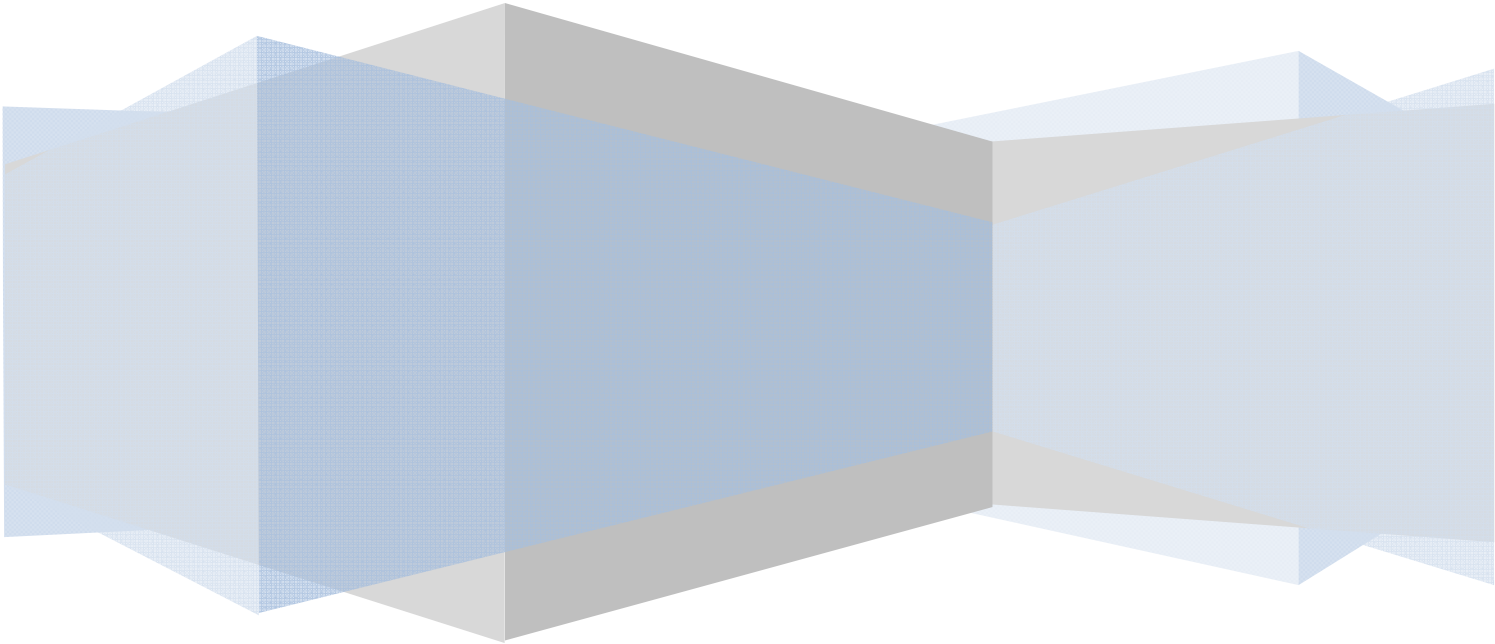
Submission to Select Committee on Australia's Food Processing Sector

September 2011



is a third generation family-owned food processing business in Victoria, and has been processing potatoes since 1929. primary business is manufacturing frozen chips, supplying foodservice wholesalers who sell to pubs, fish and chip shops and other food outlets across Australia.

The comments in this submission will draw on experience in the potato processing sector, however we believe that many of the observations will be equally applicable to other sectors of the food processing industry in Australia, which face many of the same pressures.

Submission summary

This submission focuses on the general competitive environment in the food processing sector in Australia, particularly relative to competition from foreign exports. It also focuses on input costs, particularly energy, and the likely impact of the carbon tax on those costs and consequently on the industry.

This submission notes that food processing in Australia is in a parlous state, despite being highly efficient compared to the imports with which it must compete. It compares the situation of local processors with that of competitors, including describing the production cycle for local and imported products, noting that the carbon emissions of imported products are astronomically higher than local products. It argues that a carbon tax applied to the Australian food processing sector without appropriate exemptions or free permits would be counter-productive in environmental terms, as it would make more carbon-intensive imports even more competitive, to say nothing of the economic and social consequences.

Finally, it notes the threat to Australia's future food security if the food processing sector is permitted to decline further.

Competition in the food processing sector

1. Until recently, frozen chips sold for consumption in Australia were predominantly manufactured in Australia from potatoes grown in Australia. The Australian market had vibrant, healthy competition, with many competing producers producing a low-cost product with a low profit margin. In recent years, the market has faced competition from Europe and North America, with Chinese producers currently positioning themselves to enter the market in a significant way in the near future.

2. Currently the cheapest frozen chips available in the Australian market are from Belgium, the Netherlands and the United States. This is true in the foodservice sector serviced by but also in retail, as a quick glance at the country of origin of any home-brand chips in the supermarket will confirm. The cheap imports are possible because of the much lower input costs faced by manufacturers in those countries, as well as economies of scale. This makes it

very difficult for Australian manufacturers to compete, particularly for smaller scale

3. As the second largest producer of potatoes in the world, and one of the dominant suppliers of frozen vegetable imports to Australia, China's potential as future low-cost producer of frozen chips cannot be ignored. In the last 10 years McCain, Simplot and Lamb Weston have all established plants in China.

4. The competitive pressure faced by Australian food processors also flows through to Australian farmers, as the foreign imports use potatoes grown by foreign farmers. As Australian processors lose market share, Australian growers lose customers. Likewise, when Australian processors are forced to slash margins to attempt to compete with cheap imports, the price that can be paid to local growers must fall. The farmers' blockade outside McCain earlier in 2011 was a graphic example of the tensions throughout the growing and processing chain caused by competition from cheap imports.

5. Despite being highly efficient by world standards, Australian processors are at a distinct disadvantage to foreign competitors due to the much lower cost base faced by foreign producers. These difficulties, which have been present now for several years, have been exacerbated by the high Australian dollar, which makes imports even cheaper.

6. While for the time being is surviving in a highly competitive market, the uneven playing field we face compared to overseas producers is making business tougher and tougher. Any further increase to our input costs relative to our overseas competitors, whether in the form of the carbon tax or any other measure, may well be the straw that breaks the camel's back and forces us out of business, taking manufacturing jobs and a livelihood for many Australian potato farmers and the businesses that service them along with us.

Trade subsidies

7. Agricultural subsidies in the European Union and the United States drastically reduce the price of potatoes from Belgium, the Netherlands and the USA. Potato growers in those countries can therefore afford to be less efficient in their methods, including in their use of fuel and fertilisers, than non-subsidised Australian farmers.

8. Cheap, subsidised potatoes immediately put foreign processors at a competitive advantage to Australian processors, as their main input is drastically cheaper. European and American processors therefore have a sufficient margin to cover the additional transport costs to Australia and still be competitive with Australian processors.

9. In addition to subsidies for growers, European and American processors can access other subsidies, including manufacturing subsidies, fuel subsidies and export assistance. American processors exporting to Australia are estimated to have 40% of their input costs subsidised. These subsidies further enhance the margin of foreign processors to enable them to undercut Australian processors. It is no coincidence that the cheapest frozen chips currently

available in the Australian market come from countries that heavily subsidise their agricultural and food processing industries.

10. We recognise that the Australian government is continually seeking an end to European and American agricultural subsidies in the course of international trade negotiations. We encourage the government to continue to do so vigorously. At the same time, it is important to recognise that other subsidies available to food processors in Europe and the United States are equally harmful to Australian farmers, as they squeeze the margins of competing local processors and reduce the volume of produce bought from local growers and the price paid, and also harm the processors themselves and the people they employ in Australia. Such subsidies should therefore be targeted in trade negotiations with the same vigour as agricultural subsidies.

Regulatory environment

Input costs: energy

11. Manufacture of frozen chips is undeniably an energy-intensive business. Potatoes are peeled with high pressure steam, cut into chips, sorted, blanched in hot water, dried in gas fired ovens, fried at 180°C, then snap frozen at minus 18°C. This process ensures quality and consistency are maintained at a level the market demands.

12. This process requires significant energy use. and most other Australian processors are conscious of the financial and environmental costs of an energy-intensive manufacturing process, and have implemented systems that are highly efficient relative to foreign producers. Plant equipment and processes are constantly being refined to improve energy efficiency further, however there is no escaping the energy-intensive nature of the business.

13. Given the cut-throat competition from cheap imports and the thin margins involved, potato processors are highly sensitive to small increases in the costs of major inputs, including energy.

Carbon tax

14. The main rationale for a carbon tax that applies to the manufacturing industry is to price carbon emission so as to encourage more environmentally friendly practices among producers, or alternatively, to make less-polluting products more competitive than their carbon-intensive counterparts, thereby encouraging consumers to buy from more environmentally friendly producers. In either case, the intention is to reduce the amount of carbon pollution emitted in the relevant industry.

15. In the case of the potato processing industry, the effect of the carbon tax, which will increase energy costs to which the industry is very sensitive, will be to increase the competitive advantage of foreign imports over Australian-made products.

16. As can be seen from the boxed text below, “the life cycle of chips from paddock to plate”, a tonne of frozen chips imported from the USA or Europe produces vastly more carbon pollution than a tonne of chips produced in Australia. The perverse effect of the carbon tax in this context would be to make the more efficient and environmentally friendly Australian product even less competitive against imports than they already are, displacing Australian products by the far more carbon-intensive imports. The effect would be a substantial net increase in carbon pollution attributable to the Australian frozen chip market. In the event that the increased energy costs from the carbon tax would cause some Australian processors out of business, which we certainly consider possible under current conditions, the problem would be exacerbated by an even greater movement towards imports.

The life-cycle of chips from paddock to plate

Australian-produced chips

The typical production chain for frozen chips processed at *is as follows:*

Potatoes are grown by relatively efficient farmers usually within 300km of our plant.

Potatoes are harvested and delivered fresh from the field to our processing plant .

Potatoes are processed usually within 24 hours of arrival. The plant is highly efficient in its energy use by world standards, and uses natural gas-fired boilers to produce steam.

Chips are held in freezers on site and collected by wholesalers in refrigerated trucks or vans, who deliver them to food outlets as they are ordered. Ordering and production generally occur at a similar rate, requiring much less warehousing compared to imports. Chips are often collected by wholesalers straight off the production line.

Chips imported from the USA

The typical production chain for frozen chips imported to Australia from the USA is as follows:

Potatoes are grown by relatively efficient growers on a very big scale. Energy and fertiliser input costs are cheap so growers need not be overly conscious of conserving either.

Due to very cold and snowy winters in North American growing areas, potatoes can only be grown and harvested for a short time of each year, so they are trucked into enormous storage facilities. The potatoes are loaded into these facilities where they are constantly ventilated by ventilation fans, gassed with chemicals to stop them sprouting, and the whole building is heated or refrigerated and de-humidified to ensure potato deterioration in storage is minimised. Potatoes are stored in these facilities for up to 9 months of the year.

Potatoes are loaded back into trucks and shipped to the processing plants where they are processed into frozen chips on a much larger scale. North American plants are usually relatively efficient, however the boilers generating the steam for the energy-intensive processes are usually oil fired rather than our much cleaner natural gas fired boilers in Australia.

Once processed, frozen product is loaded into refrigerated trucks and trucked to cold storage facilities where it is stored at minus 18°C in enormous refrigerated warehouses run by third party cold storage companies. Again many of these refrigerated warehouses were built in an era of very cheap power, so energy efficiency was not a crucial design factor.

When orders from Australia are received, the stock is released from the refrigerated warehouse and packed into refrigerated high cube reefer containers. These containers are trucked to the port where they are held and the containers are plugged in to a giant power supply. The refrigerated containers all have large refrigeration units that must run continuously to ensure the contents are kept at minus 18°C until they are received by the customer in Australia.

When enough containers are present in the holding yard, the containers are loaded onto a ship. The containers are plugged into the ship's power supply, which is diesel-generated, to ensure that the containers' compressors can run for the entire voyage.

If the ship went directly from port to port, the journey would be approximately 14,000 km. However in reality most ships go via Asia, making the distance travelled far greater than 14,000 km and significantly increasing the amount of diesel used to power the ship and its generators which run the containers.

Upon arrival in Australia, the container is unloaded and trucked to another refrigerated warehouse, where the container is unpacked and re-palletised to Australian pallet configuration.

The stock is held in the refrigerated warehouse until the wholesaler requires delivery. It is then loaded onto another truck and transported to the wholesaler's premises, where it is unloaded and stored in their freezer until it is delivered in another truck to the customer's shop. The additional warehousing involved in imported products is due to the fact that they are usually imported by third party importers, who bring in full containers and on-sell smaller quantities to the wholesalers, requiring warehousing in the interim.

17. In our submission, if a carbon tax is to achieve its objective, exemptions, free permits and/or compensation ought to be targeted so that the competitive balance is not tilted in favour of products with a larger carbon footprint. While there are undoubtedly some sectors of the economy in which foreign competitors are as efficient or more efficient than Australian companies in terms of carbon emissions, that is certainly not true for potato processing, nor for the bulk of the food processing industry.

18. Exemptions from the carbon tax, or free permits, or compensation for the additional cost caused by the tax (not just directly, but including the increased energy costs), should be provided to industries or individual businesses that can demonstrate that the increase cost will make them less competitive against substitutes that produce substantially higher carbon emissions. The food processing industry should receive targeted relief on that basis.

Concluding remarks: Food security and the declining food manufacturing industry

19. If Australia lets our food manufacturing industry continue to decline, its disappearance will be permanent; it is not just a matter of re-opening the factories at a later date and starting up again. If potato processing stopped, potato growers who would lose their customers would not maintain or update their machinery, as it is specific equipment designed for potato farming and highly capital-intensive. It is not just a matter of farming beef or sheep for a few years and then growing potatoes later on.

20. Taking a broader view, food is an industry that every single Australian partakes in, bar no one. With the exception of water there is nothing more important to Australia than food security. If Australia becomes reliant on importing our food then we are placing ourselves totally at the mercy of the countries who are the food producers. When the mining boom ends and the Australian dollar declines relative to the food producing nations, we will find ourselves with no choice but to pay whatever the food exporters want to charge, because lack of government support and questionable policies such as a carbon tax have caused our own food industry wither and die.

21. In order to prevent the final death knell of food processing in Australia, with all its negative ramifications for employment, agriculture and food security, we call for recognition of the additional pressures that the high Australian dollar and increasing input costs, particularly for energy, place on an industry already at breaking point. If the industry is not to be protected from subsidised imports and is not to receive subsidies on a par with those paid to competitors from Europe and North America, the government should, at a minimum, ensure that the implementation of new policies is not done in a way that causes further harm and may force some processors beyond the brink.

22. In the case of the carbon tax, the result of its implementation on the food processing industry without appropriate compensation, exemptions or free permits would be to displace Australian products with foreign imports, at an astronomically greater cost to the planet in terms of carbon emissions.

23. If the food processing industry in Australia is allowed to die, it will take with it jobs in the industry itself, but will also cost the livelihoods of small local wholesalers potato farmers and all the associated business whom they trade with and will threaten Australia's future food security.