the Government has stated that it understood the pork industry's concerns about the current economic difficulties being experienced by producers as a result of a combination of factors, including the drought, increasing import volumes, a higher Australian dollar and lower domestic prices. The Government is concerned about the current economic situation facing the industry - particularly as it relates to regional employment and the need to ensure a sustainable and vibrant Australian pork industry.

The inquiry, to be completed within 5 months, will look at issues such as competitiveness and profitability, as well as the pig meat industry's future prospects. It will investigate the pigmeat industry's current situation and outlook, and whether there is a need for any additional government and industry measures to enhance the industry's competitiveness.

This submission is provided by the Australian Meat Industry Council, which has as members many of Australia's manufacturers of smallgoods that use both Australian and imported pig meat.

THE AUSTRALIAN MEAT INDUSTRY COUNCIL

The Australian Meat Industry Council (AMIC) represents all companies and employers in the post farm gate meat industry. These include abattoirs, boning rooms, smallgoods manufacturers and retail butchers. AMIC has approximately 2,500 members in all states and territories of Australia.

The sector classified as "smallgoods" is characterised by a small group of large processors each employing over 300 persons and many smaller processors down to independent butchers who make a limited range of sometimes specialised product.

AMIC has 89 members nationally classified as "smallgoods" with approximately 4,000 employees.

The smallgoods sector has a member-elected National Smallgoods Council which meets quarterly to decide on policy and direction on industry issues.

The National Smallgoods Council has a subsidiary Technical Committee made up of the Technical Managers of member companies which considers and advises on a range of issues relating to smallgoods processing including imported pig meat.

Because the smallgoods sector is represented by a relatively small number of companies AMIC is in a unique position to seek the opinions of the decision makers on important industry issues and represent those members while protecting the commercial interests of the individual companies.

Consultations within the smallgoods sector by AMIC have resulted in a variety of views on the competitiveness issues facing the Australian pigmeat industry. Owing to the diversity of the sector and the views produced, it would be unreasonable to expect a single view to emerge of what should be done to improve the industry's competitiveness. Nevertheless a number of relevant issues have been identified through these discussions, which AMIC believes are of value to the Commission's Inquiry.

RELEVANT ISSUES FOR THE INQUIRY

The pork industry

Key facts about the pork industry are:

- Around 2,600 pork producers in Australia producing some 5 million pigs annually. The number of pig farms has reduced from 5800 ten years ago. The average herd size and slaughter weight has increased however.
- Exports are now valued at over \$228 million per year compared to \$24 million in 1997, mainly reflecting new markets in Singapore resulting from disease outbreaks in Malaysia. Around 20% of production is exported. Exports have been adversely affected by the high \$A and impact of the drought on feed prices.
- Imports are around 58,871 metric tonnes, valued at \$213.8million. They have increased by nearly two-thirds in recent years.

- Imports have come to account for the majority of the leg market which is the premium market for Australian pig producers, and for a substantial share of the middles market. Increased imports serve to limit the potential for producers to pass on cost increases resulting from drought and other factors, and have undoubtedly contributed to the poor profitability prevailing in the growing and processing sectors of the industry.

The smallgoods sector

Little statistical information is available on the smallgoods sector apart from information contained in the 1999 PC Inquiry Report.

Key features from that report include:

- There were around 140 bacon, ham and smallgoods manufacturers with a turnover of \$1240 million. The four largest firms produced 40% of the turnover but the majority was small enterprises.
- Pork represents anywhere from 40-80% of the smallgoods sector's meat input. The industry is characterised by a high level of domestic consumption, low levels of exports, and low volume sales of a large number of product items.
- Few pork products were imported and hence competition was with Australian substitute products. Relatively few imports of smallgoods were considered likely, owing to factors such as relatively short shelf-life.
- The PC considered that if the cost of a major input – pigmeat – rises owing to the imposition of safeguards on imports, the cost of supplying ham and smallgoods would also rise. A higher price would reduce consumption, leading to a contraction of the smallgoods sector. Consumers would also be worse off, paying higher prices and consuming less smallgoods.
- The PC felt that if imports of smallgoods were to expand, the smallgoods sector could suffer a double whammy, being hit by higher costs for pork and more competition from imports of smallgoods.

Competitiveness challenges faced by the pig meat industry and the smallgoods sector

Current situation facing the pig meat industry

There is little doubt that the Australian pig meat industry is facing serious challenges. In recent years, apart from normal cyclical ups and downs, it has had to cope with a terrible drought. It has been subject to low returns, increased competition from imports, and a stalling in export market growth.

Moreover it is apparent that the underlying situation facing the industry is not improving. Imports appear to be growing relentlessly, exports have not provided the solution to the industry's problems that was first thought by many, and whilst there has been a reduction in drought-induced high feed prices, profitability for much of the industry appears to be under continuing pressure.

Every stage of the pig meat value chain is under considerable profitability pressure. Australian Pork Limited say that the number of registered producers have fallen from 3,480 in June 2001 to 2,859 in June 2003 - a 17.8% reduction. It appears that returns have fallen further in the past year.

There appears to be substantial excess capacity in processing. Returns are depressed and investment has ceased. Smallgoods manufacturing is under continuing price pressure from supermarkets and is having to undertake new distribution arrangements which add to costs.

The role of imports in the pigmeat industry and the smallgoods sector

There is little doubt that the significant increases in imports, mainly leg hams from Canada and middles from Denmark, have helped to keep prices of pig meat in the domestic market down. Australian pig producers and processors have undoubtedly been adversely affected by import competition.

It should be noted that the impact on smallgoods producers is somewhat complex. For example, the mix of imports, especially Canadian leg pork imports, affects the amount of trim available from domestic pigs for use in smallgoods manufacture. Indeed this has led to imports of trim from Canada to augment domestic supply. This helps to illustrate the point that imports have become a key component of Australian smallgoods sector production.

Smallgoods producers import legs, middles as well as some trim, for manufacturing into smallgoods such as hams and bacon, sausages and salamis. (There are also some imports of manufactured smallgoods themselves, but they are not significant.) Imported pig meat forms part of the raw materials used by smallgoods manufacturers to produce their products. It is not known what proportion of total raw material supply is accounted for by imports. However pig meat imports have become a key part of the means by which smallgoods manufacturers operate.

Pig meat imports provide smallgoods manufacturers with a means of remaining viable in supplying the major retail chains. For example, some retail supply arrangements have forced smallgoods manufacturers into more expensive distribution arrangements, and this affects returns to manufacturing. Imports can play a key role in reducing raw material costs and maintaining smallgoods profitability.

However a few factors must be recognised in addressing the issue of imports:

- Not all Australian pig meat is more expensive than imported product. Legs in particular, are surplus products in Canada and are often sold cheaply on export markets. The pig industries of Canada and Danish industries can be subject to protection and subsidies too.
- The smallgoods industry in Australia is by no means indifferent as to the fate of Australian pig meat production and processing. Indeed smallgoods manufacturers have supported the industry by paying above-import prices on occasions, but cannot do this on a sustained basis if they are to remain viable. Smallgoods manufacturers have a vested interest in maintaining a viable pig production and processing industry in Australia because imports cannot supply the total needs of the sector. For example, imported trim cannot be used to make fresh sausages in Australia because all imported product has to be cooked on arrival or offshore.
- Owing to the important role played by imports in the smallgoods sector, in the event that imports are restricted to assist the continued viability of the pig production and processing sectors, assistance will need to be provided to the smallgoods sector to ensure it is not adversely affected.

Future development of the smallgoods sector

The smallgoods sector needs to improve its competitiveness irrespective of any action which is taken to improve the competitiveness of other sectors of the pig meat industry. In particular:

- There needs to be increased investment in smallgoods manufacturing, especially investment in modern technology. Many of Australia's smallgoods manufacturers need to upgrade their technology, plant and equipment, but the returns are inadequate to justify such investment. There is a lack of investment incentives to encourage this process.
- The potential for exports of smallgoods from Australia needs to be realised, and appropriate investment and Government support needs to be provided. Exports have not provided the solution to the industry's problems to date. It is also important to appreciate the linkages between pig exports and imports – for example, to supply Japan bigger pigs are required. However the Japanese market does not require legs, so these remain in Australia, and have been hit by the competition of low-priced Canadian leg imports. This adversely affects the profitability of producing pigs for export to the Japanese market

Other issues

- Pricing of pig meat products. There is concern among smallgoods manufacturers about the substantial volatility in pig meat prices which adds to uncertainty in the industry. Arrangements do not appear to have been developed to minimize volatility and reduce uncertainty.
- More broadly, there is concern that the pricing of pig meat has not been optimized – that it is perceived by consumers as a cheap meat, and opportunities for obtaining premiums are not being realised. As an example, when bacon prices have risen substantially on past occasions there appears to have been little adverse reaction from consumers in terms of purchasing habits.
- Feed grains – by far the major cost factor in pig production is feed. There appears to be a wide-spread view that Australian producers are not obtaining feed grains at export-parity prices. This needs to be fully and independently investigated in order to improve the competitiveness of the pig meat industry as a whole.

- There is a lack of up-to-date information available on the smallgoods sector. Such data needs to be assembled and used as input into development of an industry-wide strategy for the pig meat industry. That strategy needs to take into account the competitiveness needs of all sectors of industry, and the results of all the independent reviews recommended in the course of this submission.

Recommendations

1. *Owing to the important role played by imports in the smallgoods sector, in the event that imports are restricted to assist the continued viability of the pig production and processing sectors, assistance will need to be provided to the smallgoods sector to ensure it is not adversely affected.*
2. *The smallgoods sector needs to improve its competitiveness irrespective of any action which is taken to improve the competitiveness of other sectors of the pig meat industry.*
3. *There needs to be increased investment in smallgoods manufacturing, especially investment in modern technology. Investment incentives are needed to encourage this process.*
4. *The potential for exports of smallgoods from Australia needs to be realised, and appropriate investment and Government support needs to be provided.*
5. *There needs to be an independent review of the way in which pig meat is being marketed in Australia, encompassing the arrangements for supply, volatility in pricing, perceptions of the product by consumers, and realisation of price premiums.*
6. *The competitive pricing of feed grains to the pig industry needs to be independently reviewed.*
7. *There is a need for updated statistical information on the smallgoods sector and the need for an industry-wide competitiveness strategy for pig meat.*