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Agriculture Competitiveness Taskforce,
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<u>Submission to the Task Force for the Australian Government's White Paper on Competitiveness</u>

This submission will address the following numbered Terms of Reference as outlined in the Agricultural Competitiveness Issues Paper:

1. Food security in Australia and the world through the creation of a stronger and more competitive agriculture sector;
3. Access to investment finance, farm levels and debt sustainability;
4. The competitiveness of the Australian agriculture sector and its relationship to food and fibre processing and related value chains , including achieving fair returns;
5. The contribution of agriculture to regional centres and communities, including ways to boost investment and jobs growth in the sector and associated regional areas;
6. The efficiency and competitiveness of inputs to the agriculture value chain – such as skills, training, education and human capital; research and development; and critical infrastructure;
7. The effectiveness of regulations affecting the agriculture sector, including the extent to which regulations promote or retard competition, investment and private sector-led growth;
8. Opportunities for enhancing agricultural exports and new market access; and

This submission will particularly focus on the uncompetitive disadvantage affecting the Australian Beef Industry.

1. Food security in Australia and the world through the creation of a stronger and more competitive agriculture sector

Food security is becoming an increasing global concern as the global population looks set to expand exponentially with the result that the global demand for food will more than double in the coming half century. In order to meet this demand and take advantage of the opportunity to become a leading food supplier to the much touted growing Asian market, it is essential that Australia have a strong and competitive agricultural industry. The growing Asian middle class particularly provides a market for the high quality beef that Australia produces. Australia needs to improve the competitiveness of its agriculture industry so it does not get surpassed as a global power in the agriculture industry and in the provision of food. The beef industry currently exports 70% of its produce, compared to 10% in the US, making competitiveness in the international markets all the more important for the industry.

3. Access to investment finance, farm levels and debt sustainability

There is currently a debt crisis and a lack of access to much needed capital in rural Australia that is crippling many farmers and inhibiting expansion and growth. The nature of agriculture and farming, particularly in a harsh and temperamental climate such as the one we have in Australia, is that it is a long term investment. Investment in agriculture cannot be subject to a demand for immediate returns or an inability to absorb relative short term losses when faced with issues such as drought. Agriculture is therefore not suited to conventional commercial based lending focused on providing working capital credit and needs to find an alternative.

This issue is further compounded by the fact that Australia is competing in the international market against overseas competitors that have greater access to capital, subsidies and sustainable debt options. Australia's base interest lending rate is currently 2.5% compared to 0.25 % in the United States. Falling herd numbers in the United States, as a consequence of recent American drought years – 87.9 million is the lowest US cattle herd number since 1951 – and the consequent, despite the continuing drought, record prices US cattle producers are receiving for their cattle (*US Department of Agriculture and University of Wisconsin Beef Outlook 2013*), also means that Australian farmers are competing against increasing profit and therefore increasing access to capital from one of its main competitors.

Overseas competitors, including both developing and developed economies such as Brazil and the US, are often the beneficiaries of support from Agricultural Development Banks created to provide capital to farmers on the basis of long-term returns and with the ability to absorb short term difficulties and losses. The establishment of a Rural and Regional Development Bank here in Australia, along the lines of the old Commonwealth Development Bank would alleviate this problem. Such a bank would provide development finance for new and existing Australian businesses in rural and regional Australia at global competitive interest rates. The proposed Bank would be Government guaranteed and therefore AAA rated – with access to borrowing rates of at least half a percent less than Major Bank's AA rating can provide. An essentially non-profit nature, with the wider gain a successful and competitive agricultural industry, would also reduce interest rates and associated costs.

Foreign investment has always provided investment finance and capital to Australian agriculture and infrastructure, however foreign investment must not equate to foreign profit, where profit and tax dollars are taken overseas through transfer pricing, to the detriment of Australian producers. Moves more recently taken to increase levels of scrutiny on foreign investment such as that under the recent JAEPA where Japanese investors will only have to outlay a $15 million on land to trigger FIRB scrutiny, and $53 million on agribusiness investments, and any investment by State-owned businesses will only have to exceed $1 (one dollar) to be handed over to FIRB. However, the FIRB needs to be a board with teeth rather than simply a rubber stamp as it seems to have been in the past.

4. The competitiveness of the Australian agriculture sector and its relationship to food and fibre processing and related value chains, including achieving fair returns

The current profit levels of Australia's agricultural sector, and the beef cattle industry in particular, are unsustainable and are raising industry wide concern. Australian producers are suffering from a significant comparative cost disadvantage compared to their international counterparts.

The factors that have led to these current unsustainable profit levels and Australian beef industries comparative cost disadvantage are varied and accumulative. Precise figures on the amount and breakup of the comparative disadvantage are not readily available but Hunt Partners has calculated estimate figures on the basis of available published material, along with the input of a number of agricultural economists and senior industry members .

The White Paper should examine the nature and amount of these comparative cost disadvantages as a matter of utmost importance in its wider inquiry into the competitiveness of Australian Agriculture

Uncompetitive Cattle Processing Costs

JBS Swifts ,who have abattoirs in the US, Brazil and Australia, have published figures that show it costs $300 to slaughter and process a beast in Australia compared to $150 in the US and $100 in Brazil. The 1993 Report into International Comparisons of the Beef Processing Industry (Booz, Hamilton & Allen) found that Australian cattle processing costs were on average $100 a head higher than those in the US. The Report found and that after by-products were taken into account, Australian abattoirs had a $198 a head disadvantage vis-à-vis their American counterparts. These figures are not too inconsistent with the $150 a head disparity referred to by Dr Barnard in his evidence to the Senate Inquiry into the Grass Fed Cattle Levy on 7 March 2014.

The actual processing costs vary between abattoirs depending upon the efficiency of the particular plant, the age, modernity, and size of the abattoir, and the productivity of their workforce. The 1994 Industry Commission Report into Meat Processing noted that there was significant variability in costs between abattoirs, with 50% of abattoir labour costs for transformation of a live beast to boxed beef being higher than the average labour percentage of total processing costs.

The 1994 Industry Commission Report found that the average break up of processing costs was:

- labour 45%
- depreciation 3%
- materials 16.8%
- government levies 5.2%
- inspection costs 4.4%
- office overheads and marketing 19.7%
- earnings before interest and tax 6.1%

The 1994 Report found that the profit margin to be inconsistent between abattoirs, with many submissions reporting sales revenues less than expenses and approximately one quarter reporting gross losses. Half of the abattoir sample investigated reported gross profit margins between 4.5% and 15% of gross turnover.

Labour Costs

The 1993 Booz, Hamilton & Allen Report found that Australian abattoirs had significant labour cost and labour productivity disadvantages compared to our US, Argentinean, Irish and New Zealand counterparts, as well as significant government charges and inspection disadvantages.

The minimum hourly wage in Australia is over $16 an hour compared to $7.25 an hour in the United States and about $2 an hour in Brazil. The minimum wage in Ireland is higher at €8.65 per hour (approx $12), however, Ireland benefits from the above OECD average level in subsidies provided by the EU to farmers.

Conceptual Calculations

Although it is difficult to be precise, an examination of published available abattoir employment numbers and kill figures, indicate that Australian abattoirs may have an employee/ kill ratio of around 1.4 grown cattle processed each day per employee. This means that each meatworker kills and processes approximately 7 grown cattle per 5 day week or approximately 350 head of cattle each year. Based upon an average meat worker salary of $46,500, meat processing costs per beast would be $133 per head.

If we apply the JBS Swifts Greeley Colorado 1.68 employee/kill ratio, each American meat worker will kill and process about 420 head of cattle each year. Based upon an average meat worker annual salary of $23,800 in the US and the JBS Greely Colorado employee/kill ratio of 1.68 per person per day or 420 head a year, American meat processing labour costs per beast would therefore be about $56 a head. This amounts to $77 less than in Australia.

Australian Costs per Head to Kill and Process Cattle

The 1990's reviews of meat processing costs in Australia referred to earlier are outdated but Hunt Partners' guestimate of the Australian beef processor per head costs based on assumptions about average abattoir distance from domestic markets and ports and processing marketing arrangements are not inconsistent with the JBS Swifts the 1994 Industry Commission percentage break up estimate that it costs around $300 a head for Australian cattle abattoirs to slaughter and process a grown beast.

Comparative Costs per Kilo to Produce Boxed Beef in Australia and in the United States

American dressed cattle weights are higher than Australian dressed cattle weights because about 2/3 of US cattle are fattened in feedlots before they are slaughtered *(USDA)* compared to less than 25% in Australia *(ALFA)*. Consequently, the $150 a head of labour cattle processing Australian cost disadvantage vis-à-vis the US, is even greater if we apply a cost per kilogram comparison.

In 2013 the average dressed carcass weight of cattle and calves slaughtered in Australia were 267 kg *(ABS)*. In 2012 the average dressed weight for cattle slaughtered in the United States was 390kg for steers and 359kg for females *(USDA)*, which suggests an average dressed weight per carcass of 374.5 kg.

If we apply the average meatworker salaries in the United States and Australia and the two countries respective employee/ kill/ ratio then:

- US labour processing cost per kg is 1.51 cents
  (374.5 kg x 420 cattle = 157,080 kg divided into $23,880 = $.151515)

- Australian labour processing cost per kg is 5.16 cents
  (267 kg x 312 cattle = 83,304 kg divided into $43,000 = $.51618)

If these assumptions are correct, then Australian beef processing per kg labour costs are 3.4 times higher than those in the US.

If we apply the median average meatworker annual wage of $46,488, the Australian labour processing cost per kg is $.55805 or 3.7 times higher than in the US.

If we accept the JBS Swift cost figures of $150 US and $300 Australian per head cattle slaughter and beef processing costs then the US meat processing cost per beast slaughtered is 40 cents/kg compared to Australia's slaughter and processing costs of $1.12/kg.

Fair Returns

Fair returns for farmers require a competitive and open market in which they can sell their products. This is not the case in Australia. Australia has the most concentrated supermarket duopoly structure in the world and Australian farmers supplying the domestic market are being squeezed to the point that they are becoming unviable. The Land newspaper has referred to figures which state that Australian cattle producers receive 25% of the consumer dollar for their cattle whilst US producers receive 47%.

5. The contribution of agriculture to regional centres and communities, including ways to boost investment and jobs growth in the sector and associated regional areas

The population in Australia is forecast to increase to 36 million by 2050. 75% of the population currently live on the coast and the major cities have seen a population increase of over 10%. The already scant population in rural areas has been declining. The growth of urban population to the detriment of rural population has a double negative effect for agriculture, with less people available to work and run farms, and an ever increasing urban sprawl eating up surrounding agricultural land.

Increased competitiveness and profitability themselves will in turn increase the attractiveness and sustainability of working and living in more regional communities. However, the groundwork also needs to be provided by Government through the provision of greater infrastructure, social services and amenities in affected areas.

In the immediate, regional areas need an increased workforce to meet the increased food production requirements. A cost-effective manner of doing so would be to locate migrants to Australia, particularly those with a workforce skills deficit, in such areas for an initial period of time, and provide them with the training and skills to provide valuable contributions to the workforce.

Farmers already facing an uphill battle, can often find themselves facing inflated land prices for neighbouring plots of land where mining companies have bought huge swaths of land, great distances away from the actual mines, to offset their carbon tax. Regulations should require such offsets to be located in the mining area, or at least to comply with local land values so as not to price local farmers out of expanding their farms.

Incentives should be provided to business operating in, or relocating to, rural and regional areas. These could include for example, taxation zones in rural and regional Australia; payroll and stamp duty relief for businesses in rural and regional Australia; and Government relocation grants and incentives.

6. The efficiency and competitiveness of inputs to the agriculture value chain – such as skills, training, education and human capital; research and development; and critical infrastructure

A stronger and more competitive agriculture sector requires outdated Rural Organisational Structures to be updated and improved. There are many cattle and sheep producers and processors, large and small, who feel the current organisational structures are outdated and no longer adequate to serve he collective needs of the meet industry. Many red meat levy payers in particular, feel disenfranchised by the current MLA board selection process. The Cattle Council, which is meant to set policy and direct MLA operations on behalf of grass fed cattle producers, is strapped for cash and urgently trying to reform and refinance. A number of other levy funded rural industry organisational structures, such as in the egg, grain and pork industries, have a greater degree of member enfranchisement with some form of directly elected boards.

7. The effectiveness of regulations affecting the agriculture sector, including the extent to which regulations promote or retard competition, investment and private sector-led growth

<u>Government Influenced Costs and Charges</u>

The 2001 Heilbron Report, commissioned by MLA on the impact of uncompetitive Government influenced costs and charges on the Australian red meat industry, found the percentage of revenue paid by producers in government influenced costs and charges to be as follows:

- Australia - 1/3;
- New Zealand - 1/6;
- USA - 1/8 .

This means that Australian livestock producers paid more than twice as much as their United States counterparts in government influenced costs and charges.

There have been further increases in Australian Government influenced costs and charges since 2001, such as the National Livestock Identification System (NLIS), increased MLA levies, the imposition of 100% AQIS fee recovery from meat processors and the imposition of the carbon tax, which have collectively increased Government influenced costs and charges by almost $23 a head since 2001.

The AQIS inspection charges, taken as an example, currently amount to about $85 million a year, and are entirely paid for by abattoirs themselves, whilst the governments of overseas competitors pick up all these costs.

The significance of the burden of these uncompetitive government influenced costs and charges on the Australian beef industry is substantial. Australian cattle producers will have to pay $289 in government influenced costs and charges from the sale of an $800 fat steer ($800 divided by 3 =$266 + $23 = $289) while American cattle producers will only have to pay $100 in government influenced costs and charges from the sale of an amount of equivalent value.

8. Opportunities for enhancing agricultural exports and new market access

<u>Uncompetitive Tariff Charges</u>

The introduction of Free Trade Agreements in recent years has ameliorated the comparative disadvantage impact of tariff imposts on Australia's exports. Tariff disadvantages are very important to Australia because Australia exports almost 70% of its beef production whilst the United States, for example, only exports about 10% of its beef production.

Currently Australia has to pay:

- a 40% tariff to export beef to South Korea compared to 32% by the US
- a 12% tariff for bone-in/boneless cuts and 25% tariff for carcases and half carcases to export beef to China, compared to 2.7% and 8.3% by New Zealand, while the export of US beef to China has been banned since 2003.
- Australia, New Zealand and the US all currently pay a 38.5% tariff to export beef into Japan.

The recent Free Trade Agreements have amended this position. However, many of these recent changes have a significant delay until they become fully effective. Under the recent FTA, Japan will halve the current 38.5% tariff on frozen Australian beef products (to 19.5%) over 18 years, with an immediate tariff cut of up to 8 per cent in the first year of the agreement and reduce the tariff on fresh beef to 23.5% over 15 years. The FTA concluded with South Korea will result in the elimination of beef tariffs within 15 years.

The negative impact of disproportionately high tariffs is can be clearly seen in the situation that unfolded in the mid 1990s when America entered into a free trade agreement with Canada and Mexico known as the North American Free Trade Agreement (NAFTA). At the same time Canada imposed a tariff and quota on Australian beef imports. Consequently American beef exports to Canada have since more than doubled from 67,000 tonnes in 1993 (prior to the NAFTA agreement) to 163,237 tonnes in 2013 and Australian beef exports to Canada more than halved falling from about 91,661 tonnes in 1993 to 17,900 tonnes in 2013.

Thursday, 17 April 2014

Submission Conclusion

The perfect storm of the near-record Australian herd, high average carcass weights, live export bans and drought, have led to a supply and demand crash in cattle prices which combined with the high interest rates, uncompetitive tariff agreements and Australia's comparative cost disadvantage with overseas competitors has resulted in unsustainable cattle producer profit margins with costs of production generally exceeding returns.

Australia is already comparatively disadvantaged on the international stage by high production costs. This disadvantage is further compounded by the imposition of higher government influenced costs and charges which, shouldered at least partially by other governments overseas, are borne by the industry in Australia. If the $189 a head burden of uncompetitive government influenced costs and charges is added to Australia's uncompetitive processing cost disadvantage of $150 a head, then the total comparative cost disadvantage to Australian cattle producers compared to their American counterparts is $339 per head. As outlined earlier in this submission, the per kg of beef differentiation is even higher

Alongside this, Australia is amongst the lowest provider of subsidies to farmers amongst OECD countries. Where other countries with higher level production costs, such as Ireland, receive higher or above OECD average levels of subsidies from the EU, Australian farmers are suffering from all sides.

Faced with higher costs and lower subsidies, the need for access to redevelopment finance is greater than ever. Agricultural development banks have been successfully introduced around the world and continue to be used in both developed and developing countries. This success could and should be followed in Australia.

Against the backdrop of such a competitive disadvantage, Free Trade Agreements have recently failed to meet the mark. The FTAs that Australia has entered into are misnomers in that they do not amount to what they claim to offer, free trade. FTAs and foreign investment are an important aspect to Australian agriculture, however, they must level the playing field in order to be effective and mutually beneficial.

In order to successfully implement any reform, organisational structures such as the MLA themselves need to be reformed. A more democratic and universal representation of livestock producers is needed in order to both identify issues and difficulties and also to implement solutions and monitor progress.

Australian agriculture needs to instigate an urgent detailed review and analysis of its uncompetitive cost structure as a matter of urgency and the Federal and State governments need to take steps to reduce the burden of uncompetitive government influenced costs and charges on Australia's livestock industry and other agricultural export industries without delay.

Yours faithfully,

Norman Hunt

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