



APL Submission 5

**Productivity Commission Australian Pig Meat Industry
Public Inquiry**

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1 Executive Summary

This is the fifth submission APL is providing to the Pig Meat Inquiry. This submission provides key summary details from the draft competitive benchmarking study of Australia's pork supply chain, outlines the negative impact of Australian Government regulations on areas critical to the industry's competitiveness, and also documents key concerns APL holds regarding the way in which data relating to EU assistance measures and Danish export pricing has been analysed and interpreted in the Draft PC report.

Benchmarking Study

The draft international benchmarking study, 'Competitiveness of the Australian Pig Industry' (the Study) provides a valuable independently assessed tool for determining the appropriateness of the strategies entailed in the draft Industry Restructure Plan. It is noteworthy that the strategies within APL's draft Restructure Plan are frequently referred to throughout the report as providing a key means through which the Australian industry can improve its competitiveness. Significantly, the Study provides a detailed analysis of Australia's competitiveness relative to Denmark, Canada and the USA on an extensive range of key competitive drivers.

The Study identified five key areas of work that need to be undertaken if the Australian pig industry is to be competitive. These were to:

- Better address consumer preferences for food
- Rationalize production and processing capacity and operate through supply chains not supply units
- Benchmark supply chains and aim to achieve world best practice
- Improve coordination vertically and horizontally amongst all the stakeholders
- Adopt best practice systems for risk management.

The Study identified 10 key drivers of competitiveness that are considered the most important for any pig meat industry that wants to compete and win in the global market which included such things as feed prices/availability, carcass weights, production scale and processing scale/utilization and supply chain integration. A key message of the study is that a competitive industry aims to work at best practice levels for as many of these drivers as possible all the time. In analysing competitor countries while there are common themes of success, it is evident that each have varying degrees of strengths in particular key competitive drivers.

Findings of critical importance to the PC's draft recommendations included:

1. Feed grain competitiveness – In a liberalized pig meat import market, the Australian industry risks seeing global pig price variability alongside domestic feed price rigidity; critically the Australian pig price/feed ratio needs to mirror those seen in competitor markets. The industry is put at risk if domestic pig producers are not offered the same guarantees on feed supply that their competitors have.
2. Trade measures – Given the global pork market is highly volatile and cyclical, and when coupled with the openness of the Australian domestic market, it is critical that the Government put in place necessary trade measures so that the industry's restructure plan is not thrown off course by global market instability. If this is not done, private sector investment in the restructure plan will be deterred and the industry's opportunity to become competitive will be greatly diminished.
3. Sourcing capital for structural adjustment – If producers are to remain profitable they must adjust to market forces through further investment in their businesses. However, the ongoing level of uncertainty combined with the low level of cash flow in the industry is going to make change, and the necessary capital investment required to make this change, extremely difficult to obtain. If this is not done the chances of obtaining a globally competitive and sustainable pork industry are seriously weakened. Therefore, the industry needs a macroeconomic policy setting that will reduce this uncertainty and provide the necessary cash flows to generate this change.
4. Government assistance – Existing market pressures are insufficient to force competitive change and private sector investment in the industry's restructuring programme will be deterred and opportunities to become competitive will be lost forever if government assistance is not provided to remove surplus production and processing from the Australian pork industry.

The significance of advocating a Government role in the push for industry restructuring seems all the more important in light of the PC's analysis having not considered or proposed where the industry is to source capital to make the necessary adjustments to achieve competitiveness.

The Study proposed that APL needs to drive the consolidation and rationalisation process over and above the impacts of market forces, through engaging with Government to devise appropriate industry restructure packages to retire suboptimal capacity. The Study also highlighted that competitor pig industries have progressed substantially down the road of

restructuring and rationalisation with the help of government aid combined with a concerted, industry-wide approach (i.e. Netherlands). In order to achieve the enhanced international competitiveness objectives of the industry's draft Restructure Plan in the fastest possible time it is imperative that appropriate Government policies are put into place.

Impact of Australian Government Policy on Industry Competitiveness

APL contends that the Australian industry's competitiveness is not only being impeded by overseas countries subsidies to their pork industries but also by our own Government's policies which are acting to further distort the industry's input costs. APL is extremely concerned that the industry faces a double edged sword: a situation where other countries are subsidising and helping their pork industries to reduce costs, while our Government implements policies - such as the single desk policy and ethanol policy - which further drives up the industry's major cost of production, feedgrain. It is imperative that the impact of Government regulations that diminish the industry's competitiveness, particularly in relation to feed, are adequately addressed within the final report.

EU Assistance and Danish export prices

Following submissions by APL, the PC has acknowledged that there is uncertainty surrounding the accuracy of some of the data upon which their analysis relies. This was particularly evident in respect of the both the estimate by the OECD of the amount of support provided to producers in the EU and also the comparability of data on prices for similar products sold in domestic and export markets. The PC also acknowledged that the relationships between the support provided to producers in the EU and the observed patterns of trade and prices in export markets such as Australia are somewhat of a "mystery"¹.

APL is very concerned that the level of analysis undertaken by the PC in the Draft Report of government assistance to the Danish pig meat industry and Danish export prices for pig meat, to which the PC has attached considerable importance, may be inaccurate or incomplete. The anomalies in data must be resolved by the PC before it can properly assess the state of the industry and make findings with respect to the nature of government assistance. APL has therefore commissioned ITS Global to undertake this analysis and research. Key details from the analysis undertaken to date are provided here; regrettably due to the Inquiry's limited timeframe the final work will not be able to be completed and provided to the PC for incorporation into its final report.

¹ Commissioner Neil Byron, Pig Meat Inquiry Public Hearing - Melbourne 7th February 2005; Transcript P.489

The PC's analysis suffers from several deficiencies which detract from its conclusions. APL questions the accuracy of assumptions entailed in key statements made in the Draft Report Box 3.5 (p.50), particularly in respect of data used to measure assistance in the EU and the inappropriateness use of the PSE as a support measure. APL is also concerned that potentially like products are not being compared in terms of drawing price comparisons in the EU and those outside the EU. Further to this, it appears the manner in which the PC has indicated Australian industry is not adversely affected by Danish trade, by asserting prices are higher for products inside the EU than outside, has been undertaken without sufficient recognition that the patterns of trade and prices could be explained in ways other than simply government policy. The PC is not entitled to infer that farm policy determines prices in the Danish market until it has discounted other factors that can influence prices.

This data must undergo substantially more rigorous assessment before the PC can reach the conclusions it has regarding the impact of Danish support measures on the Australian pork industry.

APL contends that it is essential that these matters be satisfactorily addressed in order for the PC to fulfil its requirements under the Inquiry's terms of reference. APL again emphasises the need for the PC to seek an extension for the Inquiry up until 30th June 2005 if the PC is to provide robust, objective analyses of the competitiveness of the industry and what the industry and the Government can do to change these circumstances.

Key Recommendations

Recommendation 1

The Australian Government play a key role in fast tracking the restructure process. This extends to undertaking proactive measures to remove suboptimal supply chain arrangements. APL notes a precedent has been set in the Netherlands and United Kingdom whereby these countries Governments have chosen to take a proactive approach in the restructure of their pork industries.

Recommendation 2

The Australian Government pursue tangible measures focused on addressing the regulatory factors currently constraining the competitiveness of the Australian pork industry, particularly in respect of feed grain and capital sourcing.

Recommendation 3

The Australian Government put in place temporary trade measures so that the industry's restructure plan is not thrown off course by global market instability, further impeding private sector investment and seriously weakening the industry's ability to achieve/secure a globally competitive and sustainable pork industry.

Recommendation 4

Further work needs to be undertaken by the PC, in collaboration with APL to address the apparent inconsistencies of existing data relating to EU assistance and questionable Danish export prices. It is imperative that the PC first properly and accurately characterise the state of the industry before conclusions and recommendations can be made.

Recommendation 5

An extension for the Inquiry up until 30th June 2005 in order to enable the PC to provide robust, objective analysis of the competitiveness of the industry and what the industry and the Australian Government can do to change these circumstances.

2 Competitiveness of the Australian Pig Industry

The draft international benchmarking study, “Competitiveness of the Australian Pig Industry” (the Study), provides a valuable independent tool for determining the appropriateness of the goals and strategies within APL’s draft Industry Restructure Plan. It is noteworthy that the strategies within APL’s draft Restructure Plan are recognised throughout the Study as providing the key means through which the Australian industry can improve its competitiveness.

Undertaken as part of the Joint Industry Government funded Pork Market Improvement Program (PMIP), this assessment:

- Provides a detailed analysis of Australia’s competitiveness relative to Denmark, Canada and the USA on an extensive range of key competitive drivers.
- Focuses on key competitiveness issues that will influence the Australian pig meat industry’s growth and development, assembling primary and secondary data from sources in the four comparator countries, including a review of pig meat competitiveness studies made by other analysts in recent years.
- Outlines key recommendations as to how Australia can increase its competitiveness.

As indicated at APL’s first meeting with the PC and again at the private and public hearing, it was highly unlikely that APL would be able to deliver a public document to the level of detail required by the PC’s terms of reference in the timeframe set by this Inquiry. Since this Study is still in the process of being finalised with the consultants and given the commercial sensitivity of some sections, the information provided in this document remains confidential at this stage.

APL again emphasises the need for the PC to seek an extension for the Inquiry up until 30th June 2005 if the PC is to provide robust, objective analyses of the competitiveness of the industry and what the industry and the Government can do to change these circumstances. It is imperative that the PC first properly and accurately characterise the state of the industry before conclusions and recommendations can be made.

2.1 Important considerations

While the Study examines the relative competitive position of the Australian pig meat industry to those industries in Canada, Denmark and the USA, a number of caveats need to be highlighted to put the outcomes of this Study into context.

These caveats are:-

- The Australian industry is a different industry to those in the comparator countries for a range of historical , geographic, social and economic reasons;
- The fact that the Australian industry operates in a global pig meat market and is subject to global influences means that the Australian industry has to be aware of the relative performance parameters of key competitors;
- The pig meat supply chain is complex and its products are not homogeneous. Therefore, a focus on quantitative differences for key production and processing/ marketing statistics is insufficient. There are three problems with a simple quantitative approach:-
 - (a) Comparison on an industry basis inevitably means a comparison on the basis of industry averages rather than world best practice;
 - (b) Industries are comprised of a number of enterprise types from small family farms to large integrated production and processing operations all with varying structures. The future of the pork industry globally is all about how the larger vertically and horizontally integrated operations perform as competing supply chains in a range of domestic and export markets. Again, this cautions against the use of averages; and
 - (c) As the world's largest commercial players have moved into competing supply chains there is a reluctance to divulge quantitative performance data as these data are a key component of their competitive and comparative advantage.

2.2 Key competitive drivers

The Study identified five key areas of work for the Australian pig industry if it is to be competitive:

- It needs to better address consumer preferences for food
- It needs to rationalize its production and processing capacity and operate through supply chains not supply units
- It needs to benchmark its supply chains and aim to achieve world best practice
- It needs to improve coordination vertically and horizontally amongst all the stakeholders
- It needs to adopt best practice systems for risk management.

After extensive review and analysis of information from the designated comparator countries, the Study identified 10 key drivers of competitiveness

that are considered the most important for any pig meat industry that wants to compete and win in the global market. These are listed below (in no order of priority) and explored in more detail in the attached Study (Attachment A). Naturally each of these drivers do not have equal weighting; the key message is that a competitive industry aims to work at best practice levels for as many of these drivers as possible all the time.

- Feed prices/availability
- Technology/R & D effort
- Genetics
- Live cost of production
- Carcase weights
- Production scale
- Export marketing scale
- Processing scale/utilization
- Supply chain integration
- Exchange rates

Importantly, in comparing key competitive drivers across countries, the Study noted that while a comparison of the different major exporters will show that different exporters can have similar performance levels in terms of volume/value of exports, they have different priorities in their key drivers. Undoubtedly, there are common themes of success, notably: integration, mega-slaughter plants working at full capacity, and customer focus. But there are also critical differences to consider in drawing comparisons. Hence, the relatively low herd productivity of the USA is compensated for by its low exchange rate, large expenditures on export marketing, and mega slaughter plants. Denmark has relatively high live costs of production and small farm units but compensates with 100% slaughter capacity utilization and total product development and customer focus. Canada's policy decision to reduce the cost of feed grain in the 1990's allowed its pork export industry to grow from almost nothing to joint number one in the world but it needed large investments in modern slaughter capacity and a commitment to exporting to make this happen.

2.3 Critical findings of importance to the PC's draft recommendations

2.3.1 Feed grain competitiveness

Critically, the Australian pig price/feed price ratios need to mirror those seen in competitor countries. This certainly means better access to imported feed for Australian pig producers at times of drought. The Australian pig meat industry, and its \$2.576 billion of added value activities and employment, will be put at risk if domestic pig producers are not offered the same guarantees

on feed supply that their competitors have. With a liberalized pig meat import market, the industry risks seeing global pig price variability alongside domestic feed price rigidity. This could have a disastrous impact on Australian pig producers' and pig processors' margins.

2.3.2 Trade measures

The Study also observed that regardless of feed price volatility, the global pig meat market is highly volatile and cyclical and critically, when coupled with the new openness of the Australian domestic market, means that any restructuring programme for the pig meat industry needs, as a temporary measure, some risk-reducing actions by Government. It went on to recommend that:

“As with competitor countries, trade and government assistance measures, such as in the form of short term phased down assistance, needs to be put in place in order that Australia's rationalisation/restructuring plan is not thrown off course by global pig market instability for, say, the next 3-5 years²”.

In APL's view, and as stated in our submissions to the PC and at the public hearing, there has been a general failure by the PC to properly characterise and quantify the import support arrangements on global pork markets. APL expects the Commission to be concerned about the distortion of international trade and its impact on investment in Australia, because these in turn influence decisions about what to produce.

2.3.3 Sourcing capital for structural adjustment

In its draft findings the PC argues that existing competitive pressures are enough to force gradual change in structural adjustment and therefore enhance industry competitiveness.

Contrary to this, the study on 'Competitiveness in the Australian Pig Industry', considers existing market pressures to be insufficient to force competitive change; unequivocally the Study identifies that private sector investment in the industry's restructuring programme will be deterred - and opportunities to become competitive will be lost forever if government assistance is not provided.

² Competitiveness of the Australian Pig Industry - Report 2; p. 3; Warwick Yates & John Strak; February 2005.

Of importance here is the fact that the PC's analysis has failed to examine either the pace of adjustment, including the social impact of rapid change, or considered and/or proposed where the industry is to source capital to make the necessary adjustments to achieve competitiveness. Simply put, if producers are to remain profitable they must, as the PC report states, adjust to market forces; yet this can only be achieved through further investment in their businesses. But for pork producers to invest in their businesses they must first source the capital to do so. Producers can obtain these funds from either:

- i. Cash flow - but given the financial situation of the industry over the last few years, cash flow has not been available.
- ii. Borrow - but banks are disinclined to lend to the pork industry based on current balance sheets and the future prospects of the industry.
- iii. Producers can also look at attracting equity investors. That said, it is hard to fathom an investor risking their capital given that our competitors are subsidised and protected, the policies of the Australian government are also serving to increase production costs (see section 3 below), while the current market situation is preventing producers from making a product which is not as cost efficient as possible. These factors combined act as a major deterrent to investors, making the possibility of producers attracting and/or raising capital in practice extremely difficult.

In general, there is a failure of the PC to consider profitability against the capital employed in the industry, which in turn reveals a lack of appreciation of the commercial factors that affect decisions about production, investment and risk. The ongoing level of uncertainty combined with the low level of cash flow in the industry is going to make change, and the capital investment to make this change, extremely difficult to obtain. Therefore, the industry needs a macroeconomic policy setting that will reduce this uncertainty and provide the necessary cash flows to generate this change. If we do not, then the chances of achieving the goals of the industry Restructure Plan, namely, a sustainable and globally competitive Australian pork industry, are seriously weakened.

2.3.4 Government assistance

Interestingly, the Study found that while consolidation and rationalisation in the Australian processing sector is inevitable, securing a modern successful pig industry is not. Restructuring is expensive and risky and individual processors who make large capital investments in modern larger plants could, in the short run, be undercut by old inefficient plants with zero finance and depreciation charges. If a trough in the pig price cycle occurred in the early stages of a restructuring plan it could derail the industry's moves towards a

more efficient mode of operation. The Study recognised that APL needs to drive the consolidation and rationalisation process, over and above the impacts of market forces, through engaging with Government to devise appropriate industry restructure packages to retire suboptimal capacity. A key finding of the report urged that

‘APL work cooperatively with State and Federal Governments to develop restructure programs that will remove surplus production and processing capacity from the Australian industry’³

In order to achieve the enhanced international competitiveness objectives of the industry’s draft Restructure Plan in the fastest possible time it is imperative that appropriate Government policies are put into place. The Study found that competitor pig industries have progressed substantially down the road of restructuring and rationalisation with the help of government aid combined with a concerted, industry-wide approach.

i. Netherlands

Since 1997, the number of pigs in the Netherlands has fallen steadily as a result of a government-sponsored industry-restructuring scheme aimed at addressing environmental concerns. In 1998 the Dutch Pig Farming (Restructuring) Act (*Wet Herstructurering Varkenshouderij*) stipulated that a maximum number of pigs are permitted per farm. With effect from 1 September 1998 the pig entitlement was reduced by 10%. However, farms that had introduced additional environmental and animal welfare provisions did not have to comply with this reduction, or were subject to a lower reduction. In the autumn of 1999 further environmental measures were announced. To give pig farmers who saw no future for themselves in pig farming the opportunity to retire from farming, the government introduced pig entitlement buying-up schemes in 2001 and 2002. Farmers who quit the industry were paid Euro 16.59 per kg of phosphate that was eliminated (equivalent to Euro 122.72 per pig). Farmers also received money for demolishing building used in livestock operations at a rate of Euro 22.72 per square metre, plus an additional payment of 40% of the replacement value of the building. To receive the payment, farmers had to agree not to reopen a livestock operation in the same location for 10 years. Taken together, all the measures have led to a reduction in the size of the Dutch national pig herd by about 25% from 15.1m head in 1997 to 11.3m in 2004. Associated with this reduction in the pig herd an equivalent proportion of slaughter capacity was retired from the industry. In all, the Dutch restructuring scheme cost circa 500 million euros in national aid.

³ Competitiveness of the Australian Pig Industry - Report 2; p. 3; Warwick Yates & John Strak; February 2005.

ii. United Kingdom

The UK government introduced a two year Pig Industry Restructuring Scheme (PIRS) in 2000 in response to over-supply and severely depressed producer prices in the UK market. The objective of the PIRS was to encourage pig producers to leave the industry and remain out of it for a period of 10 years (the Outgoers scheme) or to carry out restructuring with the assistance of subsidised loans (the Ongoers scheme). The average payout under the Outgoers scheme was £97.53 per sow place removed. Total PIRS funding over two years was £66million. The PIRS had intended to reduce production capacity within the industry by 16%, in the event production capacity fell by 32% between 2000 and 2002.

In addition to the PIRS, the British government introduced and funded the Red Meat Industry Forum (RMIF) in June 2001. This is intended to assist livestock farmers and meat processors by improving the performance and profitability of the UK Meat and Livestock sector . The stated mission of the Red Meat Industry Forum is to improve the business competitiveness and efficiency of the red meat and red meat products industry by the transfer of world-class best business practices. This includes benchmarking, consultancy, training, management development, a Centre of Red Meat Excellence and best practice dissemination . The RMIF 2004/05 budget is circa £2.5 million. The RMIF draws its funds from a range of sources. These include the Department of Trade and Industry (DTI), through its Industry Adaptation Scheme and Defra. In addition, for specific projects in Wales, funding is drawn from the Welsh Development Agency and, in England, funds are drawn from some Regional Development Authorities (RDA's). RMIF has previously received financial support from the Farmers Fund and MLC.

3 Impact of Australian Government policy on industry competitiveness

Industry competitiveness is not just being impeded by overseas countries subsidies to their pork industries but also by our own Government's policies which act to further distort the industry's input costs. The Australian pork industry is being squeezed on several fronts.

Firstly, the record shows that the process of adjustment that this industry has been put through is the least artful that the Government has imposed, probably in any agricultural sector. APL again highlights that when the government bound the tariff for pig meat at zero in the WTO Uruguay Round the presumption was made that existing quarantine arrangements were not going to change; industry history has evidently proven otherwise. Significantly, the industry was not consulted at the time this commitment was made.

Secondly, and as previously documented in APL's previous submissions, the IRA undertaken in the mid 1990's has also had an extremely dramatic structural effect on the industry. There was no consultation with the Australian pork industry. Furthermore, there was no Government/Industry forum established to manage the process of change and address the impact on the industry that resulted from this government decision as has been the case with other agricultural industries such as dairy and sugar.

3.1 Feed

Clearly any regulatory impediments which increase the industry's costs of production will affect in turn the investment profile and capacity of the Australian pork industry. APL is extremely concerned that the industry faces a double edged sword: a situation where other countries are subsidising and helping their pork industries to reduce costs, while our Government implements policies - such as the single desk policy and ethanol policy - which further drives up the industry's major cost of production.

The industry's attempts to secure competitive feed are again at significant risk, threatened by the subsidy provided by the Australian Government to ethanol producers as well as the combined effect of quarantine arrangements for the importation of grain and the single desk. (The issue of the single desk has been addressed in APL's previous submissions). APL is extremely concerned that the recently announced Government subsidised ethanol plants being built in Queensland and Victoria will further drive up the price of grain, the industry's key feed ingredient.

In late 2004 the Government announced capital grants programs for plants that produce ethanol from grain. A grant recipient in Millmerran,

Queensland, plans to use 150,000 tonnes of sorghum, whilst another plant at Dalby plans to use 250,000 tonnes of sorghum. That equals 400,000 tonnes of sorghum in a market that produces only 1 million tonnes. Further highlighting APL's concerns, ABARE and Bureau of Transport and Regional Economics (BTRE) inquiry into the \$350 million bio-fuels target identified that producing ethanol would require a subsidy by the Government of \$500,000 per job created annually - not just a capital grant, but \$500,000 annually⁴. APL estimates that based on the excise holiday given to this industry to produce ethanol from grain, and also considering the phasing in of ethanol excise after 2011, these plants once built can afford to pay up to \$300 a tonne for grain before they would actually consider shutting down. APL is extremely concerned that the excise holiday the Government has provided to another industry has in effect created a subsidy for people to buy grain competitively against livestock industries and end grain users.

⁴ Appropriateness of a 350 Million Litre Biofuels Target; Report to the Australian Government Department of Industry, Tourism and Resources (DITR) by CSIRO/ABARE/BTRE; December 2003

4 EU Assistance and the Danish export prices

4.1 PC acknowledged inconsistencies

Following submissions by APL, the PC has acknowledged that there is uncertainty surrounding the accuracy of some of the data upon which their analysis relies. This was particularly evident in respect of both the estimate by the OECD of the amount of support provided to producers in the EU and also the comparability of data on prices for similar products sold in domestic and export markets. The PC also acknowledged that the relationships between the support provided to producers in the EU and the observed patterns of trade and prices in export markets such as Australia are somewhat of a “mystery”⁵.

The anomalies in data must be resolved by the PC before it can properly assess and characterise the state of the industry and make findings with respect to the nature of government assistance. Furthermore, APL is strongly of the view that this data needs to undergo substantially more rigorous assessment before the PC can reach the conclusions it has regarding the impact of Danish support measures on the Australian pork industry. APL has therefore commissioned ITS Global to undertake this analysis and research. Key details from the analysis undertaken to date follows; regrettably due to the Inquiry’s limited timeframe the final work will not be able to be completed and provided to the PC for incorporation into its final report.

4.2 Data and analysis used in the PC Draft Report

The PC Draft Report includes analysis of government assistance to the Danish pig meat industry and Danish export prices for pig meat, to which the Commission has attached considerable importance.

The PC’s analysis appears to contradict a central contention of the Australian pig meat industry’s case for adjustment assistance, namely, that the Australian pig meat industry is being undermined by low priced imports from overseas countries such as Denmark which benefit from government assistance. The PC’s analysis suffers from several deficiencies which detract from its conclusions.

4.2.1 PC Draft Report assertions and assumptions

APL is greatly concerned that based on the level of analysis undertaken by the PC, the measure of policy support may be inaccurate or incomplete. The PC’s case is as follows:

⁵ Commissioner Neil Byron, Pig Meat Inquiry Public Hearing - Melbourne 7th February 2005; Transcript P.489

- The OECD estimates producer support to EU pig meat producers to be 23.3 percent – meaning the producer support estimate, which the OECD uses to measure assistance, indicates that 23.3 percent of pig producers’ farm gate income comes from government assistance (page 48).
- The EU imposes restrictions on imports of pig meat to support domestic prices, and all other matters being equal this could be expected to increase prices received for pig meat within the EU and reduce prices for pig meat in world markets (page 49).
- The OECD estimated the total value of EU support for pig meat producers in 2003 was about Euro 0.25 per kilogram (page 50).
- Assuming there are no internal barriers to trade among EU producers, prices received by producers in Denmark would likely be higher within the EU than outside, given EU wide tariffs and quotas. However in 2003 the Danish industry appeared to receive higher prices from exports to non-EU countries than to EU countries (page 50).
- This difference could be explained by differences in the quality of pig meat supplied to different markets, with prices for products with similar specifications (e.g. carcasses and bacon) being higher in non-EU countries than in EU countries, while it is the reverse for byproducts, canned meat and other processed products (page 50).
- Average prices received by Danish pig meat producers for exports to Australia in 2003 were higher than the average for all Danish exports to non-EU countries, but broadly consistent with average prices received for exports to the Japanese and US markets (page 50). (The PC provided a chart of the time series for this to APL the public hearing).
- There is a relatively small difference, according to the PC, between the prices received by Danish pig meat producers for middles exported to Australia to be made into bacon, and prices received for all Danish bacon exports, making it unlikely that the prices received for exports to Australia were unusually low in 2003 (page 50).

APL is particularly concerned about the assumptions entailed in these statements. These assumptions include that:

- The data used to measure assistance in the EU is accurate and complete. The EU uses the PSE as a measure of support. This is inappropriate. The PSE, an estimate of overall government assistance to producers, constructed by the OECD, was never designed to be used as an economic tool in the way the PC has used it. PSE estimates are general summations of support for broad product categories (i.e. ‘pig meat’). The OECD has acknowledged to the PC that the estimates for pig meat assistance have been based on a narrow range of pig meat operations in one country. The PSE also involves a ‘top-down’

approach that infers support, given market conditions, rather than calculating all discrete support measures for individual tariff lines⁶. The only effective way to understand the impact of government measures on prices of any product is to undertake empirical research, which the PC has not done.

- The PC assumes that the products it is comparing in terms of prices in the EU and outside are the same. However, the data that the PC has used to compare the exports of Danish products to Australia, to other non-EU countries and to EU countries are based on a tariff code (0203.29.55, frozen boneless meat of domestic swine excluding bellies and cuts thereof) which potentially covers a large number of products. The products falling within this code being exported from Denmark to Australia can differ from the products exported to EU markets and non-EU markets besides Australia. Investigations to be undertaken in the EU as part of recent APL commissioned work will aim to cast further light on this.
- The PC seems to imply that the pattern of prices and trade should reflect the existence of a two-price system in the EU resulting from farm policy. That is, prices must be higher for products inside the EU than outside. However, there is no evidence that the PC has recognized that the patterns of trade and prices could be explained in other ways. The Australian industry may be adversely affected by trade from Denmark which is affected by government policy other than farm policy. It may also be explained by factors other than government policy which the PC fails to adequately take into account. This is explained in the following sections. The PC is not entitled to infer that farm policy determines prices in the Danish market until it has discounted other factors that can influence prices.

4.2.2 PC statements on Government policy and prices

- The PC's statements taken together imply that the imports of middles from Denmark do not benefit from significant government assistance as claimed by the Australian pork industry.
- The PC's argument is based on the prices of those imports apparently not being significantly lower than exports of similar goods to other EU markets.

⁶ The PSE is calculated by adding up two elements: an estimate of the gap between the domestic producer price and a reference 'world market price' at the border of the country concerned, multiplied by the quantity of the product produced in that country, following a set formula; and also budgetary transfers (subsidies).

- One would expect export prices to be lower if there was a two-price system (protected/subsidised high domestic prices/low export prices) in the EU – because the prices do not apparently fit this pattern, the PC seems to be implying that the two tier price system may not exist and the OECD’s measure of support given to the pork industry may be overstated.
- The PC also points out that the prices for Danish middles imported by Australia (which is the raw material used for making bacon here) is not significantly lower than the price of the further-processed product of bacon exported from Denmark to world markets. This suggests to the PC that the prices of product exported to Australia may actually be relatively high.
- All in all, the PC seems to infer that the imports from Denmark essentially reflect normal commercial conditions, and are not determined substantially by policy factors.

4.2.3 Potential patterns of prices and trade

The pattern of prices and trade could be explained in other ways than that proposed by the PC in the Draft report. These include:

1. The measure of policy support used by the PC may be inaccurate or incomplete. Government policy affecting trade and prices could be affected by policy which supports the pork industry and which is not picked up in the OECD measure used by the PC. This could include sub-national support. This would mean the Australian industry is facing a competitor which is more significantly subsidised than the PC suggests or implies.
2. The Australian industry may be adversely affected by trade from Denmark which is affected by government policy but not farm policy. Trade and prices can be influenced by other government policies e.g. market structures which result from weak competition policy. Market power may exist whereby a monopolist is effectively allowed by government policy to control supply and sell at different prices into different markets. The pattern of trade and prices could thus be affected by weak government competition policy, and the Australian industry could be adversely affected by unfair (non-market based) pricing.
3. The pattern of trade and prices in the PC analysis might be able to be explained by factors other than government policy. The PC analysis assumes that the products its pricing data compares

are in fact the same. They could be different, and the data being used to measure trade and prices could actually include different products with different prices. The pattern of trade and prices could thus reflect product differentiation. But a two-price system, or monopoly practices by Denmark, could still be in place.

4.3 Picture of the level and form of support for pig meat production in the EU and Denmark

Subsidy programs represent a very small portion of government support for pig meat production in the European Union. Instead, measures such as tariffs and a tariff rate quota, which fall under the MPS in the PSE, account for 90 percent of the PSE.

In 2003, the PSE estimate for pork in the European Union (EU) was €5,310 million, of which around 10 percent (€531 million) was non-MPS related, flowing from budgetary transfers. The remaining €4,779 is attributed to the MPS category.

Table 1. PSE, percentage and Euro million on pig meat, European Union, selected periods

	1986-88	2001-2003	2001	2002	2003
Percentage PSE	16	22	22	21	24
PSE Euro million	2,839	5,563	6,322	5,059	5,310

EU tariffs on pig meat range between €46.7/100 kg for fresh or chilled bellies to €86.9/100 kg for fresh, chilled or frozen loins, and fresh or chilled, boneless cuts other than hams or carcasses.

Pig meat is also subject to a tariff rate quota. For most cuts of swine fresh, chilled or frozen, excluding loins (which have their own TRQ), the quota is 5,500 tonnes. Above this quota the duty varies between €300 per kg, to €434 per kg.

Denmark imports almost all its pig meat products from other EU countries. Non EU imports are negligible.

Table 2. Sources of Danish pig meat imports, by product, 2003

Product	EU	Non-EU
Live pigs and sows	2	0
Bacon	8525	38
Carcasses, fresh/frozen	627	0
Cuts	36,646	227
Fat	3,042	0
By-products	22,170	2,419
Canned meat	11,356	11
Other processed products	6,634	58

Other key factors that may be affecting production, trade or the pricing system in Denmark include:

i. Market structure

A key factor which could affect the production, trade and pricing of Danish pork exports to Australia is the competitive conditions prevailing in the Danish pork industry. If the Danish Government allows anti-competitive market conduct by Danish pork producers exporting to Australia then the Australian industry could be subject to unfair competition. This could occur if pork production and exporting was subject to monopoly or other anti-competitive use of market power (i.e. ability to raise or lower prices above market-determined levels).

Danish export prices could be either raised above competitive market prices or below them. Given that Australia has alternative sources (other than Denmark) of imports of middles, the main source of un-competitive pricing would be if product prices from Denmark were depressed below market levels in order to achieve market penetration.

To offset the artificially lower prices into Australia, the monopolist would be able to charge higher than market prices inside Denmark. Once again, there is considerable difficulty in proving this is actually taking place. The products sold in the domestic and Australian market need to be substitutable. Conditions for access in the two markets need to be identical too, and this is clearly not the case in respect of Australia and Denmark.

What is necessary in the first instance is to prove that such conduct is potentially possible i.e. that there is a potential for monopoly or market power to be exercised in Denmark. To operate effectively, such market power would need to apply in respect of both the domestic production and export of Danish products (otherwise a strategy of seeking to raise domestic prices for pork to offset lower prices for exports would be undercut by a competitor in the domestic market).

The data required to assess this includes information on the structure, conduct and performance of the Danish pork industry, any evidence of market power in the form of monopoly or cartel structures or behaviour, or exemptions from the normal competition laws for anti-competitive conduct. As well, information is required of any regulation of such behavior undertaken by the competition authorities e.g. price monitoring. Finally, this information needs to be placed in the context of the trade pricing affecting Danish products exported to Australia.

ii. Product/market differences

Another key factor which could affect the production, trade and pricing of Danish pork exports to Australia is product differentiation. The PC analysis of trade and prices assumes that the middles being exported to Australia and to other non-EU and EU markets are the same. The PC concedes however that the observed higher price for pork exports to Australia than to EU markets could be explained by differences in the quality of pig meat supplied to different markets. The PC analysis is based on exports of a particular tariff item. What is needed to be identified is whether the pig meat exported from Denmark to Australia and other markets is included in that tariff code.

Information would need to be gathered on comparability of products exported to Australia and other markets. Similarly, information would be needed to see whether the bacon made from Danish middles in Australia, and the bacon exported from Denmark made from Danish middles, are the same. If not, then comparing the price of the middles used to make bacon in Australia with the bacon made from middles in Denmark would not be appropriate.

4.4 Data gaps

Arising from the above analysis, the key gaps in the data are identified in the Table below.

Table 3. Data gaps

Data gap for overseas investigation
1. Government assistance policy <ul style="list-style-type: none">• Accuracy/completeness of PSE measure for pork in EU/Denmark• Sub-national assistance granted to EU/Denmark• Relationship between support policy and Danish export and domestic sales and prices
2. Competition policy affecting trade and prices <ul style="list-style-type: none">• Structure, conduct and performance of the pork sector• Evidence of market power and regulation thereof in the pork sector by competition authorities• Relationship between competition policy and Danish export and domestic sales and prices
3. Other factors effecting trade and prices <ul style="list-style-type: none">• Nature of products included in the tariff item used by PC for trade and price analysis• Comparability of relevant products exported to Australia, other non-EU markets and EU• Possible sources of data on products used in trade and price analysis by the Australian industry in future

4.5 Need for an extension

In light of the evident vagaries and inconsistencies of existing information APL strongly recommends that the Inquiry's deadline be extended to enable incorporation of the further detailed analysis APL has commissioned. These irregularities need to be urgently addressed as failure to do so will present Government policy makers and industry stakeholders with an inaccurate picture of the competitiveness of the Australian pork industry.

5 Conclusion

The draft international benchmarking study of the Australian pork industry provides a valuable independent tool for determining the appropriateness of the strategies entailed in the draft Industry Restructure Plan. The Study identified five key areas of work required for the Australian pig industry if it is to be competitive and 10 key drivers of competitiveness that are considered the most important for any pig meat industry that wants to compete and win in the global market. It is noteworthy that the strategies within APL's draft Restructure Plan are frequently referred to throughout the report as providing a key means through which the Australian industry can improve its competitiveness.

Some of the key critical findings of the Study included that:

1. Feed grain competitiveness – In a liberalized pig meat import market, the Australian industry risks seeing global pig price variability alongside domestic feed price rigidity; critically the Australian pig price/feed ratio needs to mirror those seen in competitor markets. The industry is put at risk if domestic pig producers are not offered the same guarantees on feed supply that their competitors have.
2. Trade measures – Given the global pork market is highly volatile and cyclical, and when coupled with the openness of the Australian domestic market, it is critical that the Government put in place necessary trade measures so that the industry's restructure plan is not thrown off course by global market instability. If this is not done, private sector investment in the restructure plan will be deterred and the industry's opportunity to become competitive will be greatly diminished.
3. Sourcing capital for structural adjustment – If producers are to remain profitable they must adjust to market forces through further investment in their businesses. However, the ongoing level of uncertainty combined with the low level of cash flow in the industry is going to make change, and the necessary capital investment required to make this change, extremely difficult to obtain. If this is not done the chances of obtaining a globally competitive and sustainable pork industry are seriously weakened. Therefore, the industry needs a macroeconomic policy setting that will reduce this uncertainty and provide the necessary cash flows to generate this change.
4. Government assistance – Existing market pressures are insufficient to force competitive change and private sector investment in the industry's restructuring programme will be deterred and opportunities

to become competitive will be lost forever if government assistance is not provided to remove surplus production and processing from the Australian pork industry.

APL is greatly concerned that industry competitiveness is not just being impeded by overseas countries subsidies to their pork industries but also by our own Government's policies which act to further distort the industry's input costs. APL is extremely concerned that the industry faces a double edged sword: a situation where other countries are subsidising and helping their pork industries to reduce costs, while our Government implements policies - such as the single desk policy and ethanol policy - which further drives up the industry's major cost of production. Clearly regulatory impediments that diminish the industry's competitiveness must be addressed.

The PC has acknowledged that there is uncertainty surrounding the accuracy of some of the data upon which their analysis relies. This was particularly evident in respect of both the estimate by the OECD of the amount of support provided to producers in the EU and also the comparability of data on prices for similar products sold in domestic and export markets. The PC also acknowledged that the relationships between the support provided to producers in the EU and the observed patterns of trade and prices in export markets such as Australia are somewhat of a "mystery"⁷.

APL is greatly concerned that based on the level of analysis undertaken by the PC the measure of policy support may be inaccurate or incomplete. In particular, APL is concerned about the assumptions made by the PC in reaching its conclusions with regards to government assistance policy and patterns of trade and prices. APL questions:

- The accuracy and completeness of data used to measure assistance in the EU, particularly the inappropriate use of PSE as a support measure.
- Whether the products the PC is comparing in terms of prices in the EU and outside of the EU are in fact the same.
- Whether the PC has recognised and taken into account that there are factors affecting trade and prices other than farm policy, such as market power and regulation by competition authorities.

This data must undergo substantially more rigorous assessment before the PC can reach the conclusions it has regarding the impact of Danish support measures on the Australian pork industry.

APL contends that it is essential that these matters be satisfactorily addressed in order for the PC to fulfil its requirements under the Inquiry's terms of

⁷ Commissioner Neil Byron, Pig Meat Inquiry Public Hearing - Melbourne 7th February 2005; Transcript P.489

reference. APL again emphasises the need for the PC to seek an extension for the Inquiry up until 30th June 2005 if the PC is to provide robust, objective analyses of the competitiveness of the industry and what the industry and the Government can do to change these circumstances. It is imperative that the PC firstly properly and accurately characterises the state of the industry before conclusions and recommendations can be made.

THE FOLLOWING ATTACHMENT IS CONFIDENTIAL

Attachment A: Competitiveness of the Australian Pig Meat Industry