AUSTRALIAN FOOD & GROCERY COUNCIL

AFGC SUBMISSION

2020-2021

PRE-BUDGET SUBMISSION

Sustaining Australia

The Australian Food and Grocery Council (AFGC) welcomes the opportunity to make this Pre-Budget submission for the 2020-21 Federal Budget.

Food, beverage and grocery[1] manufacturing plays an integral role in Australia's economic and social fabric. The sector is diverse, dynamic and resilient, with an annual turnover of $122.1 billion.

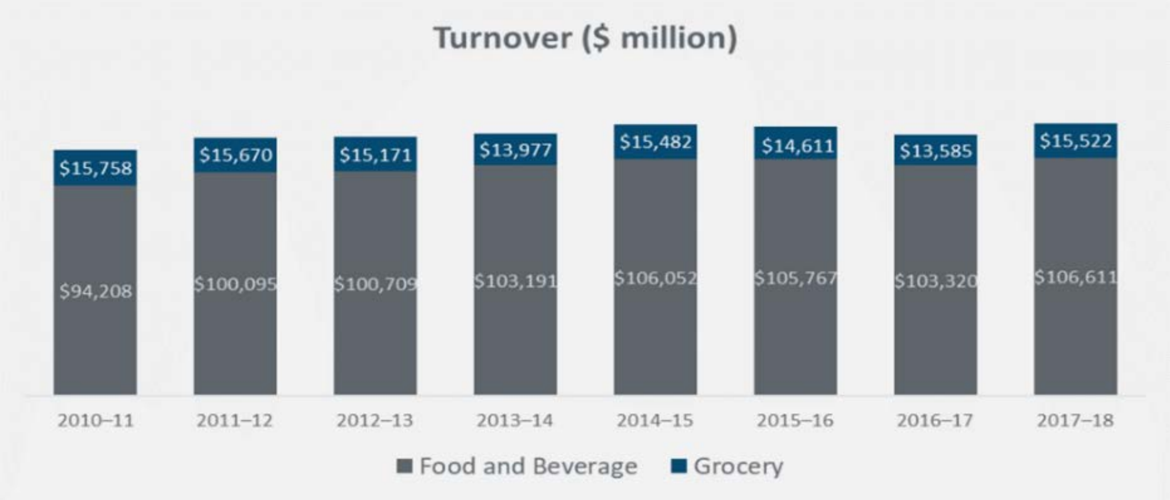
The AFGC is the leading national organisation representing Australia's food, beverage and grocery manufacturing industry. It comprises more than 150 member companies, subsidiaries and associates, whose total output accounts for 80 per cent of the gross dollar value of the sector as a whole.

More than 273,300 Australians are employed in the sector – almost 40 per cent of total manufacturing employment. It is the lifeblood of many regional and rural communities, where 39.3 per cent of these jobs are based.

Given the magnitude, significance and contribution of the industry, it should be a central consideration when shaping economic, industrial and trade policies.

To this end, the AFGC welcomes the opportunity to contribute, collaborate and advocate for the sector to ensure policy settings are right for it to thrive into the future.

Composition of the defined industry's turnover (2017-18)



The Australian community, including our political leaders, overwhelmingly want a local, value-adding food, beverage and grocery manufacturing (FBG) sector.

With pressures of wage growth and rising input costs, including high energy prices and continued price deflation by retailers, there is a squeeze on the sector. Such factors could determine if a company remains in Australia or not.

[1] The food, beverage and grocery manufacturing sector are those industries that provide value-add to agriculture, food, and other products for the purpose of producing everyday processed food, beverages and grocery products consumed and used by Australians.

Products encompassed include packaged, shelf-stable food from all categories and non-food grocery products used by consumers for personal, home and pet care.

Australian processors have very little capacity to pass rising production costs through in a deflationary retail environment. Consequently, given the small margins for operation, any increase to input costs such as energy significantly impact the industry.

A federal review into the Food and Grocery Code of Conduct is currently underway. The code helps to regulate the standards of business conduct; to build and sustain trust and cooperation; ensure transparency and certainty in commercial transactions; and to minimise disputes that may arise. It is vital to the economic viability of the sector and for facilitating a cohesive working relationship with the retail sector, while also ensuring the Australian food, beverage and grocery sector operates effectively and competitively, without distortion from undue market power dynamics.

Without a strengthened code and the continuing pressures on the sector, companies will continue to be forced to cut costs across every part of their business, using capital otherwise available for investment in automation and efficiency. As a result, only limited capital remains to allow investment in new product development, innovation and growth.

As a result, the sector is facing challenges.

There has been a downturn in capital investment, to the second lowest level in ten years. This reflects profitability challenges in the domestic industry and threatens the future viability of the industry.

Investment by government is needed to ensure the sector remains competitive on the international stage and is not hampered by red tape.

While domestic growth has been small, major jumps have been made in trade. Export in particular has seen a 7.6 per cent year-on-year increase to $34.4 billion, with imports now at $32.4 billion, a year-on-year increase of 3.3 per cent.

This growth is largely due to businesses reaping the benefits of free trade agreements and favourable exchange rates.

For this trend to continue, Australia needs trade and investment policies conducive to the growth and profitability of Australian FBG manufacturers. Such measures will help ensure a growing export market, which can help create grow new jobs and stimulate investment domestically.

The AFGC has welcomed the Federal Government’s deregulation agenda and its positive impact on international trade.

Beyond 2017-2018, the sector will work to strengthen trade, improve sustainability and create a fair playing field for Australian FBG manufacturers. Central to this are retail-supplier relationships that incentivise innovation and risk.

Pressures on the sector are real and can hamper growth and provide uncertainty. The right policy settings must be in place for growth. This includes government investing in the sector’s future, through policy that helps to fund advancement.

Community and government expectations are high for the sector to adopt changes to meet sustainability goals. At the same time, jobs must be retained and sites must remain viable. To make this possible, the sector needs to partner with government.

The AFGC appreciates this opportunity to outline proposals that will help strengthen the sector and provide business confidence for the future, benefiting all Australians.

FOOD, BEVERAGE AND GROCERY SITE MODERNISATION PROGRAM

Issue: declining investment, falling competitiveness and loss of manufacturing output in Australia's food, beverage and grocery manufacturing industry.

Problem: Australia's manufacturing capacity in food, beverage and grocery is in decline due to falling profitability. This situation is largely the result of market failure. Without government policy changes the decline is expected to continue, making our economy less diverse and more vulnerable to international conditions than in the past.

The Australian food, beverage and grocery (FBG) manufacturing sector is under economic and financial pressure due to rising costs, declining output prices and heightened international competition facilitated by retailers.

Investment in new plant and equipment is in decline with manufacturing facilities being shut down and existing capacity not being updated to world-best production standards. In short, Australia risks losing further capacity in the largest manufacturing sector in the economy.

There is a tangible risk that without government intervention further manufacturing facilities will be shuttered as their productive life comes to an end. The industry is offshoring due to weak domestic profitability and internationally mobile capital that is driving establishment of production facilities in fast growing markets across the Asian region.

The FBG manufacturing industry is currently operating in an environment of:

- Declining investment due to weak profitability, the result of rising commodity and production costs not being passed through to final prices.
- Declining productivity growth due to a lack of investment in the latest production technologies
- Declining international competitiveness due to a lack of investment in the latest production technologies. The industry is falling behind the efficient production frontier compounding the weakened competitive position.
- Rising import penetration as retailers seek to put the lowest cost products in store even if those products can be made in Australia at a comparable cost.

FBG manufacturing site modernisation and investment in leading-edge production technology has slowed due to high domestic costs and higher business taxation than international competitors. This has reduced Australia's productivity and international competitiveness (for exports and import replacements).

The industry needs to invest additional capital into more efficient plant and machinery for businesses to sustain jobs and investment, as well as invest in new capacity to take advantage of export opportunities. However, confidence in investing is low given the outlook for energy prices and constraints in domestic market conditions.

Without investing to improve efficiency and innovation, there is a high risk businesses will either need to reduce the scale of their operations or move offshore.

Industry has responded by:

- Short-term sweating of old assets – changes at the margins to reduce energy use through a range of measures but many are still using the same capital equipment. As new production facilities are established in offshore markets, the competitiveness of Australian industry weakens. There is a real risk once the useful life of these assets is reached, the facility will not be updated.
- Declining capital expenditure within the FBG manufacturing sector contracting 10.8 per cent to $2.4 billion (noting a smaller average annual decline of 4.6 per cent) in 2016-17.
- Limited investment in automation and efficiency measures, but more work needs to be done. Automation is the future manufacturing. To think this will cost jobs is wrong - not adopting the latest production technologies will cost jobs. Countries with the highest rates of automation in manufacturing also have the highest rates of manufacturing employment.

Australia needs a strong domestic food, beverage and grocery manufacturing capacity because:

- The industry directly employs more than 273,000 people across Australia and thousands more in supporting industries;
- The FGB manufacturing industry is a major employer in regional Australia. The loss of high paying jobs in regional Australia is undesirable and will put further pressure on congested urbans centres such as Sydney and Melbourne;
- Australians have very little understanding of food insecurity and nor should they given our powerful position as an agricultural producer and exporter. The loss of manufacturing capacity to other countries will leave Australia exposed to food supply disruptions and higher prices; and
- The opportunity to develop a world-leading manufacturing capacity catering to increasingly sophisticated requirements of consumers as well as fast growing international markets is something that should not be missed.

Government policy support is justified because of various market failures that are currently impacting the market for FBG:

- Fast growing and increasingly wealthy emerging economies are supporting the development of food manufacturing platforms to support their own markets and exports. Australia should not be aware this is not a level playing field, particularly in the Asian region.
- The concentration of the Australian retail sector means suppliers are not getting fair prices for their products. This lack of competition in the retail sector is a market failure that is resulting in bad economic outcomes for FBG manufacturers and - in the long run - all Australians through a less secure food supply and higher prices.
- The high cost of energy inputs into food production is jeopardising Australia’s current industrial capacity. This is a market failure given Australia’s large natural endowment in energy resources. Australian manufacturers should have an advantage, not a disadvantage, in the cost of energy inputs into manufacturing processes.
- The current industry pressures may be transitory but have a large impact on the domestic manufacturing base. Even if domestic production conditions normalise at some stage in the future, we may never recover the manufacturing capacity lost in this period.

- Australia's export base is highly concentrated by product type and destination market (primary products to large Asian economies). The loss of FBG capacity will worsen this situation making us increasingly vulnerable to conditions in a relatively small number of markets and products.

Proposed solution:

The AFGC proposes the Federal Government adopt a Food, Beverage and Grocery Site Modernisation program with the following elements:

Options to restore confidence to invest:

Part A: Three year instant asset write off or grants program

- Three year instant asset write off or a grants program (with dollar for dollar industry matched funds) for resource efficiency expenditures up to $100,000;
- For expenditures that improve the resource efficiency of the site (e.g. energy and water efficiency, reduce waste); or energy self-sufficiency.

Part B: Three Year Investment Allowance

- Aimed at stimulating new investment or bringing forward planned investments that have been held back;
- Aimed at expenditures that automate operations, adopt more efficient production technologies, or increase scale of operations;
- 30 per cent investment allowance that allows companies to claim 30 per cent of the expenditure on plant, property and equipment as reduction in their taxable income for that year;
- The allowance would be in addition to existing depreciation allowances;
- Companies must have a minimum spend of $100,000 to claim the allowance in any year; and
- The allowance would be limited to three years.

Modelled Benefit of the investment allowance

- Investment: A 4.1 per cent to 8.1 per cent (or $250 million to $490 million in 2009-10 terms) increase in industry investment in each of the three years of application;
- Employment: 750-1,475 additional FTE jobs;
- Output: A 1.1 per cent to 2.0 per cent (or $340 million to $600 million on average, each year, in 2009-10 terms) higher industry value-add;
- Cost to Commonwealth Budget: Budget: Up to $140 million annual net cost to taxation revenue in each of three years;
- Benefit to Commonwealth Budget: Positive boost of taxation revenue of $425 million to $750 million once investments operational;
- This analysis is based on modelling by KPMG in 2014.

The AFGC calls on the Federal Government to:

- Implement a Food, Beverage and Grocery Site Modernisation Program that provides short term incentives for the FBG manufacturing industry to bring forward investment in manufacturing plant infrastructure and equipment through an instant asset write off or grants program for smaller investments and targeted and efficient investment allowance for larger investments.

SUSTAINABILITY

The issue – support the industry's ability and response to transition to increased use of recycled content

Australia's FBG manufacturing businesses are progressive and mindful of consumer expectations. Over time, industry has responded to various community concerns and has now committed to deliver the National Packaging Targets and contribute to developing a circular economy.

The AFGC recognises the commitments of the Federal Government to addressing waste reduction and welcomes the commitments and agenda set out in the Targets.

However, meeting these ongoing and increasing community and government expectations comes at a cost. Packaging with high levels of recycled content is currently scarce, inflating costs. Plus, redesigning packaging requires research and development and, in many cases, considerable capital investment to upgrade manufacturing plant and equipment.

Therefore, the AFGC is calling on the Federal Government to partner with industry to help ensure that government and community expectations are met, while protecting jobs.

Proposed solution: Supporting innovation in packaging

The AFGC proposes the Federal Government implements a grants program to support FBG manufacturers as they innovate their packaging to deliver the Federal Government's sustainable packaging targets. Specifically, the program would seek to establish increased collaboration between the food, beverage and grocery, and the recycling and packaging sectors, in order to expedite the delivery of the national packaging targets of:

- 100 per cent reusable, recyclable or compostable packaging;
- 70 per cent of plastic packaging being recycled or composted;
- 30 per cent of average recycled content included in packaging; and
- the phasing out of problematic and unnecessary single-use plastics packaging.

There is scope for these grants to be structured to deliver funding to encourage companies to innovate their products and packaging, and/or support the development and construction of local recycling infrastructure, in line with these stated government policies.

The AFGC calls on the Federal Government to:

- Implement a research and development, and capital grants program to encourage and incentivise FBG manufacturers to innovate packaging and invest in packaging or recycling plant and equipment.