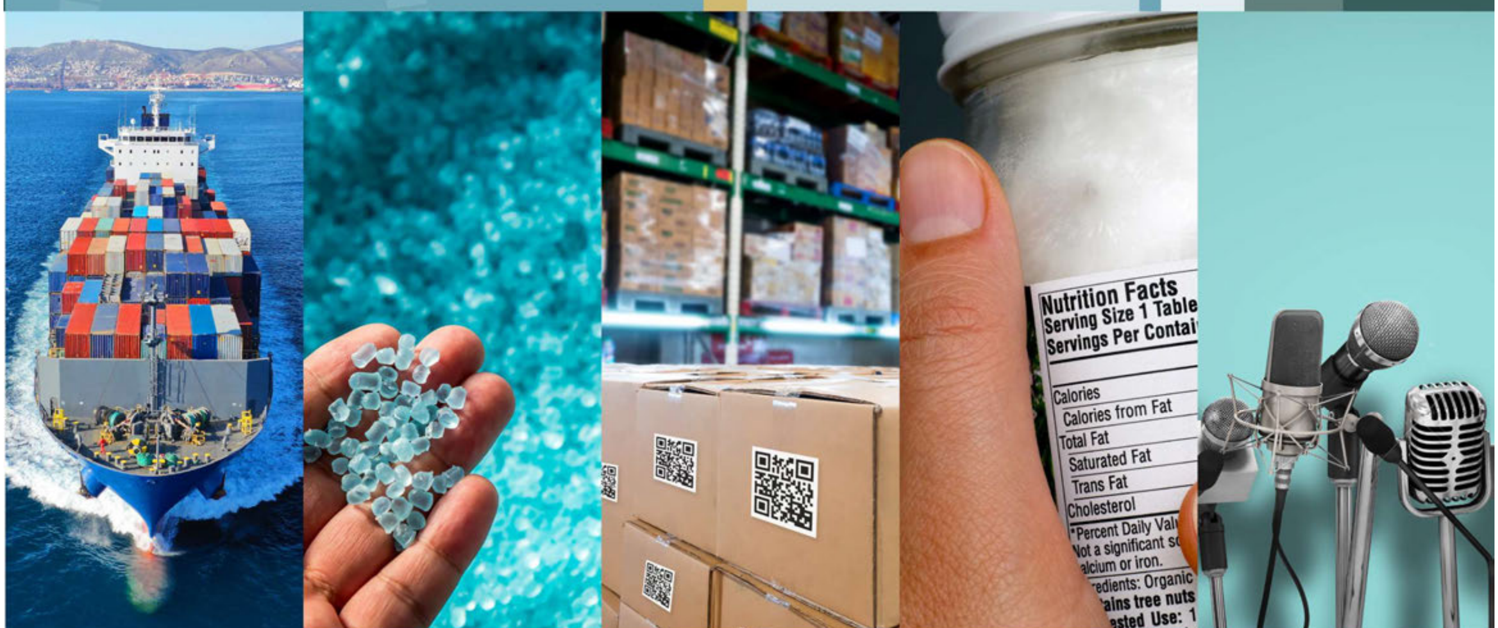
AUSTRALIAN FOOD & GROCERY COUNCIL




AFGC SUBMISSION

# Senate Inquiry to the NATIONAL RECONSTRUCTION FUND CORPORATION BILL 2022

**10 February 2023**

# PREFACE

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

With an annual turnover in the 2020-21 financial year of $133 billion, Australia's food and grocery manufacturing sector makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

The diverse and sustainable industry is made up of over 16,000 businesses ranging from some of the largest globally significant multinational companies to small and medium enterprises. Each of these businesses contributed to an industry-wide $3.2 billion capital investment in 2020-21.

Food, beverage and grocery manufacturing together forms Australia's largest manufacturing sector, representing over 32 per cent of total manufacturing turnover in Australia. The industry makes a large contribution to rural and regional Australia economies, with almost 40 per cent of its 272,000 employees being in rural and regional Australia.

It is essential to 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.

Throughout the COVID19 pandemic, the food and grocery manufacturing sector proved its essential contribution to Australian life. Over this time, while our supply chains were tested, they remain resilient but fragile.

The industry has a clear view, outlined in *Sustaining Australia: Food and Grocery Manufacturing 2030,* of its role in the post-COVID19 recovery through an expansion of domestic manufacturing, jobs growth, higher exports and enhancing the sovereign capability of the entire sector.

*This submission has been prepared by the AFGC and reflects the collective views of the membership.*

# OVERVIEW

# INTRODUCTION

The Australian Food and Grocery Council (AFGC) welcomes the opportunity to comment on the Senate Inquiry to the National Reconstruction Fund Corporation Bill 2022. The AFGC is the peak body representing Australia's food, beverage, and grocery manufacturers that deliver the everyday health and nutritional needs of Australians.

Our submission is in two parts. The first will illustrate the size, importance, and criticality of the sector to the Australian economy including the sector's investment profile, investment needs and current barriers to investment. The second part considers the Bill in detail, raising key risks to the Bill's intended objectives and propose recommendations to enhance the effectiveness of the National Reconstruction Fund Corporation (NRFC) in meeting the needs of the sector.

# PART 1: THE SIGNIFICANCE OF AUSTRALIAN FOOD AND GROCERY MANUFACTURING

## SECTOR PROFILE

The food, beverage and grocery manufacturing sector is critically important to the Australian economy, representing the largest sector of Australia's manufacturing industry. The sector provides approximately 273,000 direct jobs, 40% of which are based in regional areas. The diverse and sustainable sector is made up of over 16,000 businesses ranging from some of the largest globally significant multinational companies to small and medium enterprises. These businesses act as significant employers throughout local communities across the nation creating several thousand indirect jobs through supporting services from marketing, accounts and management through to technical and regulatory roles such as scientific food technologist and repair and maintenance trade.

The sector plays a vital role in supplying high-quality food and grocery products to Australians and markets around the world, by value-adding fresh produce from Australian farmers into the iconic products that we know and trust. Importantly the sector also services health and aged care facilities, educational and sporting institutions, workplaces, and restaurants. The sector contributed $3.2 billion into capital investment in 2020-21.

In the last financial year, total sector turnover exceeded $133 billion, representing 32.1% of total domestic manufacturing turnover. The sector is also a significant contributor to Australia's terms of trade, with exports at over $34 billion. The sector is reliant on a wide range of imported food ingredients, additives and processing aids, and packaging materials. Over a turbulent past few years, supply chains have been disrupted due to difficulty in securing freight, sky-rocketing costs and shortages of shipping containers, delays in biosecurity inspections, and a dysfunctional pallet hire and return system.

With the fragility of recent supply chain shocks, borne by significant weather disasters and a global pandemic, the food and grocery supply sector has been designated an 'essential industry' by both the Federal and State and Territory governments and is also recognised as a 'critical infrastructure' under the *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022*.

## SECTOR AMBITION

The AFGC has the ambitious target of doubling sector turnover to $250 billion by 2030, through a focus on smart food and beverage manufacturing, energising the creation of innovative food and beverage choices for Australians, and enhancing food safety, origin, and traceability systems to minimise risk and better meet consumer needs. To get there, the sector must work with the Federal Government to ensure investment incentives deliver on ***six high priority visions*** for the sector including:

| | |
|---|---|
| Vision 1 | **A climate neutral food, beverage, and grocery manufacturing footprint by 2050 or sooner, via the accelerated integration of renewable energy solutions and reduced wastage underpinned by a thriving circular food and packaging economy.** |
| Vision 2 | **Future proofing Australia's food and beverage manufacturing footprint via innovative technologies to augment and enhance the competitiveness of production, logistics, distribution, and intangible services.** |
| Vision 3 | **A food, beverage and grocery sector with a highly developed innovation and R&D presence to meet evolving consumer preferences for safe, healthy, and nutritious food and sustainably sourced and manufactured food and groceries.** |
| Vision 4 | **Australian consumers having undisrupted access to everyday food and grocery items through a resilient and robust supply chain supported by world class digital and telecommunications assets and road, rail, and port infrastructure.** |
| Vision 5 | **Getting back on track with 10 per cent year on year growth of Australian food and beverage exports and a diversification and expansion of SMEs into global value chains in growing and emerging markets by 2030.** |
| Vision 6 | **Ensuring Australians have access and information to a variety of safe and nutritious food, beverage, and grocery products to allow them to make informed choices and decisions that meet their individual, lifestyle, and cultural needs.** |

## KEY INVESTMENT OPPORTUNITIES

There are key investment opportunities to deliver on the needs of transforming Australia's food and beverage industry and setting it up the food system from farm gate to plate, for success well into the 21st century.

- ✓ **Smart food and beverage manufacturing** for consumer-driven products including responsive, fast and agile food and beverage processing and packaging to improve competitiveness and distinctive value propositions for customers such as the automation of continuous and batch control systems, inspection and line systems, high speed palletising machinery, and monitoring systems for temperature, humidity, pressure and sanitisation verification
- ✓ **Innovative food and beverages** by supporting the development of innovative food and beverages that incorporate diverse attributes to meet evolving consumer needs such as improved health and wellbeing and enhanced nutritional value, products for convenience such as ready to eat and pre-portioned meals, and high-value add products such as new and enhanced proteins, antioxidant rich food and beverage alternatives
- ✓ **Food safety, origin, and traceability systems** to enhance the quality and assurance required in domestic and international markets by increasing Australia's output of safe, healthy, and sustainably produced foods by adopting new solutions to increase value differentiation of food and beverage products in domestic and export markets such as standardised digital labelling and blockchain technologies to securely capture and store information on origin and safety.
- ✓ **Lifting export capability** to fully leverage Australia's progress in lowering tariff barriers via the implementation of regional and bilateral Free Trade Agreements (FTAs) by continuing efforts that open new market access for manufacturers whilst better navigating the increasingly complex and dynamic regulatory and technical barriers.

## KEY BARRIERS TO INVESTMENT

- × Food and beverage input prices have increased at over double the rate of the annual average rate of the broader manufacturing industry.
- × Input prices have been rising at a stronger rate than their output (wholesale selling) prices over the past decade driven by aggressive competition between major retailers.
- × Escalating trade spend (cost of doing business with supermarket retailers) now one of the largest costs of doing business for food and grocery suppliers, has distorted significant capital investment in innovation and R&D spend. Suppliers' trade spend with supermarkets as a percentage of net sales has increased from 16 per cent in 1997 to over 45 per cent in recent years.
- × The sector has experienced sustained downward pressure on operating margins, having dropped from over 11 per cent in 1997 to around 6 per cent by 2020.
- × With a reduced profitability pool, most of which is being diverted to supermarket retailers, Australia's food and beverage manufacturers have less funding to innovate and invest in the food and grocery items Australian consumers are demanding placing upward pressure on imports.
- × The decline in margins and profitability for Australia's food manufacturing sub-sector has coincided with the limited ability of manufacturers to pass cost pressures through the supply chain to supermarket retailers.
- × Capital investment has stagnant since 2010 averaging around $3 billion and needing to increase to around $8 billon annually to maintain a vibrant competitive sector

- Domestic R&D spend has flatlined for over a decade, at a time when global R&D spend in the sector is increasing at over 3.5 per cent annually
- Foreign government intervention from comparable economies (such as NZ, Canada, Ireland) is creating greater competition for capital investment, such as tax and land incentives, access to trade finance, investment incentives and special economic zones

***There is a clear need for the Australian government to set a clear industry policy strategy for the Agri-food system, that go beyond the purpose and objectives of the NRFC's intent of facilitating increased flows of finance.*** The AFGC landmark report, **Sustaining Australia 2030**, provides further detail on the challenges and opportunities faced by the sector. Whilst financing solutions may provide support to some types or forms of business investment needs, there is a need for government to lower barriers to private sector investment by embedding greater confidence in the sector's ambition to remain, evolve and thrive in Australia to 2030 and beyond.

## PART 2: THE OPTIONS AND LIMITATIONS OF THE PROPOSED NATIONAL RECONSTRUCTION FUNDING CORPORATION (NRFC) TO THE NEEDS OF OUR CRITICALLY IMPORTANT SECTOR

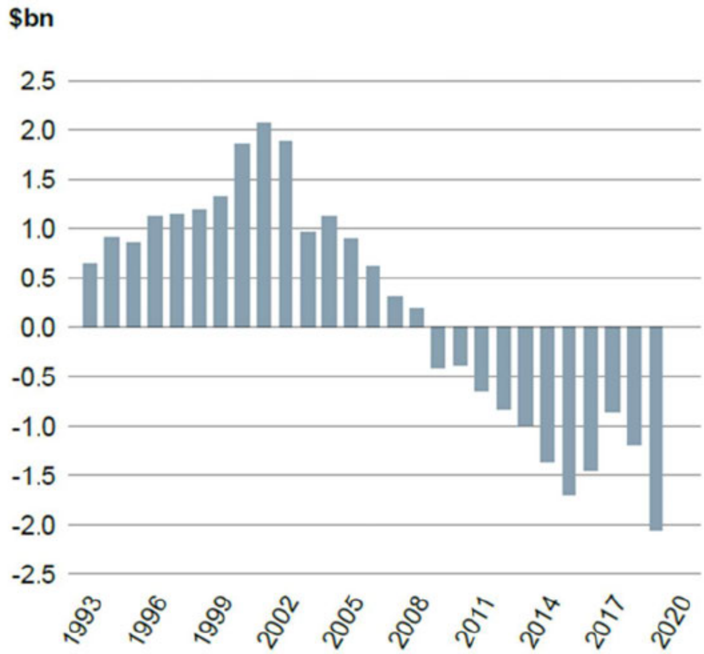
### VAGUE LEGISLATIVE INTENT AND OBJECTIVES HAVE FAILED TO INSTIL CONFIDENCE IN THE SECTOR

To date, Ministers have announced that the NRFC will fund up to $3 billion for renewables and low emissions technologies, $1.5 billion for medical manufacturing, $1 billion for value-adding in resources, $1 billion for 'critical technologies' (as defined on the separate List of Critical Technologies in the National Interest), $1 billion for advanced manufacturing and $500 million for value-adding in agriculture, forestry, fisheries, food, and fibre. The NRFC's intent is to rebuild Australia's industrial base but does not acknowledge the need for industry policy strategy for priority areas of the economy. Nor how the NRF will act to support well-established industries from further growing and developing.

### AUSTRALIA'S FOOD AND BEVERAGE MANUFACTURERS ARE CENTRAL TO VALUE-ADDING DOMESTIC PRIMARY PRODUCE

In terms of high value-added goods, Australia has traditionally been a net exporter. However, over the last 20 years there has been an almost complete turnaround in our high value-added food trade position. As chart 1 shows, Australia had a trade surplus of $2 billion in high value-added food in 2001, which has gradually weakened over the last 20 years and is now a deficit of $2 billion. This is part the result of a loss of competitiveness, driven by greater international competition for investment, as well as deepening consumer preferences for imported products. Government support for value-added food and agriculture is critical to Australia's manufacturing footprint.

**Chart 1: High value-added food international trade position**




Source: ABS, EQ Economics

## INTERNATIONAL GOVERNMENTS HAVE DEVELOPED FOOD SECTOR STRATEGIES ALONGSIDE INCENTIVES TO ONSHORE AND RESHORE MANUFACTURING

Australia's food and grocery manufacturing sector faces international competition from businesses that receive substantial government support. Food security has been a key motivation for governments to support domestic food manufacturing. Even countries that have strong agricultural sectors provide support for food manufacturing. This ensures the production of final consumer products and enhances the economic value-added by domestic agricultural production. This has impacted the relative competitiveness of Australian manufacturers in both the domestic and overseas markets. Foreign governments also provide financial incentives aimed at boosting agricultural production right through to manufacturing and retailing. Some economies are currently increasing their levels of manufacturing support to shore up their economies and ensure food security given the effects of COVID. Most developed and emerging economies will pursue sector support for food and grocery manufacturing within the context of a free trade framework.

There are a range of sector support measures that governments have utilised to promote a successful food and grocery manufacturing capability, including:

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|---|---|
| **Financial** | - **Tax incentives**<br>- **Land incentives**<br>- **Investment incentives**<br>- **Access to trade finance** |
| **Innovation** | - **Innovation clusters or hubs including technical and scientific research support**<br>- **Wage subsidies for scientific and research staff** |

| | | |
|---|---|---|
| **Economic zones** | - | **Special economic zones or foreign trade zones that provide a suite of support mechanisms including tax incentives and relief, investment incentives, collaboration assistance and innovation support** |
| **Coordination** | - | **Whole of government policy platform to navigate multiple departments and levels of government** |
| | - | **Whole of supply chain policies that promote collaboration from the farm to the factor to the retailer** |

There is a clear need for government to set a clear industry strategy for value-adding food and agriculture production in line with ambitious targets to double the size of the sector and continue agriculture's continued growth to $100 billion by 2030.

**Recommendation 1: Government to work alongside the food, beverage and grocery sector to set a clear industry strategy to inform NRFC financing decisions that prioritise long-term policy goals over the profitability and risk appetite of the proposed Commonwealth Corporation.**

The Government has proposed that the NRFC is based on the model of the Clean Energy Finance Corporation (CEFC), however, the success of the CEFC has been on its targeted focus limited to the adoption of 'clean energy technologies' as defined in the *Clean Energy Finance Corporation Act 2012*. On the other hand, the NRFC's vague and poorly defined investment focus will not be restricted to any sector ambition or target such as what has been earlier proposed across our six high priority visions for the sector. The proposed arrangement gives current and future governments considerable power to redirect NRFC investment activity into evolving political priorities, free from scrutiny or constraints that would ordinarily be found in primary legislation.

The recent Senate Economics References Committee inquiry into the Australian manufacturing industry, recommended the establishment of a 'Manufacturing Industry Fund to provide a range of co-investment incentives to the manufacturing industry in conjunction with the private sector', and that this fund should have 'the flexibility to assist a range of manufacturing sectors and private entities, using a variety of mechanisms, such as direct support for flagship projects, concessional loans, guarantees and other means that deliver a positive return on investment'. The proposed NRFC does not envisage to offer a full suite of financing options, that are fit to meet the sector's needs and does not propose to provide co-investment incentives in conjunction with the private sector. There is also significant doubt of how investment proposals will be supported as directions under the NRFC 'Investment Mandate' are yet to be determined. Government must more accurately illustrate the parameters and powers under clause 71, such as matters of risk and return, allocation of investments between the various priority sectors, the types of financial accommodation that may be provided by the Corporation and importantly the type of financial accommodation that may be provided to entities. Government must work closely with sector leaders to understand investment needs and determine the suitability of financial accommodation options.

**Recommendation 2: Government should consult industry more closely to better understand priority sector's investment needs and, in the process, diversify the financial accommodation options to meet the investment needs of priority sectors, such as food manufacturing in line with the recommendations made by the Senate Economics Reference Committee into the Australian manufacturing industry.**

The current level of detail of the NRFC and the proposed, but yet to be defined, Investment Mandate, does not provide the sector with confidence or certainty that it will be able to meet the investment needs of the sector. Further the proposed issue of ultimate beneficial ownership of Australian firms is fraught, as with sector firms, it is not possible to say with any confidence how much of the value of an Australian-based company listed on any stock exchange is owned by Australians and how much by overseas investors. It is unlikely to be possible for the NRFC to differentiate eligibility based on the Australian ownership share for listed companies, and both Australian and international investors flowing from NRFC financing. This limitation is particularly problematic for food and beverage sector firms, as most of the investment takes place in globally significant multinational firms with global significance with presence in Australia. Australia's multi-national FMCG brands do the heavy lifting in investment. This investment, of around $3 billion annually, draws in smaller to medium sized firms adding further value and diversity to the sector.

**Recommendation 3: Remove the requirement that financial accommodation be limited to wholly Australian based or owned entities as this will significantly limit funding to high priority investments in the sector.**

There is a real risk that the NRFC becomes a handicapped investment corporation, if government policy priorities conflict with the Corporation's profitability mandate. The success of any investment portfolio strategy, such as those created in the superannuation industry, is to invest in a highly diversified pool of sectors, between high-risk and high-return, to low-risk but stable return industries, such as incumbent multinationals, to maximise overall returns. As a result, the investment mandate should be focused on diversifying investment opportunities rather than profitability.

**Recommendation 4: The NRFC should better accommodate industry needs by embedding a diversification pillar to its financing strategy, that incorporate high risk/return investments with low risk/return investments.**

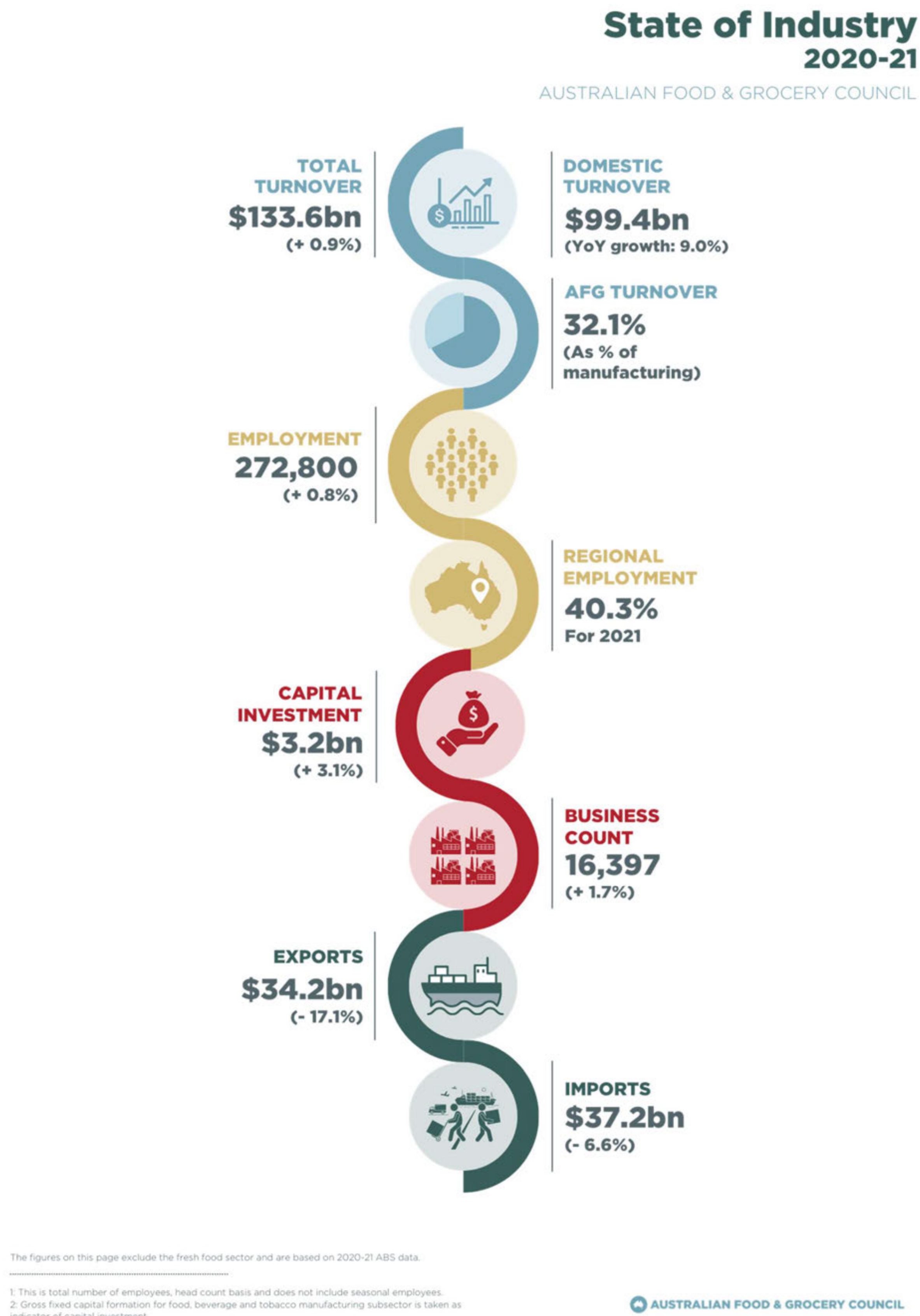
Clause 91 of the Bill proposes that the nominated Minister must arrange for a review of the operation of the proposed Act within 5 years after the commencement of the Act. In our view, given the size and significance of the financing accommodation available to industry, the Act should be reviewed no later than 3 years after the commencement of the Act. This should accommodate for the setting up of the NRFC and provide adequate time to determine the success of the provision of financial accommodation.

Issues that may arise when using a Commonwealth Corporate structure to finance investment decisions may raise several concerns, including a lack of parliamentary scrutiny before a company is established, the objects of a company may be amended by its members without parliamentary scrutiny and a company can borrow and invest money without government approval. Additionally, Commonwealth corporations relying on annual funding from the Government may not be able to enter into multi-year agreements. This significantly hampers the Corporations ability to fund multi-year investment proposals that are usually required by significant investment decisions.

**Recommendation 5: Review the operation of the proposed NRFC to 3 years from commencement of the Act to provide budgetary transparency and parliamentary scrutiny of its operational effectiveness.**

## CONCLUSION

The sector has an ambition to double in turnover to $250 billion by 2030. We have proposed six high priority visions to ensure a vibrant and competitive sector thrives in the long term. There are significant barriers to private sector investment created by market distortions, however investment opportunities can lift the sector's profitability and job creation potential through investments in smart manufacturing, innovative food and beverages, food safety, origin and traceability and export capability. The proposed NRFC may assist the sector in meeting these objectives must be improved to better incorporate the needs of the sector via an established industry strategy, that incorporates the full suite of financing options. And in the process eliminating distortionary constraints such as financing firms that are wholly or predominately Australian based and reviewing the operation of the Act in a timelier manner to provide greater scrutiny of its objectives.


State of Industry
2020-21
AUSTRALIAN FOOD & GROCERY COUNCIL
TOTAL TURNOVER
$133.6bn
(+ 0.9%)
DOMESTIC TURNOVER
$99.4bn
(YoY growth: 9.0%)
AFG TURNOVER
32.1%
(As % of manufacturing)
EMPLOYMENT
272,800
(+ 0.8%)
REGIONAL EMPLOYMENT
40.3%
For 2021
CAPITAL INVESTMENT
$3.2bn
(+ 3.1%)
BUSINESS COUNT
16,397
(+ 1.7%)
EXPORTS
$34.2bn
(- 17.1%)
IMPORTS
$37.2bn
(- 6.6%)
The figures on this page exclude the fresh food sector and are based on 2020-21 ABS data.
1: This is total number of employees, head count basis and does not include seasonal employees.
2: Gross fixed capital formation for food, beverage and tobacco manufacturing subsector is taken as indicator of capital investment.
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