

Australian Food and Grocery Council SUBMISSION

12 FEBRUARY 2014

TO:
ENERGY WHITE PAPER TASKFORCE
DEPARTMENT OF INDUSTRY

IN RESPONSE TO:
ENERGY WHITE PAPER – ISSUES PAPER



PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, drink and grocery manufacturing industry.

The membership of AFGC comprises more than 150 companies, subsidiaries and associates which constitutes in the order of 80 per cent of the gross dollar value of the processed food, beverage and grocery products sectors.

With an annual turnover in the 2011-12 financial year of \$111 billion, Australia's food and grocery manufacturing industry makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

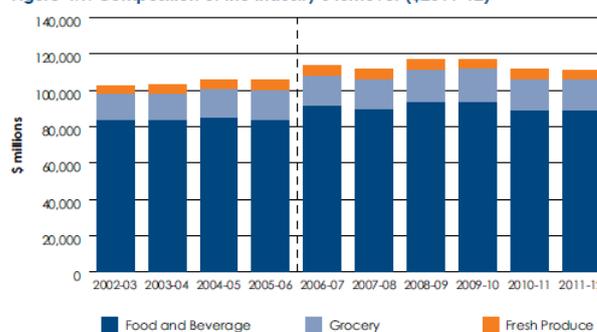
Manufacturing of food, beverages and groceries in the fast moving consumer goods sector¹ is Australia's largest manufacturing industry. Representing 27.5 per cent of total manufacturing turnover, the sector accounts for over one quarter of the total manufacturing industry in Australia.

The diverse and sustainable industry is made up of over 22,600 businesses and accounts for over \$50 billion of the nation's international trade. These businesses range from some of the largest globally significant multinational companies to small and medium enterprises. Industry spends \$535.8 million a year on research and development.

The food and grocery manufacturing sector employs more than 298,825 Australians, representing about 32.3 per cent of all manufacturing industry jobs.

Many food manufacturing plants are located outside the metropolitan regions. The industry makes a large contribution to rural and regional Australia economies, with almost half of the total persons employed being in rural and regional Australia². It is essential for the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies. Australians and our political leaders overwhelmingly want a local, value-adding food and grocery manufacturing sector.

Figure 4.1: Composition of the industry's turnover (\$2011-12)⁴



Source: Based on ABS, catalogue number 8221.0, 8159.0 and 8155.0

¹ Fast moving consumer goods includes all products bought almost daily by Australians through retail outlets including food, beverages, toiletries, cosmetics, household cleaning items etc.

² About Australia: www.dfat.gov.au

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1. INTRODUCTION

The AFGC welcomes the opportunity to provide comments on the Energy White Paper – Issues Paper. This submission is made on behalf of food, beverage and grocery manufacturers, including members of the AFGC’s Agribusiness Forum who are involved in the early stage processing of agricultural commodities.

The food, beverage and grocery manufacturing industry is significantly concerned about recent and forecast increases in the cost of energy, which are hampering the industry’s competitiveness at a time when it is facing several other challenges. These include little or no ability to pass through higher costs; retail price deflation; a major shift of profit from suppliers to retailers³, loss of flexibility in labour markets and high regulatory costs⁴.

The food, beverage and grocery manufacturing industry comprises a wide variety of businesses with different energy use profiles – from small businesses who face an information asymmetry and lack of negotiating strength through to large businesses such as agribusiness processors and paper product manufacturers who are significant users of energy and are trade exposed.

Regardless of the scale of a food, beverage or grocery manufacturing business, rising energy costs are having a significant impact. In particular, the industry is concerned about recent increases in the costs of electricity network charges, the additional cost of the carbon tax and a forecast doubling in the wholesale cost of gas.

To mitigate against these cost increases the industry has been improving and investing in energy efficiency. The industry is also committed to energy efficiency to achieve the industry’s Sustainability Commitment targets of reducing energy use by 10 percent and emissions by 20 percent by 2020 (relative to a 2010-11 baseline). However, energy efficiency comes at a significant upfront capital cost, which can be a barrier to investment. The industry is therefore concerned at the abolition of government incentives through the Clean Technology Food and Foundries Investment Program (CTFFIP).

Through this submission, the AFGC will provide high level comments on these issues. More detail in relation to the AFGC’s views on the impact of rising gas prices, the carbon tax and the operation of the emissions reduction fund are contained in the submissions to the Government’s respective consultations processes: Eastern Australian Domestic Gas Market Study; Repeal of the Carbon Tax – Exposure Draft Legislation and Consultation Paper; and the Emissions Reduction Fund Green Paper. This submission on Energy White Paper - Issues Paper should be read in conjunction with these other submissions.

In this submission, the AFGC estimates the direct impact of forecast higher gas prices on food and beverage manufacturers using data from the Australian Bureau of Statistics (ABS) at \$170 million per annum in the short term. ABS energy data are not available for the combined food, beverage and grocery industry. Due to a lack of granular data available at sub-sector levels for relevant grocery categories such as the manufacture of sanitary paper products, cleaning compounds, cosmetics and toiletries the AFGC’s analysis is limited to food and beverage manufacturing⁵. The analysis also does not capture the indirect impacts of higher gas prices on input costs such as packaging and transportation. It should therefore be

3 AFGC and KPMG, Competitiveness and Sustainable Growth report, June 2013.

4 AFGC and Deloitte Access Economics, Reforming Regulation of the Australian Food and Grocery Sector, October 2013.

5 Although AFGC does not include tobacco manufacturing in its definition of food, beverage and grocery manufacturing, it cannot be separated from the ABS energy data for the beverage category.

noted that the actual impact of higher gas prices on the food, beverage and grocery manufacturing industry will be greater than \$170 million per annum short term and \$110 million per annum long term.

2. ENERGY USE WITHIN FOOD, BEVERAGE AND GROCERY INDUSTRY

Energy is essential for manufacturing and transporting food, beverage and grocery products and also for maintaining the quality and safety of food products. Energy in the form of gas, electricity or other fuels is used in various production processes such as drying, sterilisation and baking. Energy is also consumed in processes such as air conditioning and refrigeration for chilled and frozen products, cleaning production processes, storage of products in warehouses and transportation.

According to data collected as part of the AFGC's Sustainability Commitment, the food, beverage and grocery manufacturing industry utilises 2.01 gigajoules (GJ) of energy per tonne of production, with significant variations in energy intensity depending on the nature and scale of the business.⁶

This energy intensity figure hides the significant variation in energy use within the sector, which comprises a large number of SMEs with low levels of energy use, though to agribusiness processors with significant energy use.

ABS data show that agribusiness processors are significant energy users, particularly meat and meat product manufacturing, dairy product manufacturing and sugar manufacturing.⁷ Other food and grocery categories that are high energy users include confectionary and paper product manufacturing.⁸ These results are consistent with the energy data collected in AFGC's Sustainability Commitment.

Regardless of the size of the business, rising energy costs are of great concern, particularly given suppliers' limited ability to pass cost increases through to retailers. As the following chart shows, energy costs in the food and beverage manufacturing sector have increased in recent years while industry turnover has remained fairly flat. Total energy costs (including electricity, gas, transport fuel and coal) for the food and beverage manufacturing industry has grown by 39 per cent since 2008-09 compared to its turnover which grew only by 3.5 per cent during the same period.⁹

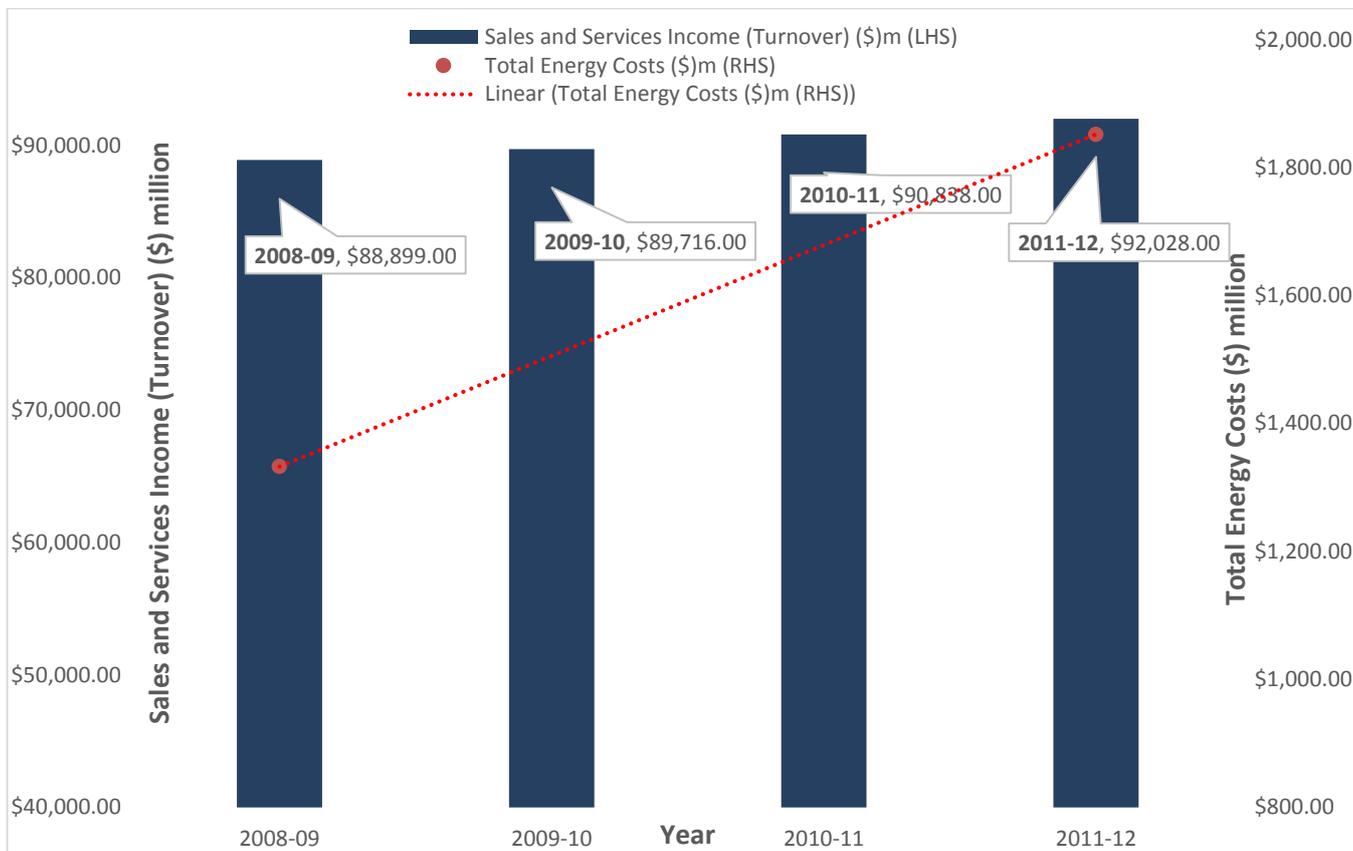
6 AFGC, Sustainability Commitment Update 2011-12

7 ABS Catalogue 5209.0.55.001: Australian National Accounts: Input-Output Tables 2009-10

8 Ibid

9 Based on data from ABS Catalogue no. 8155 and 4660 for food, beverage and tobacco product manufacturing. Due to limitations in data, the AFGC has only been able to estimate the direct impact of a gas price increase on the food and beverage manufacturing sector (that is, excluding the impact on the grocery sector and excluding indirect impact on input costs such as packaging). Further, while tobacco is not relevant to the analysis, disaggregated data are not available to remove this product category.

Comparison of energy costs and industry turnover for food and beverage manufacturing¹⁰



Data from the AFGC’s Sustainability Commitment 2011-12 show that the reported sample of food, beverage and grocery manufacturers rely more heavily on gas as a fuel source, with 54 per cent of their energy requirements coming from natural gas, 31 per cent from electricity and the remaining from coal and transport fuel.¹¹ From 2010-11 to 2011-12, the common sample of members surveyed reduced their use of electricity, coal and transport fuel use per tonne of production, instead increasing their use of gas as an energy source by 13 per cent in 2011-12 compared to the previous year.¹²

This heavy and increasing reliance on gas as a fuel source means that the forecast increases in gas prices will have a significant impact on the food and grocery manufacturing sector.

¹⁰ Ibid

¹¹ AFGC, Sustainability Commitment Update 2011-12

¹² AFGC, Towards Sustainability 2007-08; AFGC, Sustainability Commitment Update 2011-12. Available at www.afgc.org.au/sustainability

3. IMPACT OF HIGHER ENERGY COSTS

3.1 CARBON TAX

According to the AFGC's Impact of Carbon Tax Survey conducted in July 2013, about 89 per cent of the respondents experienced increases of up to 10 per cent in their operating costs as a result of the introduction of the carbon tax.¹³

The survey found that 67 per cent of respondents were unable to pass through the additional carbon tax costs to customers with a key factor being the non-acceptance of price increases from retailers/consumers. Of those able to pass through some of the additional costs, many companies were only able to pass through a small proportion.

3.2 GAS PRICE INCREASE

Analysts generally agree that the Eastern Australian gas market is likely to see a doubling of gas prices in the next few years. Given there are several scenarios for gas supply and demand and hence pricing it is difficult to determine a definitive gas price path and hence impact on the food, beverage and grocery industry.

The Australian Government's Eastern Australian Domestic Gas Market Study estimates that gas prices could more than double over the next few years as LNG exports link domestic gas prices to the more expensive Asian market, domestic supply potentially tightens and producers potentially exercise market power. This transition is unfortunately occurring at a time when existing contracts are due for renewal. Beyond this transitional period, some analysts estimate that wholesale prices will come down slightly, but will still be just under double existing rates.

For indicative purposes, the AFGC has conducted analysis assuming that wholesale gas prices increase from their current level of approximately \$5/GJ to \$11/GJ in the next two to four years, with prices then stabilising at \$9/GJ in the longer term.

Based on this analysis, **the AFGC estimates that the direct impact of rising wholesale gas prices on the food and beverage manufacturing sector alone would be approximately \$170 million *per annum* for the next two to four years (equivalent to 2.3 per cent of operating profit before tax) and over \$110 million *per annum* in the longer term (equivalent to 1.5 per cent of operating profit before tax).**¹⁴

13 AFGC, Impact of Carbon Tax Survey, July 2013 - <http://www.afgc.org.au/tools-guides-.html> (Under general publications section)

14 AFGC analysis using BREE (2013), *Australian energy statistics*, Table F; ABS catalogue number 8155 *Australian Industry 2011-12* and based on an existing wholesale gas price of \$5/GJ. Due to limitations in data, the AFGC has only been able to estimate the direct impact of a gas price increase on the food and beverage manufacturing sector (that is, excluding the impact on the grocery sector and excluding indirect impact on input costs such as packaging). Further, while tobacco is not relevant to the analysis, disaggregated data are not available to remove this product category. It is anticipated that excluding tobacco would have the effect of increasing the impact in terms of proportion of operating profit (because gas use in the tobacco industry is likely to be low given product is predominantly imported, yet the profit for the sector is captured).

The direct impact on profitability of food manufacturing alone (i.e. excluding beverages and grocery) will be significantly higher at 4.33 per cent of operating profit before tax in the short term and 2.88 per cent in the longer term.¹⁵

The overall impact of rising gas prices would be considerably greater after taking into account the impact on the grocery manufacturing sector and the indirect impacts of a gas price rise on inputs such as packaging.

Once indirect impacts are also considered, it is expected that the near doubling of gas prices will have an impact on the food, beverage and grocery manufacturing sector that is at least equal to the carbon tax, which was estimated to be equivalent to 4.4 percent of operating profit before tax, after taking into account direct and indirect impacts.¹⁶

It should be noted that the impact on profitability is an average across the food and beverage manufacturing sector and that certain sub-sectors will face a greater impact on their profitability. This includes gas-intensive agribusinesses such as meat, dairy and sugar and confectionary manufacturing as well as the manufacture of sanitary paper products.

4. POLICY ISSUES

4.1 REMOVAL OF THE CARBON TAX

The AFGC welcomes the removal of the carbon tax as a step towards reducing the cost burden on food and grocery manufacturers, which is impeding the industry's competitiveness and viability. The AFGC is concerned that any delay in the passage of the repeal of the carbon tax will add further pressures on the industry and restrain competitiveness and growth.

4.2 RISING GAS PRICES

As mentioned, the AFGC is very concerned about the impact of forecast gas price rises on the food, beverage and grocery manufacturing industry. The AFGC has prepared a separate submission with our views on the impact of the gas price rise and possible policy options. Rather than repeat those comments here, we refer you to our submission to the Government's Eastern Australian Domestic Gas Market Study.

4.3 NEED FOR A CONSISTENT NATIONAL APPROACH

There is an apparent inconsistency between energy policies (at the state and federal level), which have contributed to a significant forecast increase in gas prices, and the objectives of the Australian Government's emissions reduction policy and manufacturing policy.

Perversely, high gas prices are likely to drive an increase in emissions, as manufacturers switch to lower cost, but more emissions intensive, fuel sources. This risks undermining the effectiveness of the Emissions Reduction Fund and the achievement of a 5 per cent reduction in emissions by 2020. For

¹⁵ AFGC analysis using BREE (2013), *Australian energy statistics*, Table F; ABS catalogue number 8155 *Australian Industry 2011-12* based on an existing wholesale gas price of \$5/GJ, increase of \$6/GJ in two to four years and \$9/GJ beyond it.

¹⁶ AFGC and AT Kearney, *Impact of Carbon Pricing 2011: Potential impacts across the supply chain*.

example, several food, beverage and grocery manufacturers (including those that have installed gas fired co-generation facilities) have indicated that if gas prices increase to forecast levels, they will need to switch to alternative, cheaper fuel sources – for example directly firing coal or using coal fired electricity, depending on the application. This is akin to the recent decision by Stanwell power station to switch from a gas to coal fuel source.¹⁷

Higher gas prices also risk a contraction in manufacturing industry activity and competitiveness, contrary to the aims of the Government's manufacturing policy, which is to boost manufacturing competitiveness by keeping costs down. Some industry sectors particularly high gas users such as the paper and tissue manufacturing have indicated that it may not be possible to switch fuel source due to technical limitations and the need for significant upfront capital. As a result, some manufacturers may reduce or cease domestic production, resulting in job and income loss. This issue is particularly pertinent to the food, beverage and grocery industry due to limitations in suppliers' ability to pass cost increases on to their major customers – supermarket retailers.

In addition to the direct impact of high gas prices on the competitiveness of the food, beverage and grocery industry, businesses that switch to a higher emissions fuel source risk being penalised under the government's proposed Direct Action Plan (DAP), which will further impact their profitability.

These potential adverse consequences of high gas prices are contrary to the situation in the United States of America where access to low cost gas has led to a resurgence in manufacturing while at the same time achieving reductions in emissions.

The AFGC recommends the government take a whole-of-government approach by ensuring consistency in the objectives and outcomes of the Government's energy, emissions and manufacturing policies.

4.4 ENERGY EFFICIENCY

Rising energy costs have led to significant changes in energy management practices within the food and grocery industry. In addition, various government supported programs such as the Energy Efficiency Opportunities (EEO) program and the Energy Efficiency Information Grants (EEIG) have/ are helping businesses increase their awareness of potential energy savings.

The food processing and manufacturing industry has invested over \$339 million in energy efficiency projects through the CTTFFIP, with nearly \$220 million of this contributed by the industry. These projects included improvements to lighting efficiency, upgrading old equipment, installation of solar panels, heat recovery and co-generation facilities.

Despite this high level of investment, the task of energy efficiency is not complete. As indicated by the level of interest in the CTTFFIP at the time of closure, there continues to be strong interest from business in incentives to assist business to invest in energy efficiency improvements as a way to mitigate against the impact of high gas and electricity prices and to reduce the industry's carbon footprint. Such programs will improve energy the competitiveness and sustainability of the Australian food, beverage and grocery industry. The AFGC's carbon tax survey found that 61 per cent of the surveyed businesses intend to access capital through government grant programs.¹⁸

¹⁷ <http://www.brisbanetimes.com.au/queensland/swanbank-power-station-to-close-for-three-years-20140205-321m6.html>

¹⁸ AFGC, Impact of Carbon Tax Survey, July 2013

In a review of the EEO program, businesses highlighted “limited availability of capital” and “competition for capital” as major barriers to implementing energy efficiency.¹⁹ Nearly, 35 per cent of the energy efficiency savings in the manufacturing sector do not proceed due to a lack of internal capital and the length of the payback period.²⁰

Grant schemes such as the CTFFIP have generated significant uptake from the industry and helped get a business case for investment over the line. In the absence of grant funding, these investments are unlikely to have proceeded.

The AFGC notes that it is the Government’s intention that the Emissions Reduction Fund will be the mechanism that assists industry to fund energy efficiency projects, through the ability to sell their abatement from these projects. The AFGC is concerned that food, beverage and grocery manufacturers will be unlikely to access the scheme given its complexity; the requirement that projects be ones that would not have proceeded without the grant (ie be ‘additional’, unlike projects funded by CTFFIP); the focus on large scale, low-cost abatement; and the lack of regard for co-benefits such as improving the industry’s competitiveness. The AFGC will provide more detail on these issues in our submission in response to the Emissions Reduction Fund Green paper.

The AFGC recommends a nationally consistent approach to energy efficiency based on the following principles:

- Focus on improving energy efficiency and achievement of results rather than another compliance/ reporting burden,
- Addresses the barriers to energy efficiency by providing assistance for capital investment,
- Recognises the co-benefits of improving competitiveness,
- Consistent and effectively coordinated across all jurisdictions throughout Australia, and
- Encourages innovation and growth within the food, beverage and grocery industry.

4.5 REDUCING REGULATORY BURDEN

The AFGC recognises that the EEO program has been a key driver in raising awareness about energy efficiency opportunities. However, the program has imposed a high and unnecessary reporting burden and has not addressed the key barriers to investing in energy efficiency. As businesses have evolved and embedded energy efficiency as a key part of their business strategy, and given the unnecessary regulatory burden of the program, the AFGC welcomes announced savings in administering the EEO program and recommends the abolition of the program to reduce the cumbersome regulatory reporting. The AFGC recommends that the savings resulting from this decision be directed to assist businesses

¹⁹ ACIL Tasman , Energy Efficiency Opportunities Program Review Report, 2013

²⁰ ClimateWorks Australia, Industrial Energy Efficiency Data Analysis, 2013

<http://climateworksaustralia.org/sites/default/files/documents/publications/climatework>

implement the identified energy saving opportunities which would also contribute to the overall emissions reduction target of 5 per cent by 2020.

4.6 NEED TO OVERCOME INFORMATION ASYMETRY FOR SMES

While food, beverage and grocery manufacturers are significantly impacted by rising gas and electricity costs and are constrained in their ability to pass the cost increases on, most in the sector lack the information, scale and negotiating strength to achieve well priced and flexible contractual arrangements compared to large industrial users.

Consideration should therefore be given to group energy buying schemes, particularly for small to medium sized businesses.

5. AFGC CONTACT

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