

**Opportunity for further comment on  
Australian Piguemeat Industry**

**Draft Report**

**Productivity Commission, 2004**

**January, 2005**

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**NSW Farmers' Association Background**

The NSW Farmer's Association (the Association) is Australia's largest State farmer organisation representing the interests of over 13,000 farmers – ranging from broad acre, meat, wool and grain producers, to more specialised producers in the horticulture, egg, pork, oyster and goat industries.

## **Executive Summary**

NSW Farmers' Association views the Commissioner's multi-focal strategy as delivering competitiveness over the long term only. The pig industry has rapid cash flows which require immediate improvements in market conditions only obtainable through government intervention.

The Commission has focused on these long term strategies, however this is difficult to reconcile with the long term outlook for agricultural sectors faced with negative incomes resulting from Government ignoring the wellbeing of all players in the supply chain.

The productivity gains made over many years have not been rewarded by an increased share of the domestic market as imports continue to rise. Furthermore the industry risks losing elements of that restructure as assets lie part completed, or underutilised.

NSW Farmers' Association identifies two trading disparities, a domestic grain market distorted by the single desk exporting strategy and a domestic pig meat market distorted by foreign subsidies. This disparity is a direct consequence of Government policy.

Three factors work to reduce productivity in the pig industry, subsidised imports, drought and the \$AU exchange rate. NSW Farmers' Association believes drought and the value of the \$AU are trigger points for temporary Government intervention on imports.

### **Drought**

Many pork producers are currently producing at marginal cost and they have high debt to equity ratios from assets sunk in infrastructure and are disadvantaged by high input costs.

#### *Recommendation 1*

- *Federal Government and the Rural Assistance Authority (RAA) in NSW recognize that pork producers are considered livestock producers and therefore should qualify for EC if they are located in an EC declared area.*
- *Government agrees that regional impacts need to be demonstrated in either the region in which the property is located, or the region from which the main production inputs are sourced.*
- *The criteria of severe financial impact continue to be considered as either severe downturn in income, or severe increase in costs of production. This principle is fundamental given the inherent differences in production systems and management options between intensive and broad acre industries.*

### **Labour shortage**

Once retrenched employees leave for larger regional centres or Sydney there is little incentive for them to return.

#### *Recommendation 2*

- *It is recommended that where experienced workers face retrenchment, the government to pay the employee the equivalent of unemployment benefits, with the pork producer responsible for contributing the balance of the wages, superannuation and entitlements.*

**Feed grain price**

Many pork producers are unable to withstand the high cost of feed with the presence of imports. As a major customer of the grains industry the livelihood and survival of the pig industry plays an important role in the future of the grain farmers.

*Recommendation 3*

- *There is a need for a system of grain supply to be put into place that will deliver to livestock producers the major input they need at competitive world prices and give a fair return to grain farmers.*

**Domestic resource cost**

Australia's pork competitiveness from the standpoint of productivity includes issues such as the costs of labour, energy, land transportation, shipping and government services. There are also questions of government regulation of the industry, taxation, tariffs and the availability and cost of capital.

*Recommendation 4*

- *Australian Governments to reduce taxes and charges to allow pork producers to earn a higher and more consistent return on capital so as to provide adequate funds for expansion and to avoid obsolescence of technology and equipment.*
- *Government to accelerate all aspects of microeconomic reform especially the industrial relation reform to ensure that the combination of costs and labour productivity is not unfavorable in comparison with overseas competitors.*

**Regulation**

Overseas pig industries have gained advantage by adopting varying environmental standards which compounds the difficulties for Australian producers from multi-layered ad hoc domestic legislation.

*Recommendation 5*

- *Bureaucratic delays for approvals of extension of existing piggeries and new projects should be reduced and changes to conditions during their currency avoided.*

**WTO Safeguards**

Since 1998 the industry has responded to the call of global competition, however, imports continue to rise despite these efforts and with the interaction of drought and the high exchange rate of \$AU it is unlikely that investment will continue in the industry at the same rate.

*Recommendation 6*

- *NSW Farmers' Association request that the Productivity Commission recommend an investigation into the Provisional Safeguards under WTO rules.*

**Anti-dumping and countervailing legislation***Recommendation 7*

- *The Government commit to a prompt review of its anti-dumping and countervailing legislation.*

**Statistical and Cost Benefit Analysis**

Finally, in order for the Commission to satisfy the industry that its findings can be adopted with confidence and enable full implementation of the Australian Pork Limited endorsed restructure plan, the Productivity Commission must address the NSW Farmers' Association concerns over the following:

*Recommendation 8*

- *The lack of statistical analysis demonstrating which of import, exchange rate or feed cost affects significantly (in statistical terms) to productivity within the industry.*

*Recommendation 9*

- *The lack of Cost Benefit Analysis in regards to the impact on productivity of each measure considered by the Productivity Commission.*

**Production Technology and Capital Investment**

The Commission in its Draft report stated that "Capital investment in the infrastructure used in the pig producing and pig processing industries can lead to improved productivity". The Association agrees with this view but would like to highlight that due to negative return in the industry, capital investment in new technology is not occurring at the rate required to remain competitive in the long term.

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# 1. Summary comments on draft findings of the Commission

## Australian markets

### Finding 2.1

Pig producer numbers in NSW have rationalised, with greater production from those remaining (yet total NSW production declining). However, the occurrence of two droughts within 10 years has forced an increasing number of NSW pig producers to **diversify their farming system in order to manage risk** – ie. fluctuations in demand for pig meat, to manage risks in other enterprises, to manage grain price fluctuations and now to manage the risk of imports lowering domestic price. Such diversification generally includes grain production to augment purchased feed, however this and purchase of other livestock **diverts capital from pursuing economies of scale.**

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### Finding 2.2

NSW Farmers' Association agree that the pig meat market is global and that NSW producers keenly feel the market fluctuations from disease reducing global supply and subsidies reducing global price. It must also be remembered that **the domestic grain industry should also belong to the global market**, however the domestic grain market is now proven to be distorted by the Government endorsed single desk marketing during drought (mid 1990s and 2002/3). Pig meat was exposed to competition yet grain as the major input was without competition. This is the first major trading disparity.

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## Competitiveness

### Finding 3.1

NSW Farmers' Association confirms that many NSW producers made a loss during 2002/03 and with many breaking even during 2003/04 due to an easing of grain prices.

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### Finding 3.2

Fluctuations in feed prices and exchange rates are likely to continue. These have a compounding effect on the more profound and ever present impact of greater volumes of imports reducing domestic prices over long periods. NSW Farmers' Association views drought (affecting feed price) and exchange rates (affecting export volumes) as **trigger events** for implementation of intervention programs to provide temporary relief from imports. Exchange rates were not found by the Commission to be consistently related to the volume of imports suggesting overseas subsidies are a sufficient buffer against the \$AU for importers.

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### Finding 3.3

Decoupling of subsidies from production levels will improve the competitiveness in the global market however this is a long term objective – **there is no immediate sign of reform of world subsidies** while the Australian Government follows free trade policies. This is the second major trading disparity. NSW Farmers' Association judges that actual prices for imported and domestic pig meat are not important while subsidies persist as imported product is persistently cheaper. This apparent dumping of product cannot be absorbed by such a small domestic market. As a result **Australian achievements in efficiencies are not rewarded by increased domestic market share.** If continuing decline in markets share persists there is small incentive for the industry to make further efficiency gains.

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*Finding 3.4*

Restructuring of the domestic industry and of each pig producing enterprise is only one component of a many faceted strategy for improving global competitiveness as no single component will be effective over the short and long term and in all enterprise scenarios. NSW Farmers' Association also perceives that producers will become **increasingly sensitive to the risk of a negative return on investment in any technology necessary for competitiveness.**

**Impediments to competition**

*Finding 5.1*

NSW Farmers' Association supports the ongoing efforts of the Government in reducing trade barriers under WTO rules. If fair global trade in inputs and product existed, the pig industry would successfully compete and would not be seeking help. The Government is selective in its support for fair trade on the domestic front providing significant interventions for ethanol, sugar and grain while exposing the pig industry to injurious foreign subsidies. The Governments policies in relation to fair trade are the root causes of the pig industry's problems.

*Finding 5.2*

Increasing global competition does benefit consumers, retailers and manufacturers, however all externalities must be included in a cost benefit analysis. It is likely, as regional production of pig meat declines and abattoir capacity is underutilised, and when other agricultural products are affected by global competition that **regional unemployment will rise, requiring long term government intervention.** Furthermore, if users of a subsidised product are changing the domestic market in a way that requires a more dramatic restructure (which is beyond the reasonable capability of producers to achieve in a short time frame), **the reliability of the domestic based supply is questioned.** Lastly the Commission has focused on strategies which will deliver productivity in the longer term, however this **is difficult to reconcile with the long term outlook for agricultural sectors faced with negative incomes resulting from Government ignoring the wellbeing of all players in the supply chain.**

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*Finding 5.3*

NSW Farmers' Association agrees with the description of the effect of drought on the price relationships between the domestic and export grain. There are potential increased prices for other end consumers/users of grain as a result of these relationships, however the Commission limited its description to the impact on consumers from pig meat.

*Finding 5.4*

Reducing regulatory impediments may have a small effect on improving competitiveness across the industry however the combined effect of many small interventions can produce significant change. Therefore NSW Farmers' Association **supports multiple mechanisms to achieve competitiveness.**

**Improving competition**

*Finding 6.3*

Temporary relief from pig meat imports triggered by specific domestic events (eg drought) would provide short term benefits to producers *and processors*. A producers business risk assessment using projections of diminishing demand for higher priced domestic product

and a fluctuating export demand yet with the knowledge of some **short term relief is exactly the low risk climate under which investment in technologies and restructure will occur**. If relief were to continue when all compounding domestic events had subsided it is agreed that *ongoing* restructure would be discouraged.

## **2. Information requests**

The Association is surprised that the call for additional information is so extensive and the Association is concerned that the Commission has made its findings in the absence of this information.

### ***2.1 Impact of drought on pig meat producers, and on the impact and effectiveness of drought assistance programs***

During the recent drought, pig farmers feed costs increased by 50-70% pushing many of them out of business. ProFarmer (10/41) reported that domestic prices for wheat exceeded export parities by up to \$40 tonne in October 2002.

The average pig cost of production using wheat prices of \$350/ tonne was \$2.00/kg live weight, which translated to \$2.66/kg Hot Standard Carcass Weight. This represented an increase in the average Pig Cost of Production of 29.9% between January 2001 to December 2002.

In the middle of drought an average pig farmer marketing a load of 120 pigs a week was losing between 10 – 15 cents a kilogram which translated to \$1, 000 - \$1, 400 per load or a monthly loss of close to \$6, 000.

Many pork producers are currently producing at marginal cost. Added to this is the high sunk cost of infrastructure and relatively high debt ratios well in excess of other livestock farming. The majority of pork producers can be classified as monoculture or at least have less choice of production options than many other livestock production systems. This means that the recovery from drought is often more difficult for pork producers and risk of foreclosure is high, eg. since the 1995 drought close to 500 pork producers have left the industry.

### **Effectiveness of Drought Assistance Program**

All intensive livestock industries are severely impacted by drought, yet most are unable to access assistance due to current Exceptional Circumstances eligibility criteria as follows:

- The EC criteria and assessment processes have been designed with broad-acre farmers more in mind, not catering for the inherent differences in production systems and management strategies employed by the pig industry to cope with drought. For example, the impact on pig industry is predominantly on costs of production rather than immediate income effects, as farmers will continue to produce to service debt given their existing high capital outlay. Additionally the pig industry cannot simply de-stock because the re-entry costs and timeframes are prohibitive and regaining market access and contracts is difficult if not impossible.



- Some pig farms are located around metropolitan and regional areas, which are not drought – declared and/or the impact of drought is not as evident yet their cost of inputs still rises. The flow on effects of drought conditions in NSW, especially in relation to grain and water costs, should not be underestimated. If Exceptional Circumstances remains the mechanism of providing support during severe drought then immediate changes are needed to EC eligibility criteria to enable access by pork producers.

#### **Recommendation 1**

- **Federal Government and the Rural Assistance Authority (RAA) in NSW recognize that pork producers are considered livestock producers and therefore should qualify for EC if they are located in an EC declared area.**
- **Government agrees that regional impacts need to be demonstrated in either the region in which the property is located, or the region from which the main production inputs are sourced.**
- **The criteria of severe financial impact continue to be considered as either severe downturn in income, or severe increase in costs of production. This principle is fundamental given the inherent differences in production systems and management options between intensive and broad acre industries.**

## **2.2 Retention of skilled rural workers**

Drought impacts on all members of rural and regional communities. Farm workers, non-farm rural business, as well as down stream producers and their employees are all directly and financially affected by drought. In the current drought, recognition of the impact on agriculturally dependent businesses has been given with some new assistance measures introduced e.g. Small Business Interest Relief Rate Program in December 2002.

Consideration has also been given during this drought to ways of retaining farm workers in a community when producers can no longer employ them because of drought. Employees who are out of work often move in search of employment. Once they leave for larger regional centres or Sydney there is little incentive for employees to return. This loss is felt by rural employers and communities alike.

In December 2002 the Federal Government introduced a Work for the Dole – Drought Force program in response to the concerns about retaining rural workers. While the pig industry was pleased the Federal Government recognized this issue, it believes this scheme is mis-targeted because the only way for a farm worker to access assistance under these work for the dole arrangements is for their employment to be terminated.

#### **Recommendation 2**

- **It is recommended that where experienced workers face retrenchment, the government pay the employee the equivalent of unemployment benefits, with the pork producer responsible for contributing the balance of the wages, superannuation and entitlements.**

**2.3 Factors affecting Feed Prices and possible methods of reducing and/or stabilizing those costs**

During the last decade there has been a steady increase in the use of grains in the domestic market, with nearly all of the increase in demand coming from the livestock industries. The growth in demand highlights the importance of the linkages that exist between the livestock and the grain industry. However this relationship appears not to be fully understood by the government with its protectionist policy for the grain industry.

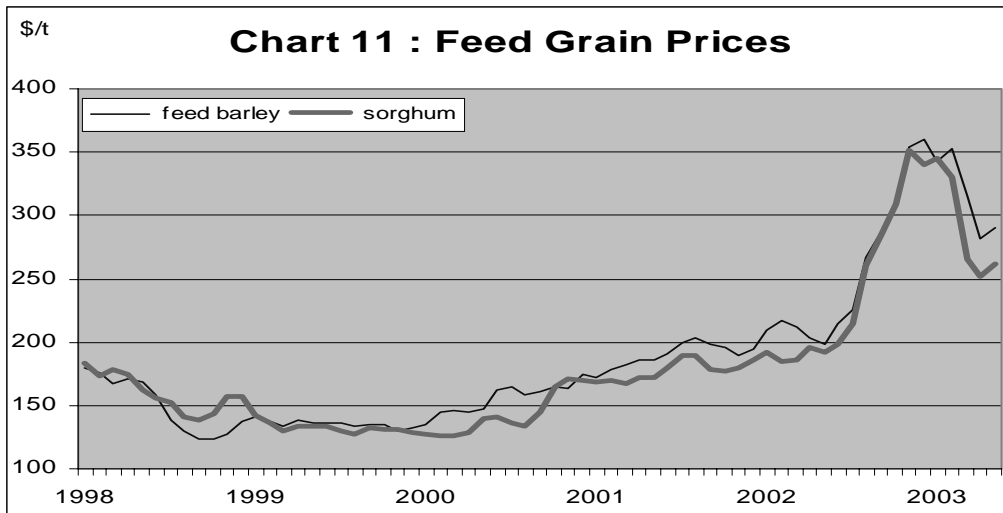
For instance, the pork industry is forced to bear the cost of the current wheat marketing arrangements without provision for the impact on its own competitiveness in domestic and international markets. By failing to address this problem, the government puts at risk the prosperity of not only the pork producers but also other livestock producers who depend on grains for livestock production and thousands of other people in rural and regional Australia through further job losses.

**Grain Prices**

While grain prices subsequently declined in late 2004, they increased by close to 94%, from \$180/tonne prior to the on-set of drought to \$350/tonne in November 2002. This pushed the price of feed up by around \$127/tonne.

Pork producers have struggled with the impact of the explosion in the cost of feed, and have sought to reduce costs across their operations to stay profitable. However, prices have started falling since some of the intensive industries started importing grains. This instantly capped the feed grain market as shown in Figure 1.

**Figure 1: Feed Grain Prices 1998 - 2003**



Source: ProFarmer, The Land

Many pork producers are unable to withstand the high cost of feed especially without a corresponding increase in the price of pork and pork products. Small to medium size pork producers have had no option but to de-stock their farms while others have closed down completely. In excess of 5000 sows have been culled to date in NSW.

Therefore the issue for the pork industry is not that the single desk is retained or abandoned but that the Government addresses the impact on domestic grain users of any price premium through regulations that they have granted. The industry acknowledges that any removal of the single desk system cannot guarantee domestic and export price parity either during drought or not.

As a major customer of the grains industry the livelihood and survival of the pig industry plays an important role in the future of the grain farmers. Total feed grain usage by the intensive industries has grown by almost 100% since 1992/93 to 10.92 million tonnes in 2001/02. The pig industry's usage of grain has increased by 35% from 1.57 million tonnes to 2.13 million tonnes over the same period. ABARE's Feed Grains Projections (July 2003)<sup>1</sup> reports that demand for feed grains is expected to rise significantly over the next five years with total feed grain supply increasing only slightly, prompting regional shortages especially in northern New South Wales, southern Queensland and northern Victoria. The shortage would impose increasing costs on producers. Further, there are strong prospects for pork industry growth to supply domestic and export markets. The government's recent assistance package for ethanol plants will further distort the operations of the domestic feed grain market.

Any distortions in the feed grain market will reduce the pork industry's capacity to expand exports and its ability to attract investment to build the critical mass.

### **Single Vision for the Australian Grains Industry**

The Single Vision strategy was released by the Grains Council in March 2004.

The Single Vision grain industry strategy has three primary objectives<sup>2</sup>:

- For the Australian grains industry to become more economically and environmentally sustainable
- For the wealth generated by the grains industry to build prosperous and vibrant rural communities
- To increase the grain producers' share of the 'grain dollar' from the current 19% to a minimum of 25%.

In relation to the third objective it is very likely that grain prices in the domestic market will increase over the years. If this happens, locally produced pork will find it that much more difficult to compete internationally and in the domestic market with heavily subsidised pork imported into the country.

### **World Feed Grain Situation and Price Outlook**

As highlighted earlier in the report, pork prices depend to a large extent on the grain production situation and price. The following figures give a brief account of projected world grain prices made by the Food and Agriculture Policy Research Institute (FAPRI) of the Iowa State University, USA<sup>3</sup>.

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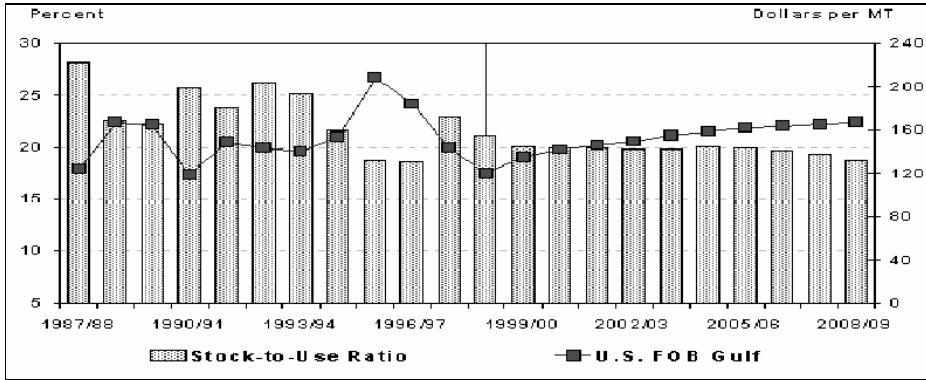
<sup>1</sup> Connell, P. and Hafi A. 2003, *Feed Grains: Future Supply and Demand in Australia*, ABARE, Prepared for the Grains Research and Development Corporation, Canberra.

<sup>2</sup> Australian Government, GRDC. 2004, *Towards a Single Vision for the Australian Grain Industry 2005 – 2025*.

<sup>3</sup> World Agriculture Briefing Book 1999, Food and Agriculture Policy Institute, Iowa State University.

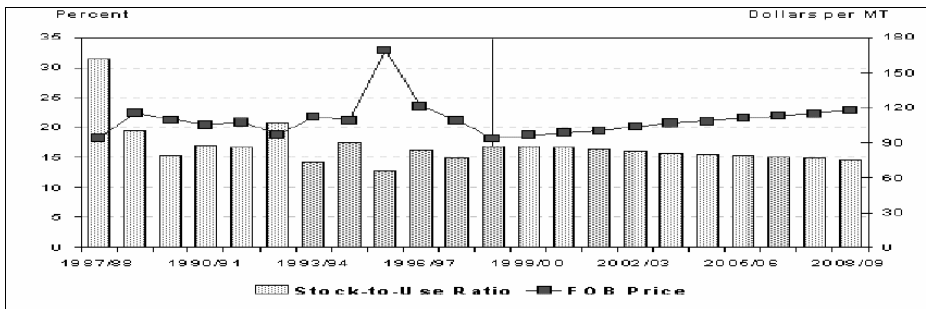
The projection shows that as the global stocks to use ratio falls it places an upward pressure on prices. Consequently, most feed grain prices are projected to increase steadily in the medium term to 2008/9. The pork cost of production is therefore likely to increase in other countries as well. However the cost increases in relation to pork exports from the exporting countries will be cushioned by the various agricultural subsidies prevailing in those countries as shown in Figure 4 below.

**Figure 2: World Wheat Stock-to-Use Ratio vs. Price**



Source: Iowa State University, Food and Agriculture Policy Research Institute

**Figure 3: World Corn Stock-to-Use Ratio vs. Price**



Source: Iowa State University, Food and Agriculture Policy Research Institute

In view of the proposed increase in the grain producers' share of the 'grain dollar' from the current 19% to a minimum of 25% and the projected increase in the world grain prices making it uneconomical for the pork producers to import grains, the issue of competitive access to domestic feed grains will be crucially important in influencing the growth prospects of the industry over the next decade.

### **Recommendation 3**

- ***There is a need for a system of grain supply to be put into place that will deliver to livestock producers the major input they need at competitive world prices and give a fair return to grain farmers.***

#### **2.4 Key potential impediments to improving competitiveness, and on options to address those potential impediments (including the feasibility of such options, the role for industry and government, and the possible benefits and costs of implementation).**

### **Competitiveness in Context**

Banse et al. (1999)<sup>4</sup> argue 'no single measure or definition of competitiveness has gained the universal acceptance of either economists or management theorists.' The various definitions put forward have come about as a result of the concept of competitiveness being applied to different organizational setup (firm, sector/industry, region and state) and measured using an array of measures (balance of payments, market share, costs, job creation) (Banse et al. 1999).

Porter (1990)<sup>5</sup> claims that 'the only meaningful concept at the national level is national productivity.' Likewise, Krugman (1994)<sup>6</sup> also questions the usefulness of the concept at a national level.

However the most widely quoted definition of competitiveness is one which has been adopted by the European Commission. It defines competitiveness as the ability of a country to increase its share of domestic and export markets where '... a country has a comparative advantage in a product when it can produce at a lower opportunity cost than other countries' (European Commission, 1993)<sup>7</sup>.

We believe there are two main factors underlying international competitiveness. The ability to compete in international markets depends on price competitiveness or on product quality. In the former case, long run competitive advantage depends on securing a lower comparative cost structure (Porter, 1990). A differential strategy based on product quality will be successful where customers are willing to pay a premium for higher or more uniform quality, branding or service (Porter, 1990).

### **International Competitiveness**

The growing globalization of the world economy has increased the importance of sectors that are predominantly trade-oriented - such as agriculture - maintaining their competitiveness in both domestic and overseas markets. This is particularly the case given the high levels of support that are offered by many overseas countries to their traded goods sectors. For example, Figure 3 shows agricultural producer support levels for Australia and a number of other agricultural producers.

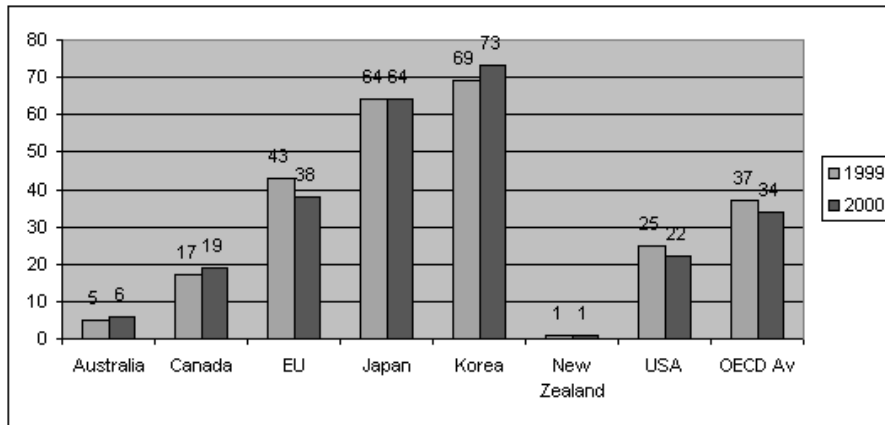
<sup>4</sup> Banse, M., Gorton, M., Hartell, J., Hughes, G, Kockler, J., Mollman, T. and Munch, W. (1999), 'The Evolution of Competitiveness in Hungarian Agriculture: from Transition to Accession', paper presented at *The IXth European Congress of Agricultural Economists*, Warsaw, Poland, 24<sup>th</sup> – 28<sup>th</sup> August.

<sup>5</sup> Porter, M. (1990), *The Competitive Advantage of Nations* (New York: The Free Press).

<sup>6</sup> Krugman, P. (1994), 'Competitiveness: a dangerous obsession', *Foreign Affairs*, **73**, 2, 28-44.

<sup>7</sup> European Commission (1993) *Economie européenne: rapport économique annuel pour 1993* (Brussels).

**Figure 4: Producer Support Estimate<sup>8</sup> for Agricultural Sector in Australia's Major Trading Partners**



Source: The Department of Agriculture, Fisheries and Forestry – Australia, Fuel Taxation Inquiry, Submission 342.

The above shows that the level of support in the OECD as a whole was around 34% of gross farm receipts - more than five times Australia's support level. Those countries which compete with Australia in world agricultural markets - with the exception of New Zealand - have significantly higher support levels, ranging up to more than 60% in Japan and Korea.

### Domestic Resource Cost

One measure of international price competitiveness is the domestic resource cost (DRC) ratio. The DRC compares the opportunity costs of domestic production to the value added it generates (Tsakok, 1990)<sup>9</sup>. The numerator is the sum of the costs of using domestic primary resources - land, labour and capital (non-internationally traded inputs) valued in terms of shadow prices. The denominator is the value-added (value of output minus tradable input costs per unit of output) in border prices. When the DRC is smaller than 1, domestic production is efficient and internationally competitive, because the opportunity cost of domestic resources is smaller than the net foreign exchange it gains in export or saves by substituting for imports (Gorton et al. 2000)<sup>10</sup>.

The opposite is true when the DRC is larger than 1. However, it should be noted that DRCs are sensitive to the choice of shadow prices for non-tradable inputs and to the choice and changes in exchange rate and international prices.

Hence Australia's pork competitiveness is discussed in the above context and from the standpoint of productivity which includes issues such as the costs of labour, energy, land transportation, shipping and government services. There are also questions of

<sup>8</sup> Producer support estimate is an OECD indicator of the annual monetary value of gross transfers from companies and taxpayers to agricultural producers, measured at the farm gate level, expressed as a percentage of gross receipts.

<sup>9</sup> Tsakok, I. (1990), *Agriculture Price Policy: A Practitioner's Guide to Partial-Equilibrium Analysis* (Ithaca: Cornell University Press).

<sup>10</sup> Gorton, M. Davidova, S. and Ratering, T. (2000), The Competitiveness of Agriculture in Bulgaria and the Czech Republic vis-à-vis The European Union, *Comparative Economic Studies*, **42**, 1, 59-86

government regulation of the industry, taxation, tariffs and the availability and cost of capital. While we have a good record in a few of these categories and a number of pork producing and processing companies have generally made a positive effort to improve productivity, but there are still some important areas that need urgent attention to make the industry more competitive.

The industry has been very conscious of the cost of production and has continually looked at all of the factors that affect the cost; a number of the important ones are highlighted above.

Not only should the local costs be examined but also those of competitors, both in the production of the raw materials and in processing. The countries of particular or potential importance in the first connection are chiefly: Denmark and Canada.

In a second category are those countries with significant resources in pork production, (US, EU, Brazil, Chile, Hungary, Korea, Mexico, New Zealand, South Africa, Taiwan and Philippines) except perhaps similar disease status as Australia. All of these countries have applied to export pork to Australia.

While we do not have up to date figures from our competitors to make a meaningful comparison of our competitiveness, the following have been highlighted by pork producers as potential impediments to improving productivity and competitiveness.

#### ***Recommendation 4***

- ***Australian Governments to reduce taxes and charges to allow pork producers to earn a higher and more consistent return on capital so as to provide adequate funds for expansion and to avoid obsolescence of technology and equipment.***
- ***Government to accelerate all aspects of microeconomic reform especially the industrial relation reform to ensure that the combination of costs and labour productivity is not unfavorable in comparison with overseas competitors.***

#### ***General Labour***

The important point is that Australian skilled or semi-skilled labour costs, even allowing for productivity improvements, are far higher than those of our principal competitors.

The detailed analysis of labour costs and productivity, though difficult, is of much interest, it is clear that Australia's future competitors are most likely to have labour costs well below ours and that there is very little what the industry can do to alter the position. The industry is of the view that there is little scope to reduce labour on-costs significantly without fundamental changes in taxation and national savings policies.

The current labour market arrangements are complex and costly and inhibit the adoption of more flexible work policies. Continuing reforms in Workers Compensation, Payroll Tax, Superannuation and Work Cover are necessary to facilitate more productive and competitive workplaces.

### **Skilled Work Force**

There is evidence that the industry is short of highly skilled management level workers and skilled labour at production level. The industry is also facing shortages of semi and unskilled workers. This needs to be addressed if the industry is to improve its competitive advantage in the next decade.

### **Fuel**

Recent increases in world oil prices and a slide in the value of the Australian dollar against the US dollar have led to unprecedented rises in the price of petrol and diesel.

The Australian Bureau of Statistics (ABS) surveys a large number of farm enterprises on an annual basis in its Agricultural Finance Survey. It produces among other things data showing farm business finances for the average Australian farm.

Figures for 1998-99 show that the average Australian farm spent \$12 600 for fuel in that year. This figure includes payments for petrol, diesel, LPG and lubricants. This is a cash figure and does not include subsidies. It represents 8.1% of total farm purchases and selected expenses. In 1997-98 Australian farms spent an average \$11 900 on fuel representing 10.3% of total farm purchases and selected expenses<sup>11</sup>.

Every year Australian Bureau of Agricultural and Resource Economics (ABARE) surveys Australian dairy and broadacre farms. As a result it produces financial, physical and socioeconomic information representative of over 70% of Australian farms.

In 1998-99 the average Australian broadacre farm spent \$11 115 on fuel, oil and grease. This represented 6.8% of total cash costs. Average farm fuel, oil and grease expenditure ranged from a low of \$6775 in the beef industry (representing 5.5% of cash costs) to a high of \$20 940 in that year in the wheat and other crops industry (7.9% of total cash costs)<sup>12</sup>.

Comparative figures in the US and UK are much lower as shown below.

"The oil price is creating a greater cost of production burden for farmers this year. We're talking about an increase of 1 to 2% in our production cost," said American Farm Bureau Federation senior economist Terry Francl<sup>13</sup>

"Farm production expenses in 2000 are expected to be up 3.5% from 1999 with fuel and wages expected to increase the most", Gregg Ibendahl, UK Extension Agricultural Economist<sup>14</sup>.

### **R&D in Value-adding**

In the longer term, the availability of suitable graduates is of concern not only in the production side but also in the implementation of new technology through research and development. With the passage of time, the technology necessary for finding better solutions to reducing cost of production and further processing will gradually become obsolete and non-competitive and it must be updated.

<sup>11</sup> Baker, G. (2000), 'Farm Fuel Cost', *Research Paper no.12*, Department of the Parliamentary Library, 2000-01.

<sup>12</sup> Baker, G. (2000), 'Farm Fuel Cost', *Research Paper no.12*, Department of the Parliamentary Library, 2000-01.

<sup>13</sup> Steever, T. (2000), 'High Fuel Cost', *The Voice of Agriculture*, American Farm Bureau Federation.

<sup>14</sup> Ibendahl, G. (2000), 'Rising Fuel Prices Drive up Farm Production Expenses', College of Agriculture, University of Kentucky.



Research and development in the pork industry is conducted for the following reasons

- to improve existing processes to maintain competitiveness,
- to improve existing products to create differentiation as a marketable quality,
- to produce better or cheaper products,
- to initiate products new to Australia but with accepted markets elsewhere,
- to modify and improve purchased technology,
- to evaluate potential technologies prior to buy-in or adoption, thereby minimizing risk,
- to undertake environmental impact assessments for improved environmental protection.

R&D is of particular concern in the further processing and value adding of the pork output and it plays a progressively larger part as the product moves closer to its final marketable form. There is evidence that many of the sources of new technology accessed by Australian industry in the past are no longer available. Furthermore, the in-house R&D effort within the industry and its equipment suppliers has been considerably curtailed over recent years. It will be increasingly difficult for the pork industry to obtain a continuing stream of innovative technology from these sources to help it remain competitive.

However, the pork producers are fortunate that, for decades, those divisions of CSIRO and departments in Universities and other education institutions with responsibilities and interests in livestock have generally maintained close relationships with the pig industries. They have mostly been comfortable with the alignment of their research activities with business aims. Both sides have supported the "facilitating" bodies such as the Pork Council of Australia and its successor Australian Pork Limited.

Overall, the pork industry has developed a unique publicly- and industry-funded research infrastructure in the husbandry, disease, product development and nutrition areas. More recently government has approved the establishment of the Pork Cooperative Research Centre with the overall objective of making the industry internationally competitive. The funds will be utilised to carry out research to reduce cost of production for high quality pork through more reliable, consistent and innovative grain production and through better feed conversion efficiencies.

### **Environment and Regulatory Issues**

The cost of environmental controls has a bearing on competitiveness.

Since environmental standards are not determined by international consultation, the pork industries located in other countries have gained advantage by adopting varying environmental standards.

Regulatory issues are regarded as any government action which, either directly or by financial inducement, encourages business to alter their commercial behavior. All levels of government - Commonwealth, State and local - take part in the regulation of the pork industry, often without coordination and with frequent and sometimes ad hoc changes. This has resulted in a bewildering mish-mash of regulations.

**Recommendation 5**

- ***Bureaucratic delays for approvals of extension of existing piggeries and new projects should be reduced and changes to conditions during their currency avoided.***

**2.4 Production Technology and Capital Investment**

The Commission has reported in its draft report that "Capital investment in the infrastructure used in the pig producing and pig processing industries can lead to improved productivity".

The Association agrees with this finding. However the reality of the situation is due to the declining return coupled with uncertainty of future returns, producers are unable and/or reluctant to invest in new technology and infrastructure.

Figures reveal that over the last three years capital expenditure at QAF Meat Industries (the largest pig producing company in NSW) has not occurred at budgeted level due to negative returns. No significant investment has taken place at the company since 2002. This has been the general trend in the industry.

The details of lack of capital investment at QAF is highlighted in Attachment 1.

**3. Multifaceted approach to achieving competitiveness****3.1 Strategy**

The draft report canvasses a multifaceted approach to achieving competitiveness in the pig meat industry including the Australian Pork Limited restructure plan. The approaches that were considered impact on:

1. Volume of product produced per unit cost through achieving economies of scale (sow numbers, litter size and carcass yield).
2. Cost of inputs through buying alliances, vertical integration, streamlining legislation and increasing grain price competitiveness.
3. Value of outputs through product labelling, contractual arrangements, appropriate payment for yield, pursuance of antidumping measures and temporary safeguards from imports.

**3.2 Omission of Provisional Safeguards from the recommended draft strategy**

Since the Productivity Commission report into Safeguards (Pig and Pig meat Industries: Safeguard Action Against Imports, November 98) imports have more than doubled, Australian pig meat exports have more than doubled, the production per producer has increased, the number of producers has decreased, and average pig meat prices and cost of production has increased. Given the massive change in this industry without it being able to gain a competitive position domestically, a second review into Safeguards is needed.

The Commission's 1998 report found serious injury caused by imports however there were constraints to recommending provisional safeguard action under WTO rules. These included the lack of incentive to restructure when it was urgently needed. Since that time the industry has responded to the call of global competition through rationalisation and consolidation, growth in exports, closer links between growing and processing and quality improvements. However, imports continue to rise despite these efforts and with the interaction of drought and the high exchange rate of \$AU it is unlikely that investment will continue in the industry at the same rate.

The Commission in its 2004 report promoted an apparent causality by drought and the exchange over the effect of imports on Australian pig producers. However NSW Farmers' Association sees all 3 elements as being important. It is the fact that **imports are continuing to rise beyond the competitive capacity of Australian producers that gives concern.**

A comparison of the levels of subsidies listed in the Commissions report has indicated that large operators in NSW could effectively compete with USA and Canadian pork with export parity grain prices. However, the 24% Danish subsidy is calculated to be beyond reach of such operators.

The Commission does not provide an analysis of the case for or against provisional safeguard actions under WTO rules as per its Terms of Reference. However, the draft report discusses possible ramifications from using safeguards.

The 2004 report states that such measures would assist any producer regardless of whether they are profitable. Conversely, the report of 1998 states that the effects would not necessarily be enjoyed uniformly across individual pig farms but rather the distribution of benefits within the industry would be determined by domestic competition. NSW Farmers' Association believes that producers are on the path to restructure and are accepting that competitive producers would reap the benefits of temporary safeguards and enable them to continue to invest in restructure.

A second argument from the Commission against safeguards is that it is a disincentive to restructure. NSW Farmers' Association views the protracted risk exposure in this industry as an immediate disincentive to further uptake of technology and provisional safeguards would enable a risk free climate to invest.

The third argument from the Commission is that other sectors will pay more (consumers, manufactures and retailers). NSW Farmers' Association is extremely concerned with the championing of consumers household budgets at the expense of those of Australian farmers. With the importation of product subsidised to the extent of 24% (EU subsidies), Australian consumers, retailers and manufactures are not paying any where near the cost of production and are distorting the domestic market.

Additionally, continued downturn in the regions of NSW supplying the domestic market will affect the broader regional community. Table 1 shows statistics in the Federal electorates supplying the domestic market.

**Table 1 Social snapshot of Federal electorates supplying domestic market**

% of Electorate	Riverina	Parkes	Page	New England	National average
Unemployment	6.4	7.9	12.8	8.9	7.4
Youth unemployment (15-19yrs)	15.2	17.7	22.8	20.8	16.7
Persons with no qualifications	59.6	61.1	58.9	58.8	53.8
Persons of indigenous origin	3.4	8	4	5.4	2.2
Families with weekly income below \$500	25.1	31	36.1	31	23.7
Persons employed in agriculture	15.4	18.3	9.5	15.7	4

Source: Information and Research Services (2003)<sup>15</sup>

**Recommendation 6**

- **NSW Farmers' Association request that the Productivity Commission recommend an investigation into the Provisional Safeguards under WTO rules.**

**3.3 Analysis of the proposed strategy**

NSW Farmers' Association views the proposed strategy presented by the Commission as delivering over the long term and is concerned by the absence of anything that can increase the competitiveness of the industry in the short term. The pig industry has rapid cash flows which demand immediate improvements in market conditions only obtainable by government intervention.

**3.3.1 Economies of scale through restructure**

The Australian pork industry is unable to achieve the scale of Canada and the USA due to the lack of a specialised and subsidised feed grain industry or of Denmark due to the absence of subsidies. This leaves Australian producers and processors as niche product suppliers in the global trade of pork seeking economies of scale only sufficient to support this market (eg carcass weights increase to meet demand in exports).

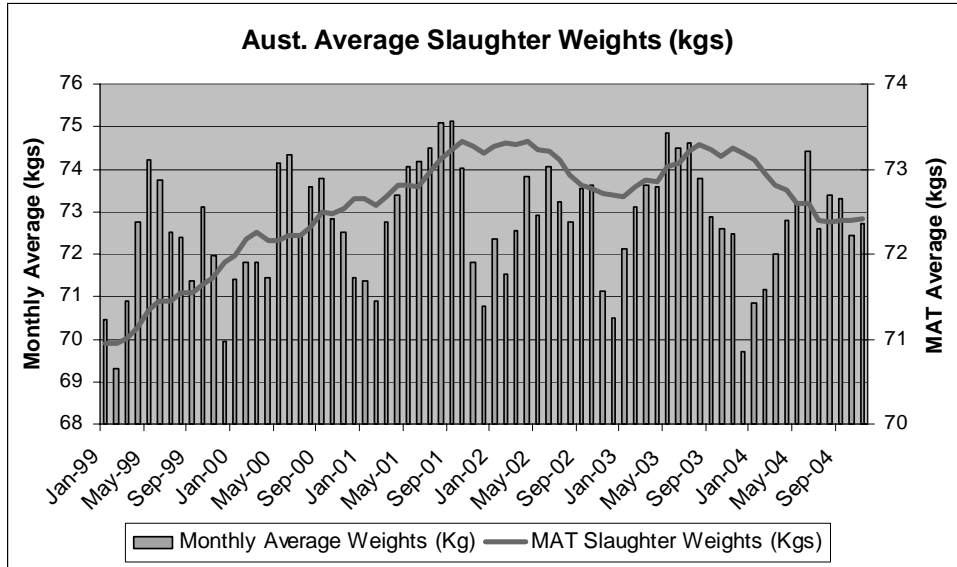
Economies of scale require significant investment which has been stalled in recent years. Examples of this are - postponement of threefold expansion of sow numbers calculated as a saving of 5c/kg in cost of production; postponement of new facilities mid construction creating dead capital since 2001; postponed upgrade calculated as a 5c/kg saving in cost of production.

The environmental impact requirements of the Development Application process will necessarily constrain scale while producers are unable to invest in environmental management technologies with low pigmeat prices, falling domestic market share and fluctuating export volumes.

<sup>15</sup> Information and Research Services (2003). Electorate Rankings: Census 2001, Research Paper No, 2 2002-2003. Department of the Parliamentary Library, Canberra

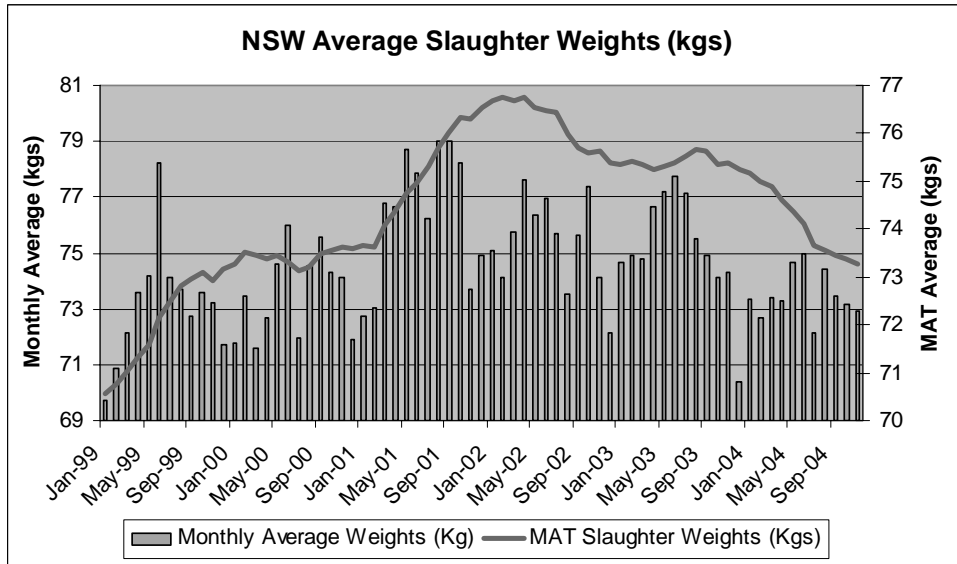
An increase in carcass weight is desirable as per the Australian Pork Limited restructure plan however NSW Farmers' Association realise that the volume of export trade in the short term will remain the determiner of carcass size. Additionally, the preference for small carcasses by the domestic trade may take some years to influence thus it is likely that the industry will seek of smaller carcasses and some regions or states may specialise in filling that requirement (Figures 5 and 6).

**Figure 5. Australian average slaughter weight**



Source: APL November 2004 Pork Production Report

**Figure 6. NSW average slaughter weight**



Soucre: APL, November 2004 Pork Production Report

### 3.3.2 Reducing cost of inputs

The impact of buying alliances will be constrained by the regional spread of producers within NSW as transport costs between regions can offset purchase price gains. Their collective buying power declines as each producer exits the industry and as turnoff per farm declines; these factors are currently occurring in NSW.

Vertical integration of large scale operations (which can more effectively manage greater consistency of product) with processors and exporters is seen by NSW Farmers' Association as a more profitable strategy than for the smaller scale producers. Thus the impact of vertical integration as a competitive strategy is limited while large scale producers remain few in number.

Streamlining of legislation is likely to take several years, moreover, animal welfare, environmental and food safety legislation will have to provide the community with greater confidence. This will be given through expensive on farm risk management systems in which the industry will only invest during times of foreseen profit.

Grain prices are difficult for pigmeat producers to manage if capital is not available for sinking in grain storage and long term grain contracts are difficult to obtain. Industry wide strategies which ensure access to globally competitive feed grain must be pursued. It is untenable for the pig industry that in contrast to the market for its output, its major input (nearly half the cost of production) cannot be sourced in open competition.

The Commission did not adequately justify why it concluded that changes to competition in the grain industry would not have a significant effect on productivity, given grain is the most significant input cost (70%) during times of drought. For example, we estimate that for each \$100 rise per tonne of grain adds 23c/kg to the cost of production. For a 200 sow piggery the productivity during drought would have decreased by \$84,562 over 6 months which is directly attributable to the cost differential between grain at export price (\$180/tonne) and AWB Nov 2002 price (\$350/tonne). NSW Farmers' Association finds the Commissions conclusion incongruous with the facts it published.

### 3.3.3 Increasing the value of pigmeat

The HomeGrown initiative will penetrate some market share however NSW Farmers' Association sees the success of cheap product marketed in supermarkets<sup>16</sup> and views product labelling as an expanding niche over the longer term.

Contracts with larger producers are a more attractive commercial arrangement, as is the case with vertical integration, however, they tend to be short term thus provide only limited risk management for the industry. While contracts do give some stability in price to producers but the volatility in the feed grain market and other input costs are such that entering into a long term contract with one processor is not considered as the best approach to risk management. Such agreements would lead to lost opportunities of increased prices in future.

Managing supply of pigmeat to spread risk is not possible in the form of a rapid response. As has been said in previous submissions, producers are captive suppliers with an inability to hold product from sale when it reaches marketable quality. Therefore producers are forced to trade at a loss. Their response to demand has a 40 week time lag.

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<sup>16</sup> Spencer S, 2004. Price Determination in the Australian Food Industry, A Report, Australian Government Department of Agriculture, Fisheries, Forestry, Canberra.

There is potential to replace the current payment system with that based on Carcass Value Technology 2 (CVT2) measurement which is better reflective of carcass yield and thus will more accurately reward producers and improve the quality consistency of product. This measurement is however still in the evaluation stage with its application to the payment system yet to be developed. This is hoped to be implemented by the end of this decade.

APL's second submission to the Productivity Commission<sup>17</sup> analysed the limitations of the *Customs Act 1901* which, with other anti-dumping and countervailing laws, were acknowledged by the Commission to be in need of review. Such a review would occur at best over the medium term and would be subject to National Competition Policy. As such there is little likelihood of short term relief for pig producers as a sufficient body of evidence to satisfy anti-dumping legislation is difficult to build.

***Recommendation 7***

- ***The Government commit to a prompt review of its anti-dumping and countervailing legislation.***

***Recommendation 8***

- ***The lack of statistical analysis demonstrating which of import, exchange rate or feed cost affects significantly (in statistical terms) to productivity within the industry.***

***Recommendation 9***

- ***The lack of Cost Benefit Analysis in regards to the impact on productivity of each measure considered by the Productivity Commission.***

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<sup>17</sup> Australian Pork Limited, 2004. APL Submission 2, Productivity Commission Australian Pig Meat Industry Public Inquiry.

## **Conclusion**

The government has made policies that strive to meet the needs of those consumers high up the supply chain by ensuring adequate price competition. This is applied to pig meat with great effect as manufacturers, retailers and consumers access product not only subsidised by Canadian and European tax payers but also subsidised by Australian pig farmers. The Government is however selective in its application of this philosophy, as the purchasers of feed grain cannot access a highly competitive grain market.

The Australian pig farmers' exposure to risk is increased on two fronts directly as a result of government policy. This situation is iniquitous and unsustainable.

The industry has responded to the calls for restructure relying on the incentive that productivity would deliver sustained market share, however the Government has underestimated the interacting effects of rising imports, drought and the exchange rate. The industry can-not meet the cost of continued restructure as it contracts yet it must restructure for the long term. If Government policy pursues fair competition in grain and pig meat, the industry can evolve.