

# Safeguards inquiry into imports of Processed Tomato Products

## Submission by Senator Bridget McKenzie, July 2013

### Executive Summary

- Australia's tomato growers who supply the SPC Ardmona cannery are facing financial ruin. Thirty years ago, 400 tomato growers supplied seven canneries. Today, seven growers supply a single cannery.
- Australia's canned tomato industry is threatened by a sudden and sustained surge in low cost imports, particularly over the past year. In the year to 2011-12, the quantity of canned tomato imports rose by 48 per cent. Italian processed tomatoes now outsell their Australian competition by a ratio of four cans to one.
- The European Union has protected its processed tomato industry with subsidies since 1978. From 1992 until 2002, Australia fought the dumping of cheap Italian tomatoes by charging the importers duties. But in 2002, an importer legally challenged the federal government over the measures and won.
- There is a significant link between a strong and sustainable food industry and employment opportunities in rural and regional areas. Employment in the agricultural sector in the Greater Shepparton and Upper Goulburn Valley areas totals over 7,200 jobs (2011 Census), representing around 10.8% of overall employment across these regions
- With a localisation of industry in the Goulburn Valley the importation of low cost goods is proportionally higher amongst the factories, businesses, farmers and workers supplying industry in that region.
- A crucial aspect of Australia's membership of the World Trade Organisation is recognition that within that framework and following formal investigation, the safeguard mechanism can be applied following to prevent or remedy serious injury.
- To address the negative effect of the flow of cheap imports Australia needs to pursue safeguards as a matter of urgency.

## Introduction

Australia is the world's 6<sup>th</sup> largest agricultural exporter and enjoys a first-rate reputation as a 'good citizen' in terms of adherence to the WTO rules governing global agricultural trade. Our agricultural industry receives minimal assistance from the Australian taxpayer, unlike many other countries. Indeed, assistance to the entire Australian agricultural sector in 2011/12 was less than the level of assistance provided by the European Union to its tomato and fruit growers and canned processing industry.

The long-run economic viability of Australia's agricultural sector is critical to the health of Australia's regions. Economically healthy regions provide for the benefits of demographic diversity and dispersion, underpin our national food security objectives, and generate necessary export income. For all these reasons, our agricultural industry should remain a national priority.

Australia's canned tomato industry is currently confronting an existential threat from a sudden and sustained surge in low-cost imports, particularly over the past year. In turn, Australia's tomato growers who supply the SPC Ardmona cannery are facing financial ruin. While Australia's agribusinesses and food manufacturers have long faced healthy competition from abroad unaided by large taxpayer subsidies, the rapid market penetration of subsidised Italian canned tomatoes is threatening the immediate and longer term financial sustainability of the industry and the tomato growers that supply the SPC Ardmona cannery in Shepparton, Victoria.

As a World Trade Organization (WTO) Member, Australia has made binding commitments in relation to the trade of goods and services. A crucial aspect of the WTO framework is the safeguard mechanism, which can be applied, following formal investigation, to prevent or remedy 'serious injury' to an import-competing industry resulting from unforeseen import surges in relevant markets. As recently reinforced by the Chairman of the Productivity Commission (see Hansard, Senate Legislation Economics Committee, 6 June, p. 79), there is a legitimate role for member countries to utilise the safeguard mechanism where justified. Indeed, the temporary measures offer a means to actively pursue liberalised global trade with some recourse to address exceptional market circumstances.

The current market environment clearly warrants a detailed assessment and we welcome the Productivity Commission's investigation into this important matter.

The focus of this submission is to highlight the acute financial challenges being faced by the processed tomato industry given the dramatic influx of low-cost imports which have flooded the Australian market. We discuss these challenges, and their attendant issues, in areas being examined by the inquiry and where specific information is being sought by the Commission.

## Industry context

### *A brief history of canning in Australia*

The food canning process was invented in the 1790s in Europe and by the 1840s a small canning factory had opened in Sydney. By 1869, manufacturers in Queensland were exporting over one million kilograms of canned meat each year. In Victoria, around Shepparton, SPC produced 430,000 cans of fruit in 1917 and in 1925 Ardmona's first year of canning produced nearly 3 million cans of fruit. Edgell & Sons first began canning asparagus in 1926 at Bathurst and Heinz & Company began producing baked beans in tomato sauce at Richmond, Victoria in 1935.

During World War II the Australian canned food industry expanded rapidly and new products, such as cauliflower, brussel sprouts and whole tomatoes were canned. By the 1980s dozens of canning companies operated throughout Australia and produced over 1,000 different types of canned foods for the Australian market and for export ([www.cannedfood.org](http://www.cannedfood.org)).

However, in recent years there have been a number of cannery closures. In 2011, SPC Ardmona closed one of its factories in the Goulburn Valley that produced mainly canned tomatoes and tomato paste. And Heinz closed its tomato processing factory at nearby Girgarre in 2012, shifting operations to New Zealand.

### *Current State of Play*

The Australian canned tomato industry has been under pressure from lower-priced foreign imports for a number of years, but the situation has become acute in the past 12 months. Thirty years ago, 400 tomato growers supplied seven canneries. Today, seven growers supply a single cannery. In the year to 2011-12, the quantity of canned tomato imports rose by 48 per cent.

Italian processed tomatoes now outsell their Australian competition by a ratio of four cans to one. A 400gm tin of Italian canned tomatoes often sells for between 80-99 cents at the major supermarkets, undercutting SPC Ardmona by 40-60 cents. As a result, the industry is now at a tipping point where further falls in production volumes will, by definition, destroy any remaining economies of scale and accelerate the demise of the industry.

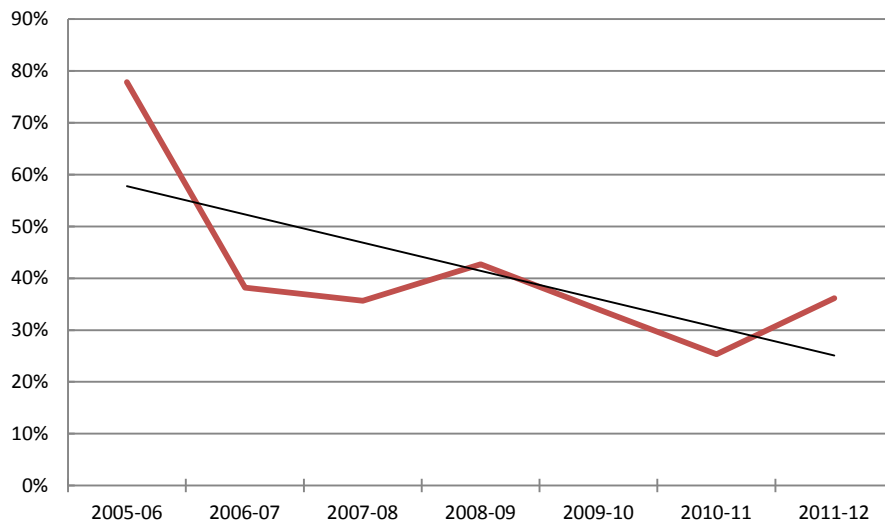
While we acknowledge the economy-wide benefits of lower prices for consumers, a key issue is: *are the Italian producers playing by the rules and, hence, are their prices sustainable?* In this regard, we note that the European Commission will review subsidies to European agricultural production next year with an objective to increase efficiency in the industry. There would be no economy-wide welfare gain if the local industry were to shut down only to see the price of imports rise because of further subsidy reform in Europe.

Because the local industry is highly concentrated in the Goulburn Valley, the consequences for the regional economy are particularly dire should current market circumstances persist. The range of suppliers and other dependent businesses is considerable. Moreover there is a significant link between a strong and sustainable food industry and employment opportunities in rural and regional areas. The local economic and social repercussions if the factory shuts down are likely to be considerable and should be a key consideration of the Commission's inquiry.

### *The international picture*

Three countries (Italy, the United States and Spain) account for more than 90 per cent of world exports of canned tomato products. Italy in particular has benefited from substantial industry protection in the form of direct subsidies to producers, cheap (and sometimes illegal) labour from North Africa and Eastern Europe and lower industry standards and regulatory burden.

Over the past 6 years, the locally produced share of the market has declined from almost 80 per cent to less than 40 per cent (Chart 1). Over the same time period, imports of canned tomatoes from Italy have doubled as a share of total imports from 44 per cent in 2007 to 88 per cent in 2012.

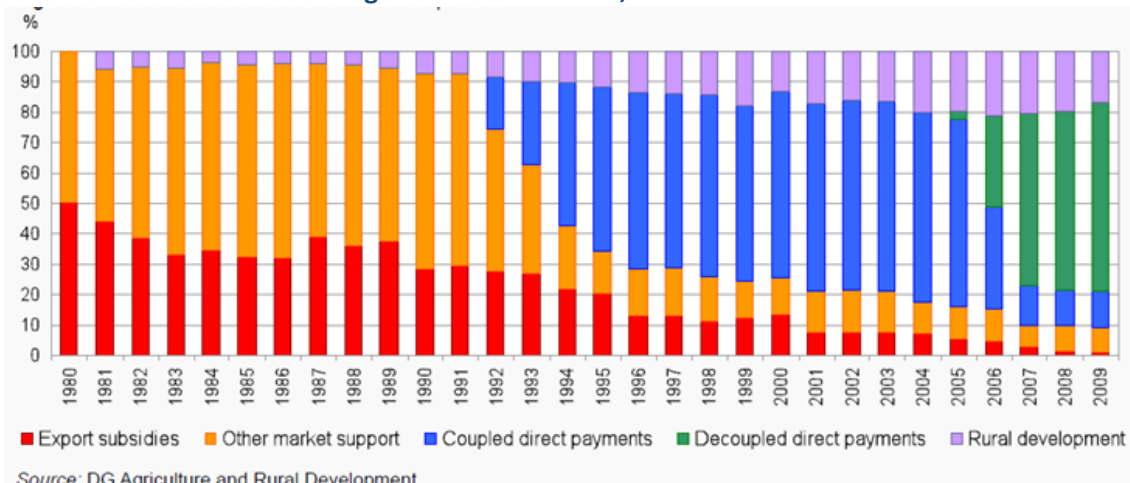


Source: ABS, trade data at the Standard International Trade Classification (SITC) level 5.

Despite ongoing reform to its Common Agricultural Policy (CAP), the European Union continues to subsidise tomato growers and processors with an array of border measures and direct domestic production and income subsidies. This policy severely distorts global trade patterns for processed tomato products to the detriment of Australian tomato growers and processors.

The figure below demonstrates that while the delivery mechanism for industry support in Europe has changed, the fact is that industry subsidies remain and are harming Australian producers. In order to accord with WTO rules, industry support in the EU has changed from direct subsidies to products to direct subsidies (income support) to producers. This is the green bar in the chart below.

**Chart 1: Evolution of EU agricultural assistance, 1980-2009**



The European Union has protected its processed tomato industry with subsidies since 1978. While annual payments to farmers and canneries have peaked, they remain substantial and globally distorting. From 1992 until 2002, Australia fought the dumping of cheap Italian tomatoes by charging the importers duties. But in 2002, an importer legally challenged the federal government over the measures and won.

The Australian Customs Service has previously found that both the production aid system and the export refund system in the European Union fall within the definition of a specific subsidy under section 269TAAC of the Customs Act and Articles 2 and 3 of the World Trade Organization Agreement on Subsidies and Countervailing Measures (ACS, *Canned Tomatoes from Italy, Statement of Essential Fact No.66*, p.10).

#### *The Australian Dollar*

The strength of the Australian dollar has further exacerbated the competitive disadvantages of the local industry. While there is no doubt that a floating exchange rate has served Australia well in terms of delivering macroeconomic stability, it is widely considered that the Australian dollar is currently over-valued as it has de-linked from the decline in our terms of trade (that is, our commodity prices have fallen but our dollar has not fallen by as much). This means, that our exchange rate is probably higher in the short-term than what it should be, hurting our exporters – and, potentially killing off our processed tomato industry before the exchange rate declines to a level that would reflect the fall in our export prices.

### **Issues being examined by the inquiry**

The Productivity Commission is looking at three key issues as part of its inquiry:

- whether safeguard measures are justified under the WTO Agreement
- what measures would be necessary to prevent or remedy serious injury and to facilitate adjustment
- whether those measures should be implemented

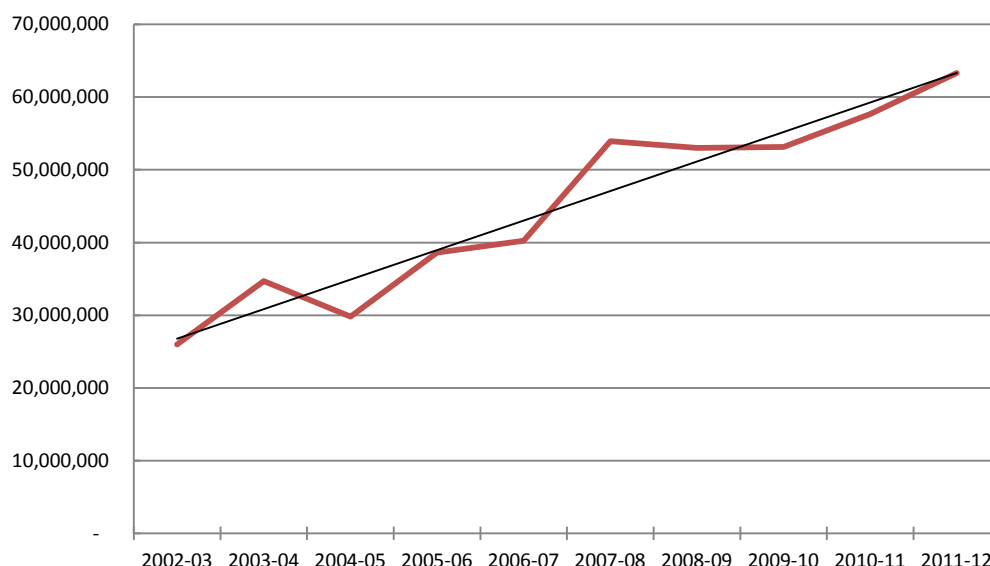
These areas are examined below.

#### *Determining whether safeguard measures are justified*

##### *What has happened to imports?*

Over the past decade annual imports of processed tomatoes have more than doubled from less than 30,000 tonnes to 63,000 tonnes in 2011-12 (Chart 2). Over the past two years, the volume of canned tomato imports has risen by 19 per cent, from 53,000 to 63,000 tonnes.

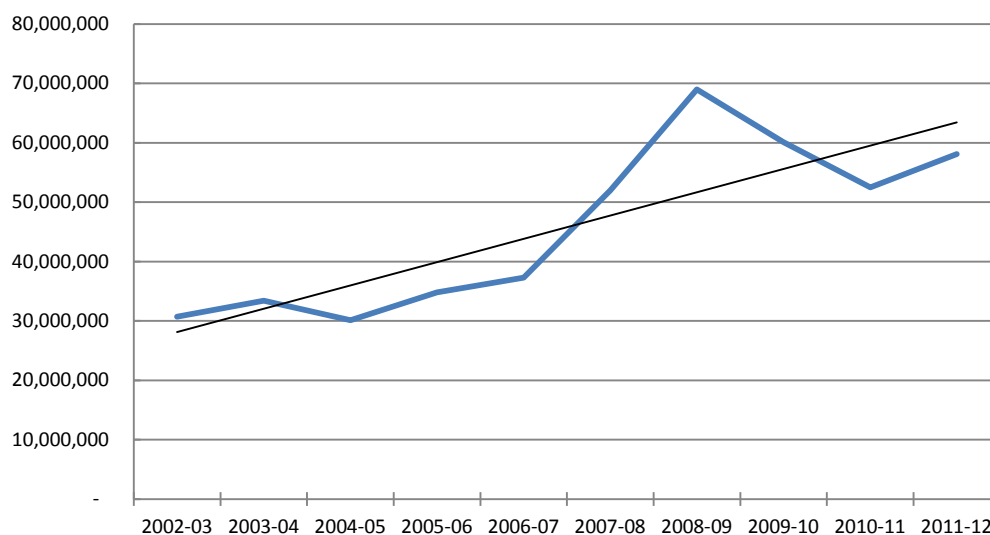
**Chart 2: Tomato imports by volume (kg), 2002-03 to 2011-12**



Source: ABS, trade data at the Standard International Trade Classification (SITC) level 5.

In nominal terms, the value of imports has also doubled from \$30 million per year in 2002-03 to just under \$60 million in 2011-12 (chart 3). In real terms (deflated by the CPI), the value of imports has increased by about 50 per cent, which is significantly below the increase in volumes. In other words, there has been a significant decline in unit prices over the past decade. Over the past two years, in real terms, the value of imports has declined by 8 per cent.

**Chart 3: Tomato imports by value (\$), 2002-03 to 2011-12**



Source: ABS, trade data at the Standard International Trade Classification (SITC) level 5.

All canned tomato tariff classifications have experienced substantial increases in the 5-year moving average of annual imports over the past 5 years (Table 1). This indicates a significant and sustained structural adjustment in the volumes of canned tomato imports into Australia.

**Table 1**      **Increases in processed tomato imports by weight**

Product	Tariff class	5-year moving average in 2007	5-year moving average in 2012	Increase
		tonnes	tonnes	%
Whole or pieces < 1.14 L	2002100060	59,453	64,632	8.7%
Whole or pieces > 1.14L	2002100061	11,405	16,393	43.7%
Not whole or pieces < 1.14L	2002900030	9,399	14,442	53.7%
Not whole or pieces > 1.14L	2002900031	13,900	29,114	109.5%

**Table 1: Hurdles within the WTO safeguards framework**

WTO hurdle	Requirement	Industry factors
<i>That imports have increased</i>	WTO provisions require evidence of an increase in imports, either in absolute terms or relevant to domestic production.	<ul style="list-style-type: none"> <li>Over the past two years, the volume of canned tomato imports has risen by 19 per cent, from 53,000 to 63,000 tonnes.</li> </ul>
<i>That there has been serious injury to the industry, or the threat of serious injury</i>	The Agreement on Safeguards contains a stringent 'injury' test. This requires evidence that increased imports (as set out under the specific Customs tariffs for processed fruit products) have caused 'serious' injury to the relevant domestic industry.	<ul style="list-style-type: none"> <li>SPC Ardmona is Australia's sole processed tomato canner. According to the company, over the past three years sales have dropped by 28 per cent, profitability by over 200 per cent, while imports have increased by 35 per cent.</li> <li>SPC Ardmona's export market volumes have declined by 90 per cent in the past five years.</li> <li>There has been a severe rationalisation in the number of tomato suppliers to SPC Ardmona. For the 2014 growing season, supplying tomato growers has dropped to just seven.</li> </ul>
<i>That the increases in imports constitute an unforeseen development</i>	Provisional safeguards can only be imposed where there are critical circumstances where delay would cause damage which would be difficult to repair.	<ul style="list-style-type: none"> <li>The magnitude and suddenness of impairment to the industry over the past two years appears well beyond what could be considered to represent normal market fluctuations that might be based on technology, innovation and cost.</li> </ul>
<i>That critical circumstances exist which warrant provision safeguards</i>	Provisional safeguards can only be imposed where there are critical circumstances where delay would cause damage which would be difficult to repair.	<ul style="list-style-type: none"> <li>The canning industry has reached a tipping point in terms of economies of scale. Hence, by definition, any further deterioration would wipe out the industry.</li> <li>There is a significant link between a strong and sustainable food industry and employment opportunities in rural and regional areas.</li> </ul>



WTO hurdle	Requirement	Industry factors
<i>That increased imports are causing serious injury</i>	A causal link needs to be established. In this it must be shown that imports have caused, or are threatening to cause, serious impairment of the domestic industry.	<ul style="list-style-type: none"> <li>The canning industry is clearly on the brink of collapse with a single cannery remaining. The sudden and significant increase in imports over the past two years is now threatening the viability of the remaining cannery in the Goulburn Valley.</li> </ul>

## **What measures would be necessary to prevent or remedy serious injury and to facilitate adjustment**

Many canned tomato growers in the Goulburn Valley currently find themselves in awful financial circumstances with current market conditions. With SPC Ardmona's recent decision to drastically cut the number of suppliers, on top of ongoing incremental rationalisation, the profit outlook is poor across the industry. It is clear that some businesses will be commercially unviable with little equity and limited cash flow going forward.

In this difficult environment, it is inevitable that some growers will exit the industry — as has already occurred. This is an unfortunate outcome for many farmers which can exact a terrible toll on individuals and families.

The introduction of immediate provisional tariff support on processed tomato products would be a useful start to help prevent further serious damage to the industry. This would be consistent with established procedures for undertaking inquiries by the Productivity Commission into whether safeguard action is warranted (Commonwealth of Australia Gazette No. S 297, 25 June 1998). This provides for provisional tariff increases for up to 200 days, which would be revoked when the Government reached a decision on the imposition of safeguard measures following receipt of the Commission's final report.

While access to financial assistance through Commonwealth and State Government programs such as concessional loans can provide some relief, supporting less viable canning tomato businesses leave the industry may also have merit. In this regard, the process of structural adjustment in the form of fewer and generally larger scale operations has long been a feature of Australia's farming landscape.

## **Assessing the impact of regulation — whether those measures should be implemented**

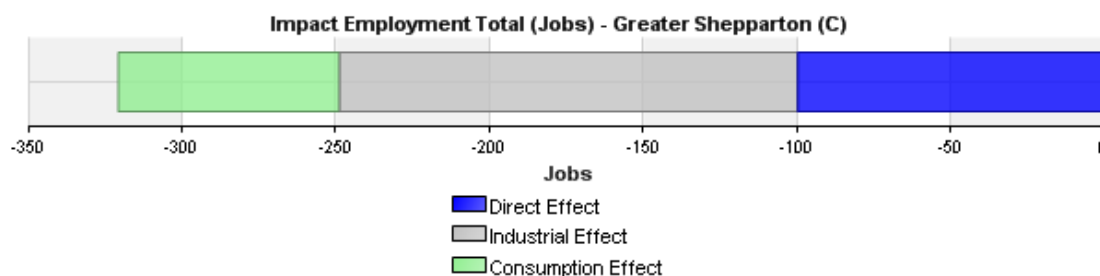
The importance of a sustainable agriculture and food manufacturing industry to the regional economy is highlighted in the significant levels of employment in farming within the region. Employment in the agricultural sector in the Greater Shepparton and Upper Goulburn Valley areas totals over 7,200 jobs (2011 Census), representing around 10.8% of overall employment across these regions.

It has been reported that more than 1500 jobs including seasonal work such as fruit-picking are expected to be lost. 533 part-time, casual and full-time jobs have already been lost on peach and pear orchard (D Gray, 'Future not so peachy but growers keen to stay', The Age, 10 June 2013).

According to REMPLAN Economic Impact Analysis using data from the ABS 2011 Census JTW Employment Data, ABS 2008 / 2009 National Input Output Tables, and ABS June 2012 Gross State Product, from a loss of 100 direct jobs in the Fruit Product Manufacturing Industry Sector it is estimated that Greater Shepparton's annual economic output would decrease \$82.690 million. From this direct contraction in the economy, flow-on industrial effects in terms of local purchases of goods and services are anticipated, and it is estimated that these indirect impacts would result in the loss of a further 149 jobs.

The decrease in direct and indirect output and the corresponding loss of jobs in the economy are expected to result in a decrease in the wages and salaries paid to local employees. A

proportion of these wages and salaries are typically spent on consumption and a proportion of this expenditure is captured in the local economy. The consumption effects under this scenario are estimated to further reduce employment by 72 jobs.



Total employment, including all direct, industrial and consumption effects is estimated to decrease by up to 321 jobs. This represents a Type 2 Employment multiplier of 3.210. That is, for every 100 direct jobs lost in the Fruit Product Manufacturing Industry Sector it is estimated that up to a further 221 jobs would be lost in the Greater Shepparton economy once flow-on industrial and consumption effects are taken into consideration (REMPPLAN Economic Impact Analysis).

While domestic canning operations are concentrated in one company (SPC Ardmona), the supply chain across the processed fruit industry is relatively broad. It extends from canning operations, on-farm activities, and to agribusiness suppliers and other businesses. Employment within a region also impacts on other services like housing, education and health services. In this sense, fruit processing provides a form of logistics architecture for the region.

While domestic canning operations are concentrated in one company (SPC Ardmona), the supply chain across the processed tomato and fruit industry is relatively broad. It extends from canning operations, on-farm activities, and to agribusiness suppliers and other businesses. In this sense, tomato processing provides a form of logistics architecture for the region.

An important consequence of these linkages is that any further impairment in the processed tomato industry will have detrimental spill-over impacts across the region. Simply put, a reduction in income to canners and growers, and attendant decreases in employment, will lead to reduced demand for agricultural suppliers and other industries, generating a further loss in employment.

Such considerations need to be carefully weighed up in deliberations over the merits of introducing safeguard measures and other forms of structural assistance for the industry. For a region heavily geared towards agriculture, the potential adverse consequences for overall economic activity are particularly acute.

## Some additional matters

### *WTO frameworks*

WTO provisions and their interpretation, including by the WTO appellate body, have taken a highly restrictive position on the application of safeguard measures. Many of the safeguard

measures have been challenged in the WTO dispute resolution process. And most, if not all, cases have found the challenged measure to be in violation of WTO law.

As a result, the safeguards mechanism has proven increasingly impractical due to legal impediments.

There is a concern that such issues will come into play during this inquiry process and any resultant determination. This would serve to undermine the legitimate grievances of the industry concerning the substantial cost-price squeeze generated by the flood of imported products into the Australian market.

While limiting the use of the safeguards mechanism is an explicit intention of the underlying agreement — indeed, it is intended as a temporary, ‘emergency action’ — an overly restrictive and legalistic approach can be counterproductive to promoting welfare-enhancing trade liberalisation in world markets. For instance, it can encourage countries to be excessively ‘cautious’ in their commitments to ongoing trade reforms and to pursue alternative forms of redress. This can further add to the already complicated maze of (potentially distorting and discriminatory) international trade arrangements.

In this sense, improving how implementation of the safeguards mechanism corresponds to the intent of the WTO rules should be a longer term priority for countries as part of international trade discussions. Other worthwhile reforms to the global trade framework could include measures to improve the transparency of broader WTO processes and to enhance the provision of relevant trade data (for instance, on the level of tariff, non-tariff barriers and subsidies applying in agricultural and food markets).

Such issues were recently highlighted by the Director-General of the WTO (speech at the University of International Business and Economics in Beijing on 20 September 2012) in the context of improving the integration of preferential trade agreements within the WTO multilateral trading system.

Many of these matters (which often go to issues of WTO jurisprudence) are clearly beyond the remit of the Commission in prosecuting its obligations under this inquiry. Crucially, however, they point to areas where concerted policy attention is required.

#### *Terms of Reference*

The terms of reference for the Productivity Commission Inquiry into the Import of Processed Fruit Products concerning the application of safeguard measures (in line with our obligations as a signatory of the World Trade Organisation) are outlined in Commonwealth of Australia Special Gazette No S 297.

According to the Gazette, before recommending any safeguard measures the Commission must inquire and report on the following:

- a) whether the conditions are such that safeguard measures would be justified under the WTO Agreement;
- b) if so, what measures would be necessary to prevent or remedy serious injury and to facilitate adjustment

c) whether, having regard to the Government's requirements for assessing the impact of the regulation which affects business those measures should be implemented.

Under Section 6 of Gazette, the Commission has been asked to conduct a broad ranging inquiry, including public hearings, in "which importers, exporters, and other interested parties can present evidence and their view....as to whether or not the application of a safeguard measure would be in the public interest."

In response, the Commission has stipulated that in accordance with the Best Practice Regulation Handbook and the Productivity Commission Act 1998 it will consider the need to "achieve higher living standards for all members of the Australian community". In that context, the Commission will also consider the impact of safeguard measures on "fruit growers and other suppliers, downstream industries such as food services, grocery wholesalers and retailers, importers, local exporters and consumers"(pg 20 PC Issues Paper).

It is essential that during the course of the Inquiry the Commission consider the varying degrees of impact on different stakeholders. The proportional impact of emergency safeguard measures will have a much greater effect on residents of the Goulburn Valley, than those living in Sydney. In line with the terms of reference, the Commission also needs to consider the socio-economic benefits of a sustainable domestic food industry and Australia's food security.