



8th May 2014

Mr Bruce Layman
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Economic Regulation Authority
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PERTH BC WA 6849

Economic Regulation Authority Inquiry into Microeconomic Reform- Potatoes

Dear Bruce,

I write in response to the Economic Regulation Authority (ERA)'s Draft Paper on the above topic released in April 2014.

It is of great disappointment that such a respected body as the ERA has reached the far reaching conclusions that it has on scant, selective anecdotal, historical and at times plain wrong information.

The Potato Growers Association of Western Australia (PGA) **totally** rejects the analysis and conclusions reached in the ERA's report.

The PGA asserts that the ERA Draft report on Potatoes, is **ideological and based on outdated and incorrect anecdotal information.**

At the outset the PGA warned the ERA that the potato supply chain was complex and required extensive understanding before analysing it. The ERA understandably has constraints on its resources and potato marketing was no doubt seen as a small part of its Inquiry into Microeconomic Reform. Nevertheless, the ERA's selective choice of scant information and its findings in regard to its review of the potato industry are not supported by the facts and any reasonable economic analysis of the industry.

To this end the PGA requested AVC consultants to review and prepare a response to the ERA's draft report and their detailed review accompanies this letter. I trust that the ERA will carefully study this report to understand the errors in the analysis underpinning the ERA's conclusions in its Draft report, and reflect these in its final report.

The conclusion reached in the AVC review report summary is telling:

"The ERA has not presented adequate evidence to make a case for its recommendation to de-regulate the production of ware potatoes in Western Australia. Much of the ERA's argument is based on out dated, factually incorrect, irrelevant or inappropriate information. It fails to take accurately into account the immediate significant costs to the Government of repealing the Act, and it does not take into account the effect deregulation may have on regional economies that in many cases are already suffering from economic duress which will likely be further exacerbated by a disruption of the ware potato industry. Any decision to repeal the Act will require further investigation including factual evidence, and an argument that goes beyond ideology."

The facts are that without regulation:

- potato prices will not fall
- consumer 's choice of varieties will not increase
- potato growers will be worse off
- potato seed producers and exporters will not benefit
- the State taxpayer and regional economies will be worse off

Prices- potato consumers in Western Australia do not pay more than consumers in the rest of Australia. Contemporary comparative price data shows that over:

- the 12 years from 2002 to 2012, Perth prices were below the average price paid in the rest of Australia for at least 7.5 out of the 10 years;
- the 12 months from September 2012 to September 2013, retail prices in WA were lower than the national average;
- the past 84 weeks to May 2014, WA consumers consistently paid less than consumers in Sydney (the largest consumer market) and on average less than consumers in Adelaide, the market leader and the largest volume producing state for potatoes; and,
- since January 2014 retail potato prices in Perth have been lower than in any other capital city in Australia.

In addition, the Potato Marketing Corporation (the Corporation) manages the supply of potatoes to match consumer demand and this reduces the supply excesses and shortfalls that lead to large price swings and high cost shocks observed in the rest of Australia.

Choice of varieties - WA consumers do not suffer from limited choice or poorer quality than consumers in other States. Whilst 6 main varieties account for 88% of production, there were 36 varieties grown in the past 12 month period and the selection of what is on the shelf at any point in time is dictated by consumer demand as determined by retailers, not growers nor the Corporation).

Restrictions on growers - the supply of potatoes is managed by the Corporation to closely match consumer demand and avoid unnecessary waste by a Domestic Market Entitlement (DME) expressed in tonnes of product. Growers are free to buy and sell entitlement and reach their optimum business size. In a deregulated market the major retailers would have contracts with growers to do this same function.

Grower Returns - The concentrated power of the supermarkets and the impact of this on suppliers is well known in the horticulture industry and has been recently highlighted by the actions taken by the Australian Competition and Consumer Commission. Growers would be subject to unrelenting pressure to accept lower prices for ware potatoes in WA without the countervailing power of the Corporation.

Seed production and exports - the issues constraining the seed industry in Western Australia put forward in the ERA draft report would exist whether or not the PMC continued to manage the growing and marketing of ware potatoes for the local market. Namely;

- Seed exporters prefer smaller tubers
- Seed crops will not be certified or registered if it is found to have viruses above certain limits
- Some required varieties are not currently grown in Western Australia

It is a nonsense to assert that the PMC influences these facts of the seed market. None of these market factors are controlled by the PMC. They will remain as issues dictated by the market, Australian and Western Australian Government Department of Agriculture protocols designed to control diseases and enhance exports.

No cost to the State/taxpayers - The activities of the Potato Marketing Corporation are self funding (growers fund all the activities of the Potato Marketing Corporation with no costs borne by the government/taxpayers) and it is not dependent on any financial support from the State Government. This reduces the cost to the State for research, biosecurity and market promotion of this major vegetable crop with growers and consumers of potatoes meeting these costs.

The Potato Marketing Corporation is continuing to implement recommendations from the McKinna Report (2011) to further reduce the costs and improve the efficiency of the potato industry in WA, which has already made significant improvement since 2002 when the industry arrangements were last scrutinised (through the National Competition Policy Review process). At that time, then as now, the conclusion of the studies was that there was no evidence that growers or consumers would be better off with the removal of the regulation.

Recent consumer research in the PMC Tracker prepared by Colmar Brunton (2014) indicates that the PMC is strongly supported by consumers, with 81% of consumers believing that the PMC should exist and 75% supporting its role in managing the supply of fresh potatoes.

The ERA's case for deregulation of the Western Australian Potato Industry is purely ideological and not supported by the facts. Consumers would not be better off and the negative impacts of deregulation on the growers and the regional economies would significantly increase costs to the State.

Yours sincerely,

Jim Turley
Executive Officer
Potato Growers Association of WA Inc

Potato Grower's Association of Western Australia

Response to ERA Draft Report: Inquiry into
Microeconomic Reform in Western Australia

8 May 2014



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Disclaimer and Disclosure

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Executive Summary

The evidence and analysis presented by the ERA in support of its recommendation to deregulate the ware potato market in Western Australia is flawed and does not adequately justify its recommendation.

On 11 April 2014 the Economic Regulatory Authority of Western Australia ('ERA') published a draft report titled Inquiry into Microeconomic Reform in Western Australia ('ERA Draft Report'). One of the subjects of the report is the regulation of the growing and marketing of ware potatoes by the Potato Marketing Corporation as legislated by Marketing of Potatoes Act 1946 and the Marketing of Potatoes Regulations 1989 ('The Act'). The ERA Draft Report recommends repeal of the Act either on an immediate basis or within an as yet undetermined adjustment period. Repealing the ACT over an adjustment period would most likely lead to chaos within the sector, and is not viable. This recommendation by the ERA appears to be primarily driven by ideology and is not supported by factual analysis. The findings and analysis presented are based on a topical and, at times contradictory, inaccurate and ill-informed analysis. Furthermore, the ERA Draft Report asserts that the regulation of the ware potato growing industry in Western Australia is a net cost to the Western Australian economy and that deregulation would lead to a net benefit to the economy. The cost-benefit analysis presented by the ERA is based on unqualified assumptions, and cannot be relied upon for decision-making in its present form.

During the submission period prior to the Draft Report, The Potato Growers Association of Western Australia ('PGA') submitted a report to the ERA titled Costs and Benefits Analysis of the Current Statutory Requirements for Growing and Marketing Potatoes in Western Australia, February 2014. The PGA commissioned Australian Venture Consultants to prepare the report.

This report is submitted in response to the ERA Draft Report.

The ERA Draft Report is highly subjective and often relies on outdated data and irrelevant information. In addition, the Draft Report makes a number of unfortunate and overly simplistic assumptions that appear to be anecdotal, and in some cases, assertions are based on a single individual's opinions. There are a number of conclusions and citations of information that appear to be incorrect, irrelevant or unsubstantiated. In some cases, the ERA ignores credible and substantiated presented evidence derived from Australian Bureau of Agricultural and Resource Economics and Sciences ('ABARES'), Australian Bureau of Statistics ('ABS') and highly regarded industry-specific analytics and market intelligence providers, Fresh Logic. In forming conclusions, the ERA findings also ignore ongoing support for the current system by relevant industry representative bodies and Murdoch University agronomics experts; as well as potato growers and consumers. In addition to ignoring credible evidence provided by AVC and others, the ERA fails to provide compelling evidence to lend weight to its counter-arguments.

The ERA Draft Report sensationally infers that the PMC has used draconian powers to enforce the Act. The Report goes as far as comparing the PMC's enforcement activities and powers to the practices used in combatting the illicit drug trade. While there are 'search and seizure' powers enabled by the Act, the case cited does not accurately reflect the enforcement practices of the PMC. Specifically, the case referred to in the report was

related to an ongoing dispute regarding alleged over-production and quality issues with a single grower that resulted in litigation. The litigation was subsequently settled.

The reality is that the PMC is highly engaged with growers to meet the needs of the market through research and development, market development and quality improvement.

The ERA claims that the PMC acts as a monopoly in the Western Australian potato industry, despite acknowledging that there are no restrictions on growers from other states selling potatoes into the Western Australian market, which would not be the case if the PMC were genuinely a monopoly. Indeed, evidence exists of both imports to and exports from Western Australia's fresh potato market, which contradicts a number of the ERA's claims around quality, variety, price and the PMC's perceived control over the market.

The trading of Domestic Market Entitlements ('DME') and the value of the transactions is often mentioned and cited in the ERA Draft Report, and infers that the PMC is a participant in the secondary market for trading DME's. The mechanics of DME licensing appear to be misinterpreted in the ERA's draft report, which implies that the PMC does not 'grant new or additional DME to licence applicants in exchange for only an administrative fee' when in fact the PMC does exactly that. In addition, the values assigned to DME transfers by the ERA do not appear reflective of the actual prices by a factor of nearly two times the estimated prices paid. In fairness, there is no way of precisely tracking the actual amounts paid in exchange for existing DME's, however, the ERA appears to have chosen an extreme anecdotal example for its calculations. It should again be noted that the cost of DME obtained from the PMC is a nominal administrative cost.

It appears that the ERA has confused the operation of the formal regulated environment governed by the PMC with an informal trading mechanism between two parties that can occur from time to time on an ad-hoc basis. The ERA also incorrectly states in its report that the PMC takes a position regarding the value of DME in this informal mechanism. As articulated in AVC's report, there are no cases where new applicants have been denied or where the transfer of licence has not been approved. Furthermore, the PMC has a pipeline of 10,000 tonnes of incremental DME that it will allocate over the next three years.

The ERA Draft Report purports that as a result of the PMC, Western Australian consumers have limited varietal choice when purchasing potatoes. The figures and examples stated by the ERA in its draft report are generally incorrect and do not reflect the true nature of consumer access to desired potato varieties at the consumer level. There are at least 28 varieties being grown in Western Australia. The ERA implies decisions made related to production by variety are driven by grower economics. In fact, variety choice is to a large degree controlled by the major retailers. The matter of variety choice is further complicated by the unique conditions required for certain varieties. New varieties typically require some degree of agronomic R & D in order to be successfully grown in Western Australia. Irrespective of whether a market is regulated or unregulated, the introduction of new varieties to meet consumer demand will require R & D activity that may result in some lag in implementing the production. The PMC provides ongoing benefits to the market place by meeting consumer demand through the funding and delivery of the required R & D to ensure that new varieties can be produced in a manner that is economically viable and can deliver the quality required by consumers.

The ERA Draft Report draws conclusions that the restrictions on potato marketing have raised the incomes of potato growers in Western Australia and has restricted productivity growth, however provides no evidence to substantiate either of these claims. The ERA states that WA

consumers are paying higher prices than consumers on the east coast and cites the 2011 McKinna report as its source of evidence, however the ERA is factually incorrect in its statement which is inconsistent with McKinna's findings. In fact the McKinna report stated that 'if anything, WA prices are below the eastern states and are less volatile' and 'it does indicate that WA consumers are not being penalised in terms of prices by the existence of the regulated system'¹.

The ERA quotes McKinna's report and relies upon a statement by one wash-packer who estimated that the market was undersupplied by 20 percent. Aside from being out-of-date, this statement, as acknowledged in the relevant citation is a subjective verbal estimate by a sole party and is not supported by any underlying data pertaining to grower and wash packer performance that are tabled in the PMC's annual reports

If, as the ERA argues, the PMC is motivated to maximise returns to growers at the expense of the consumer, one would expect WA retail prices to rise in the event of a supply shortage nationally to reflect a profit maximisation strategy. However there is no evidence of such pricing practices at the retail level, nor in the farm-gate price PMC pays to growers. In fact, the average prices the PMC has paid to growers have declined 10 percent in the 2013/14 year to date relative to 2012/13. Indeed in the example provided by the ERA, the only conclusion that can be drawn is that a 38 percent increase in the PMC to Merchant price over the two year period from 2006 to 2008 resulted in a corresponding 17 percent increase at the retail level. That is, an 18 percent per annum rise in the cost of goods at wholesale level resulted in a corresponding 9 percent per annum rise in the WA retail price, or approximately half of the rise in the cost of goods, not as the ERA states, a proportionately larger price rise.

Contrary to the view presented by the ERA, the corresponding change in retail prices that followed the increase in the cost of potatoes at the wholesale level indicates that overall, the combined margin at the wholesale and retail levels declined and the cost increase was not passed on in full to consumers.

It must be noted that recent consumer research indicates the PMC is strongly supported by consumers, with 81% of consumers believing that the PMC should exist and 75% supporting its role in managing the supply of fresh potatoes².

The ERA devotes a considerable proportion of its analysis surrounding the ware potato industry to discussion of the seed potato industry, which, it concludes is being materially disadvantaged by the existence of the PMC. It is unclear how the ERA arrived at this conclusion, particularly considering that the relevant industry body provided a written submission to the ERA that directly refutes this position.

The ERA's view that evidence presented regarding Western Australia's high cost environment is 'inconclusive' because 'the claim of a high cost of production is inconsistent with claims that Western Australia is achieving higher yields than in other states' is an illogical conclusion since one does not necessarily define the other.

AVC disputes claims by the ERA that there is a reasonable balance in market power between wholesale sellers and buyers of ware potatoes in Western Australia if the PMC were to be removed from the market. Misuse of retailer buyer power can be significant to the

¹ McKinna, D. et al (2011), *Strategic Analysis of the WA Ware Potato Supply Chain*, p23

² Colmar Brunton (2014), *PMC Tracker*

extent of distorting competition even if the retailer controls as little as 8 percent of the total market³. Together, the three major customers account for over 60 percent of wholesale potato sales in Western Australia, and Coles and Woolworths alone account for approximately three-quarters of Class 1 potato sales in WA⁴. These statistics are supported by consumer research data that indicates 76 percent of WA consumers usually purchase their potatoes from Coles or Woolworths.

The ERA states that in the case of the Australian dairy industry 'while the adjustment was large, deregulation occurred because the net benefits of deregulation outweighed the costs', however the Report provides no evidence to substantiate that such benefits have been realised. Ample evidence exists to challenge the notion that the deregulation of the dairy industry has resulted in the realisation of long-term benefit to consumers and productivity growth.

The original terms of reference for the ERA's inquiry welcomed experiences from other jurisdictions, and examples were provided in AVC's report to illustrate that other developed nations had identified that a shift in market power had occurred away from traditional supply-side dynamics into the realm of the retailer, by virtue of increasingly high levels of retailer concentration. Australia has the highest level of retail concentration in the world. Substantial economic literature of appropriate currency is available to support the existence of misuse of retailer power in fast moving consumer goods, the most vulnerable sectors of which are perishable produce industries. To that end, there is precedence and justification for the existence of industry bodies to coordinate a range of functions such as those undertaken by the PMC in Western Australia.

The ERA has not presented adequate evidence to make a case for its recommendation to de-regulate the production of ware potatoes in Western Australia. Much of the ERA's argument is based on out dated, factually incorrect, irrelevant or inappropriate information. It fails to accurately take into account the immediate significant costs to the Government of repealing the Act, and it does not take into account the effect deregulation may have on regional economies that in many cases are already suffering from economic duress which will likely be further exacerbated by a disruption of the ware potato industry. Any decision to repeal the Act will require further investigation including factual evidence, and an argument that goes beyond ideology.

³Competition Commission (2000), *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*

⁴ Statistics provided by Paul Graham at Market Strategy, 1 May 2014.

Commentary on the ERA Draft Report

PMC Function and the Marketing of Potatoes Act

The ERA cites an obscure and unused clause of the Marketing of Potatoes Act relating to a theoretical situation empowered under the Act, to infer that legal action taken by the PMC in relation to a non-compliant grower was inappropriate. The likening of action taken in relation to a grower who consistently exceeded production by some 500 tonnes annually, to the search, seizure and impoundment of goods and prosecution of a farmer found to be in possession of 50 kilograms of potatoes without a licence is irrational.

It is true that, as with most legislation of significant tenure, outdated individual clauses exist within the Act. A critique of the Act is not the exercise at hand, however, the issue is whether or not the PMC performs a role that is relevant and valuable in today's market, and therefore whether its role remains justified.

The specific functions of the Potato Marketing Corporation are to⁵:

- a) regulate the production of ware potatoes so as to ensure the supply of the quantities, kinds and qualities preferred by consumers in the State;
- b) take delivery of, and otherwise deal with, potatoes in accordance with the Act and market potatoes in the State and elsewhere;
- c) register persons who are to be authorised to carry on business as a commercial producer of potatoes, and license the areas of land to be used in any such business;
- d) encourage and promote the use of potatoes and provide for the monitoring and, if thought fit, regulation of the production of potatoes for propagation or for any other prescribed kind of use; and
- e) foster methods of production and adopt methods of marketing that will enable potatoes grown in the State to compete in price and quality against potatoes from alternative sources of supply;
- f) promote, encourage, fund and arrange for the conduct of research into matters relating to the production and marketing of potatoes, and undertake market development; and
- g) seek and apply knowledge of new and improved techniques and materials that will assist it to perform its functions.

The circumstance noted in ERA's report reflects the sole grower to be prosecuted under the Act in the past decade, since the PMC works collaboratively with growers to resolve issues around crop quantity and quality. In keeping with this principle, this particular issue was subsequently successfully resolved by mutual agreement at the initiative of the PMC.

The ERA highlighted the issue of quality of WA ware potatoes in its Draft report and while criticising the PMC's actions in prosecuting the grower, the ERA failed to recognise that the PMC alleged the same grower consistently delivered poor quality produce which would not be considered acceptable for sale by the major retailers.

The justification for the PMC's actions is clear – if all growers in the WA ware potato market replicated the behaviour of the prosecuted grower would consumers benefit or be disadvantaged? Without question, an oversupply of poor quality ware potatoes is not in the

⁵ Marketing of Potatoes Act 1946, Division 2— Functions and general powers of Corporation, Section 17A

best interests of either consumers or growers, thus, the PMC's actions were consistent with the intent of the Act.

The ERA claims that the PMC acts as a monopoly in the Western Australian potato industry, despite acknowledging that there are no restrictions on growers from other states selling potatoes into the Western Australian market, which would not be the case if the PMC were genuinely a monopoly. Indeed, evidence exists of both imports to and exports from Western Australia's fresh potato market, which contradicts a number of the ERA's claims around quality, variety, price and the PMC's perceived control over the market.

The ERA's cost benefit analysis around removal of the PMC is based on a number of unsubstantiated assumptions and fails to account for the financial benefits associated with the functions delivered by the PMC that would be forgone in the event of deregulation. These benefits include but are not limited to marketing, consumer education and insights, research and development programs and its quality program.

The ERA provides no justification for disregarding these financial benefits in its analysis, despite evidence provided by ABARES for example that investment in R&D is critical to achieving gains in agricultural productivity growth⁶. The ERA also fails to accurately account for the costs associated with winding up the PMC and the cost of compensation to growers.

DME Licences

The mechanics of DME licensing appear to be misinterpreted in the ERA's draft report which implies that the PMC does not '*grant new or additional DME to licence applicants in exchange for only an administrative fee*' when in fact the PMC does exactly that.

As articulated in AVC's report, there are no cases where new applicants have been denied or where the transfer of licence has not been approved. In the past three years the PMC has granted seven applications for DME to new growers, of which three were completely new DME and four were leasing existing DME; plus five applications for additional DME to existing growers. In all cases the PMC has granted applications in exchange only for an administrative fee. Furthermore, based on forecasted demand, the PMC has a pipeline of 10,000 tonnes of additional DME that it will likely allocate over the next three years.

The ERA further states that allocation of additional DME is made by the PMC '*per pool on a pro-rata basis, with poorer growers receiving the same percentage as better growers*'.

This is factually incorrect, since the PMC allocates DME to each pool according to its expectation of domestic demand, and requests expressions of interest from growers within the relevant pool/s that it considers to be have demonstrated suitable performance to warrant additional DME. The ERA's comments around grower payments rewarding poor performance are similarly incorrect, since growers are remunerated based on pack-out rates according to the class (quality) of their produce.

It appears that the ERA has confused the operation of the formal regulated environment governed by the PMC with an informal trading mechanism between two parties that can occur from time to time on an ad-hoc basis. The ERA assumption is based on a static DME environment where increases and decreases in DME are traded via this informal mechanism. The ERA also incorrectly states in its report that the PMC takes a position regarding the value of DME in this informal mechanism.

⁶ ABARES (2011), *A Turning Point in Agricultural Productivity: Consideration of the Causes*

The PMC has no role in any such transaction, other than to administer the transfer of DME, and any financial consideration is subject to negotiation between transacting parties, and is not endorsed, administered, recorded or reported by the PMC.

The ERA has reported no examples of transactions which have occurred between buyers and sellers of DME and has provided no evidence of historical volumes, magnitude (tonnage) or commercial consideration per tonne.

Under the Act, the PMC is required to facilitate the matching of supply to demand (and reports against a self-imposed KPI that assesses the accuracy with which it achieves this objective). To that end, the PMC maintains a total level of DME per growing season that moderately exceeds the size of the domestic market in order to closely match domestic demand once wastage and other adverse growing conditions are taken into account.

It is possible that there may be circumstances where a grower may wish to increase production levels outside of the DME cycle or to volumes that the PMC considers would result in an adverse outcome to the market and consumers. In such circumstances the grower may seek further DME via transfer from another party if desired.

AVC's investigation during the industry interview process revealed historical 'permanent transfer' fees that were consistent with those reported at \$150-\$300 per tonne however no reliable historical data exists on the magnitude, number or frequency of such transactions on which to base any credible future assumptions; and they sit outside the regulatory environment.

AVC, the PMC and the PGA are not aware of evidence in the market of permanent transfer fees reaching \$600 per tonne as reported by the ERA. The ERA does not cite the source of this data therefore it cannot be substantiated. Similarly, the ERA does not provide supporting evidence for its assumption of perennial leasing arrangements at \$50 to \$80 per tonne per annum adopted in its cost benefit analysis. AVC considers that the underlying logic to this assumption is flawed and there is insufficient basis to apply such an assumption to the cost benefit analysis.

AVC considers that the ERA's assertion that *'growers wishing to expand would not sensibly pay amounts for a transfer or lease of a licence if they expected the PMC to approve any new licence application'* is overly simplistic. In drawing this conclusion, the ERA fails to recognise that a number of variables exist which may motivate a grower to expand their operation (or the reverse) outside the standard PMC 'free' DME approval cycle.

AVC notes that DME is not approved purely on a tonne basis, rather it is approved based on the grower pool structure which categorises growers into four 'pools' that correspond to 13 week fiscal quarters, according to the ability of growers in each region to produce consistent supply during that quarter to ensure year-round availability of potatoes in Western Australia. Growers may produce for more than one pool, though few growers produce in all four pools.

As outlined in the AVC report, the inputs required to participate in the potato growing industry such as land, capital intensive equipment and large quantities of clean water are scarce resources which can be difficult and expensive to acquire. In particular, land acts as a major constraint on WA growers as it is a fixed resource, which in many cases would provide a greater impediment to grower expansion than DME entitlements.

The ERA's position relies on an over-simplified theoretical construct that ignores these and other constraints and does not accommodate the practical mechanics of the market.

Potatoes are seasonal produce, and the climactic conditions in the region where a grower is located will largely dictate the appropriate pool/s under which each grower may be granted DME. It is entirely feasible (and statistically reasonably likely) that a mismatch may exist between new or additional DME allocated to a particular grower pool and the business growth aspirations of a grower in a different pool.

For example, the PMC recently allocated new DME to the Northern region, which encompasses Dandaragan, Lancelin, Gingin and Baldivis. The growing season in this region is precisely the opposite of the growing season in the Manjimup/Pemberton region.

According to the ERA's theory, a Pemberton grower with a spare 100 hectares of land seeking to expand potato production would 'not sensibly pay' for DME from a retiring potato grower locally in the same region because they could acquire 'free' DME from the PMC (albeit for the Northern region). When considered in a real world context the ERA's theory would lead to absurd outcomes since it assumes an environment where land is freely available (at negligible cost), and the total absence of logistical (e.g. distance, water, etc) and seasonal constraints.

In the circumstances articulated in the above example, an incentive may exist for a grower to pay to acquire additional DME should they already have access to proximate land; capital equipment, water and other requisite resources; provided they considered there was a potential financial benefit to do so. There are a number of reasons why growers may simultaneously seek to exit the market at any time, including retirement or lack of profitability.

The timing of these potential transactions is significant, since DME is allocated at the same time each year for grower pools which produce during different times each year. The potential value of the DME entitlement is directly linked to the proximity of the production season for its associated grower pool for that grower year.

Level of Choice in Western Australia

The ERA cites statements made in the McKinna report around the level of choice available to WA consumers despite being aware that a number of reforms have been implemented since its publication that have significantly improved the availability of choice to those consumers.

The ERA incorrectly states on page 268 of its report that 70 percent of ware potatoes grown in Western Australia are of the Nadine variety, when in fact in the 2013/14 growing year Nadine comprised half (50.3 percent) of ware potatoes grown in Western Australia.

Blue, red, cream/yellow and other white fleshed varieties represented 19 percent, 11.7 percent, 9.6 percent and 9.4 percent respectively⁷.

It is not clear where or from which year ERA sourced its data, however the Nadine variety has not comprised 70 percent of ware potatoes grown in Western Australia in at least the past three growing years (50.3 percent in 2013/14, 53 percent in 2012/13, 59 percent in 2011/12⁸ - prior years are considered irrelevant for the purpose of assessing the current state of an industry and have therefore not been reviewed by AVC).

⁷ Potato Marketing Corporation (2014), *Domestic Market Entitlement Summary – 2013/14 Season*

⁸ Data sourced from Potato Marketing Corporation Annual Reports for years 2011/12 and 2012/13, and from interim grower data in the current 2013/14 year

Irrespective of how long ago it was sourced, when considered in light of the above grower statistics the ERA's data effectively highlights that the dominance of the Nadine variety has steadily declined over time - a trend that is attributed to consumer demand and the consequences of the combined effect of the PMC's industry-wide R&D and varietal marketing programs.

The ERA claims that a free market will always respond more quickly to consumer demand than a regulated market, however provides no evidence to substantiate this claim, particularly with respect to grower produce industries. The ERA subsequently contradicts itself when it considers that the PMC's project to transition WA growers from white flesh to yellow flesh varieties will encounter resistance by growers due to profitability and yield issues.

The manner in which a market responds to demand depends on a number of factors, including but not limited to market incentives, cost and revenue drivers, profitability, and availability of alternative options to producers, retailers and consumers. In the context of fresh produce, it is also true that to a certain extent the varieties grown in any particular region will depend on suitability to regional soil and climactic conditions. To that end, the PMC DME licences specify only colour categories consistent with its major customers' category marketing requirements, rather than specific varieties. Within each colour category growers are free to choose the best yielding varieties for their individual growing conditions.

Indeed, the high proportion of the Nadine variety historically grown in Western Australia is symptomatic of its high yielding, cost efficient properties. It is arguable that in the absence of the colour category DME requirements set out by the PMC, WA growers may choose to grow greater proportions of the Nadine variety since it is one of the most efficient potato varieties for growing in WA, and is the variety more consumers are familiar with and purchase⁹.

Many varieties which are grown in other jurisdictions, within Australia and internationally, require significant investment in R&D in order to achieve acceptable production yields and quality standards within Western Australia. Currently the only central industry body that coordinates and funds this R&D to any degree in Western Australia is the PMC.

Agricultural experts at Murdoch University have recognised the PMC's role in facilitating R&D support for the potato industry in Western Australia (as detailed in Appendix 1), and this view is strongly supported by interviewed growers by AVC.

It is true that it would technically be feasible for another entity to take on the R&D role, although the PMC delivers an integrated R&D, marketing and consumer education portfolio of functions which is quite unique. There is no evidence of an appetite to assume marketing and consumer education functions within any other agricultural industry body, and in the event an alternative body adopted the functions it would occur at a cost to operate, which one would assume would be at least comparable to that of the PMC. Removing a function from a market at a financial cost to taxpayers, in order to replace it with an equivalent one seems illogical and a questionable use of resources.

ERA cites Department of Agriculture and Food (DAFWA) as the logical body to undertake R & D, and credits DAFWA with delivering the varietal development program in the years

⁹ Colmar Brunton (2012), *Project Spud*

between 1998 and 2008, yet of the 28 varieties that are currently grown in Western Australia DAFWA introduced three, two of which are currently being phased out¹⁰.

The ERA fails to make the distinction between consumer demand and retailer demand in drawing its conclusions. To make the assumption that deregulation of the industry would result in better matching of consumer preferences is at best naïve, when in the vast majority of cases no direct relationship between producer and consumer exists (or has existed for some decades), and nor would it suddenly exist in the absence of the PMC.

In today's market it is retailers that define product category offerings, and therefore to a greater extent inform consumer demand. The major retailers typically define most potato product lines via a simplified colour category such as white, red or blue, as distinct from detailing many product varieties; with a few exceptions where varieties are considered to comprise niche or high-value segments (e.g. Kipfler).

The PMC's role is to ensure the varieties grown in Western Australia are consistent with the category marketing requirements of their customer groups (retailers) and associated consumer preferences. Consumer research identifies the Nadine, Royal Blue and Ruby Lou as the top varieties with WA consumers in terms of both awareness and propensity to purchase¹¹.

Nadine accounts for half of all potatoes cultivated in WA and 55 percent of surveyed consumers regularly purchased this variety, with 44 percent indicating it was their preferred or 'main' variety of potato purchased. Similarly, Royal Blue accounts for approximately 19 percent of potatoes grown in WA, with 27 percent of consumers indicating that they regularly purchased this variety, with 14 percent considering it their main variety¹².

Desiree, Delaware and Kipfler varieties ranked behind the most popular varieties but still demonstrated a high level of consumer awareness¹³. Fewer than 20 percent of WA consumers were aware of any one other specific potato variety, which is largely attributed to the category marketing practices of the major retailers as outlined above¹⁴.

The close matching of the awareness of varieties in Western Australia relative to the proportions grown is indicative that no unmet consumer demand for other varieties of any significance exists. If demonstrable unmet demand existed, these varieties would most likely be imported since no barriers exist to the importation of potatoes from interstate.

The ERA's statement that there is a large difference in varieties produced in each state may be true however AVC notes that approximately 80 percent of fresh potatoes consumed in Australia are grown in South Australia so differences in varieties produced in other states is not necessarily reflective of varieties consumed or consumer preferences in other states.

In any case, differences in varieties produced across states is not evidence of a lack of consumer choice in WA, rather it is likely to be symptomatic of a combination of factors including closed loop marketing (PVR/PBR) restrictions, soil and climactic conditions and consumer preferences. Similarly, the ERA's statements of the prevalence of brushed

¹⁰ Potato Marketing Corporation (2014), *Weekly Receival Summary for Season 2014 by Variety*

¹¹ Colmar Brunton (2012), *Project Spud*

¹² Colmar Brunton (2012), *Project Spud*

¹³ Colmar Brunton (2012), *Project Spud*

¹⁴ Colmar Brunton (2012), *Project Spud*

potatoes in the eastern states compared to WA are simply a reflection of consumer preferences, as is supported by consumer research data¹⁵.

AVC considers that while differences do exist between states, the major retailers typically adopt similar category marketing practices across the nation and differences are not major.

Recent consumer research indicates that the PMC is strongly supported by consumers, with 81% of consumers believing that the PMC should exist and 75% supporting its role in managing the supply of fresh potatoes¹⁶.

AVC considers the absence of submissions from supermarket retailers in response to the perceived issues raised in the ERA's inquiry into the potato growing industry in Western Australia is reflective of market sentiment.

Production Efficiency and Quality

The ERA draws conclusions that the restrictions on potato marketing have raised the incomes of potato growers in Western Australia and has restricted productivity growth, however provides no evidence to substantiate either of these claims.

The assumption of production efficiency applied in the cost benefit analysis is highly optimistic and does not fully consider the extent of real world constraints that affect grower production costs and ability to achieve economies of scale. To produce a reliable modelling assumption that reasonably reflected the mechanics of efficiency within the industry would be a complex exercise that requires substantially more investment by the ERA.

Quantity of Supply

The ERA quotes McKinna's report and relies upon a statement by one wash-packer who estimated that the market was undersupplied by 20 percent. This statement, as acknowledged in the relevant citation is a subjective verbal estimate by a sole party and is not supported by any underlying data pertaining to grower and wash packer performance that are tabled in the PMC's annual reports.

The PMC applies a self-imposed KPI on closely matching domestic supply with consumer demand (the KPI is +/-5%) and the results are as follows¹⁷:

¹⁵ Colmar Brunton (2012), *Project Spud*

¹⁶ Colmar Brunton (2014), *PMC Tracker*

¹⁷ Data Source: PMC Annual Reports, Freshlogic

WA Ware Potatoes	2012/13	2011/12	2010/11	2009/10
DME Licenced	54,879	54,762	53,258	52,640
WA Ware Potatoes Delivered (t)	51,877	50,200	52,544	50,765
% of PMC Target	94.5%	91.7%	98.6%	96.4%
Potatoes Imported to WA (t)	2,188	4,688	1,448	1,156
Total Consumer Demand in WA	54,065	54,888	53,992	51,921
Target production/ Actual demand %	101.5%	99.8%	98.6%	101.4%
% Under-production (Actual)	4.05%	8.5%	2.7%	2.2%

TABLE 1: DME, DOMESTIC SUPPLY AND IMPLIED MARKET DEMAND 2009/10 – 2012/13

As explained in AVC's report and identified by the ERA in citation of Potatoes South Australia's article¹⁸ regarding the impacts of the recent regional weather event in South Australia, production yields and quality can vary significantly according to adverse weather conditions such as extreme heat and prevailing wind (which are often also experienced in Western Australia) that cannot be predicted.

Since there have been no reported cases in Western Australia of a potato supply shortage in recent history, it is assumed that any market demand unserved by local production is met with ware potato imports to Western Australia. Thus the total market demand is estimated to be the sum of local production plus imports, which almost certainly overstates actual consumer demand since perishable produce is inevitably subject to wastage.

If residual unserved market demand existed this would be reflected in terms of increased prices to growers when in reality the converse has been the case (e.g. recommended pool prices were not achieved in 2012/13 and pool prices further declined in 2013/14). Similarly, WA retail price data does not support the theory of unserved demand.

If growers had been able to successfully deliver the quantity of potatoes targeted by the PMC over the past four years, actual production would have been within 1.5 percent of implied market demand. When actual production is considered, local supply generally meets at least 95 to 97 percent of consumer demand, with the exception of 2011/12 where severe weather conditions hampered domestic production yields¹⁹. There is no evidence to support the ERA's claim that the market is undersupplied by 20 percent.

The ERA admits that it cannot find any research to substantiate its assumption that domestic potato supply would be 'reasonably responsive to the lifting of DME restrictions'. However, the ERA concludes from its analysis that domestic potato supply would increase by 700

¹⁸ Potatoes South Australia (2014), *Heatwave in SA Causing National Potato Shortages*, Available from: <https://www.potatoessa.com.au/wp-content/uploads/February-heatwave-in-SA-causing-national-potato-shortages.pdf>

¹⁹ Potato Marketing Corporation (2012), *Annual Report 2011/12*

tonnes as a result of removing supply restrictions, yet acknowledges that the PMC intends to increase domestic production by 10,000 tonnes over the next three years.

Based on the above it is difficult for the ERA to argue that the PMC is restricting supply when in fact the PMC's DME system will result in a greater quantity of supply in the WA market than would be the case in the absence of the PMC.

Quality of Produce

ERA cites South Australia as producing industry best practice in potato quality based on information in the 2011 McKinna report, however as indicated above, production quality can vary significantly between states and from season to season according to prevailing climactic conditions.

This view is supported by Potatoes South Australia in its recent commentary around the significant decline in the quality of produce from the current growing season in South Australia resulting in significantly lower grade 1 pack out rates than has previously been achieved²⁰.

In its draft report, the ERA compares 2010/11 South Australian produce quality data presented in the McKinna report with 2012/13 Western Australian produce quality data without reference to any of the factors affecting produce yield and quality for either state in either year. AVC therefore considers that this comparison is not valid.

The ERA draft report also draws a link between recent increases in major supermarkets' quality standards to a WA farm-gate price increase over the two year period from 2006 to 2008 without any basis to substantiate this link, and despite the evidence that retail prices increased markedly across the nation over the same time period.

Conclusions ERA draws about consumer satisfaction with pre-packed potatoes are not specific to WA, since the practice of pre-packaging Class 2 potatoes and marketing Class 1 potatoes on a loose self-selected basis is consistent nationwide among major retailers. It is perfectly logical that consumers of self-selected Class 1 potatoes would report higher quality satisfaction since the quality of the product is in fact superior.

The ERA incorrectly states that growers are being rewarded by the PMC for poor quality produce through grower payments which are not effectively rewarding better growers and deterring poorer growers.

Contrary to this claim, the PMC pool prices paid to growers are based on individual grower pack-out rates, that is, the proportion of the grower's produce that meets various quality standards. There is a significant difference between the price paid by the PMC for Class 1 produce and that paid for Class 2 produce. While these differences vary between pools and varieties, Class 2 produce is typically remunerated at between 30 to 50 percent of the per tonne price of Class 1 produce²¹.

²⁰ Potatoes South Australia (2014), *Heatwave in SA Causing National Potato Shortages*, Available from: <https://www.potatoessa.com.au/wp-content/uploads/February-heatwave-in-SA-causing-national-potato-shortages.pdf>

²¹ Based on top 3 consumer preferred varieties for Pool 1 2013: Nadine Class 2 attracted 55% of Class 1; Royal Blue Class 2 attracted 28.5% of the per tonne price of Class 1 and unspecified Class 2 Red potatoes attracted 32% of the per tonne price of Class 1.

Detailed information relating to the actual per tonne prices paid to growers by the PMC according to class and variety is available in the public domain via the Grower Report section of all PMC Annual Reports.

Retail Prices and Returns to Growers

The ERA states that WA consumers are paying higher prices than consumers on the east coast and cites the 2011 McKinna report as its source of evidence, however the ERA is factually incorrect in its statement which is inconsistent with McKinna's findings.

In fact the McKinna report stated that *'if anything, WA prices are below the eastern states and are less volatile'* and *'it does indicate that WA consumers are not being penalised in terms of prices by the existence of the regulated system'*²².

While the ERA conceded that it considered the Australian Bureau of Statistics (ABS) Cat 6403 Average Retail Price data unsuitable as a comparison for inter-city retail potato prices, it failed to recognise that the data has been categorically disproven, as stated by the Bureau when it discontinued production of the report in 2011 due to bias and lack of robustness²³.

The ERA's claim that the analysis of retail price presented in AVC's report suffered a similar bias if held to the same standard is inaccurate and indefensible. Indeed, the ERA fails to qualify its position with any specific perceived limitation with the retail price data supplied by Freshlogic.

Freshlogic is an independent specialist food industry research and data analytics provider in Australia. It is used by all major supermarket retailers and other major food industry participants for retail, wholesale and promotional pricing comparisons and market intelligence data between the five major states. Appendix 2 outlines the data collection methodology undertaken by Freshlogic.

AVC acknowledges that the data supplied by Fresh Logic remains subject to some limitations, for example it excludes the NT and ACT; however the vast majority of the Australian market is represented in the data.

The ERA evidently has not examined the specific detail of the ABS Cat 6403 report since it claims that the ABS *'could not find a satisfactory way to construct a robust comparison of retail potato prices between Australian capital cities'*, yet the report cited was not constructed for the purpose of such a comparison and to AVC's knowledge the ABS has not attempted to construct a comprehensive comparison for fresh potatoes in any other published report.

The ABS report was constructed for the purpose of comparing the change over time in an average basket of retail goods across different states as an indicator that was used in the formulation of the Consumer Price Index (CPI). To that end, ABS Cat 6403 attempted to compare nominal average prices across eleven categories of retail goods including food items such as milk, bread, fresh meat, fresh fruit and vegetables; petrol, alcohol, household supplies and personal care items.

AVC concurs with the ERA's view that the ABS is the preeminent national provider of *general* statistics, however the ABS is not principally in the business of providing detailed industry-specific analytics, including with respect to fast moving consumer goods (FMCG).

²² McKinna, D. et al (2011), *Strategic Analysis of the WA Ware Potato Supply Chain*, p23

²³ ABS (2011), *Final Issue of Average Retail Prices*, available from:

<http://www.abs.gov.au/ausstats/abs@.nsf/mf/6403.0.55.001?OpenDocument>

A key limitation of the ABS report was that it compared raw averages across states without accounting for relative proportion. This aberration is resolved in the Freshlogic data. Potato prices comprised a single line item in the ABS report and did not attempt to provide a detailed comparison at product line level. Conversely, Freshlogic collects and analyses detailed data on all fresh potato product lines available through major supermarkets, including the product description and variety, per kilogram pricing, class, size and type.

The retail potato price data collated by Freshlogic is superior to that supplied in ABS Cat 6403 since it provides a means of direct comparison between identical varieties and grades sold in major retail supermarkets, and identifies high volume product lines.

The ERA's claim that the recent adverse weather conditions experienced in South Australia²⁴ 'would likely dwarf any impact the PMC has on relative retail prices for potatoes' is inaccurate since potato prices across the nation respond to various market forces and the relative positioning of WA retail potato prices remains relevant in all market conditions.

The adverse weather conditions in South Australia are not unique and represent one of the challenges which exist in the potato growing industry across Australia. Irrespective of South Australia's relative market share of fresh potato production, the impacts of a seasonal weather event on retail prices are likely to be reasonably short-term, particularly given the all year round growing conditions present in South Australia. The retail pricing comparison supplied by Freshlogic and presented in AVC's report extends to over a decade of data.

The aspect of the article cited by the ERA that is most relevant to the retail price discussion is the prediction by Potatoes South Australia that retail prices would escalate from the typical range of \$2.98 to \$3.48 per kilogram to \$5 per kilogram in response to the supply shortage²⁵.

Recent retail price data collected by Freshlogic supports Potatoes South Australia's prediction, with prices observed exceeding \$4.10 per kilogram in some states. Figure 1 below illustrates current season price trends across the nation, including the comparative stability of Perth retail potato prices.

²⁴ Potatoes South Australia (2014), *Heatwave in SA Causing National Potato Shortages*, Available from: <https://www.potatoessa.com.au/wp-content/uploads/February-heatwave-in-SA-causing-national-potato-shortages.pdf>

²⁵ Potatoes South Australia (2014), *Heatwave in SA Causing National Potato Shortages*, Available from: <https://www.potatoessa.com.au/wp-content/uploads/February-heatwave-in-SA-causing-national-potato-shortages.pdf>

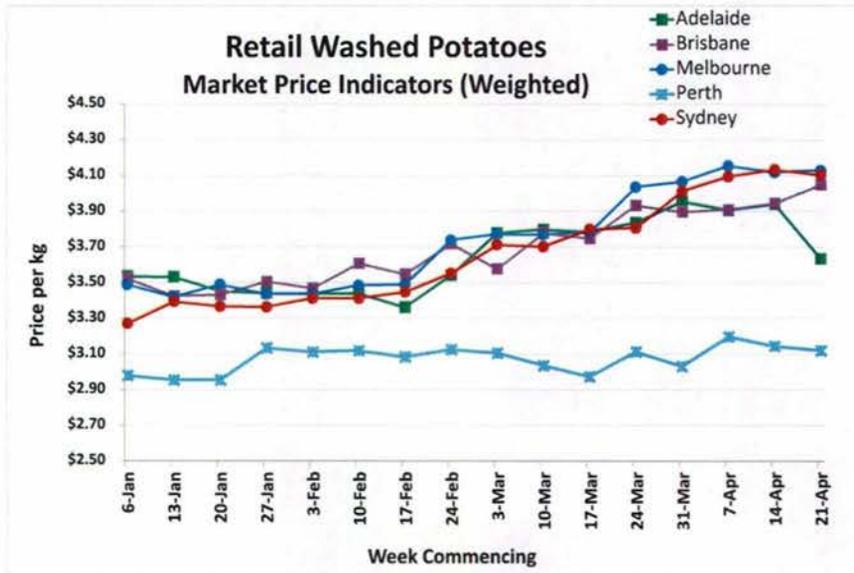


FIGURE 1: RETAIL WASHED POTATO PRICES JAN-APR 2014

If, as the ERA argues, the PMC is motivated to maximise returns to growers at the expense of the consumer, one would expect WA retail prices to rise in the event of a supply shortage nationally to reflect a profit maximisation strategy. However there is no evidence of such pricing practices at the retail level as indicated in Figure 1 above, nor in the farm-gate price PMC pays to growers. In fact, the average prices the PMC has paid to growers have declined 10 percent in the 2013/14 year to date relative to 2012/13²⁶.

It is not surprising however that the ERA was unable to draw conclusions about retail potato price data in Western Australia based on farm-gate prices the PMC pays to growers since it is an inappropriate measure that sits several layers below retail pricing in the industry value chain. There are a number of issues with the ERA's analysis, including insufficient data at the merchant and retailer level to determine the extent to which the increase in cost of goods was passed on to consumers.

The ERA incorrectly classifies the PMC payment to grower prices as wholesale prices, when in fact they are not. It appears that the ERA lacks understanding of the structure of the Western Australian potato value chain and the role of the PMC in the administered pricing mechanism.

As indicated in the AVC report, the PMC determines pricing at two levels:

1. The price per tonne that the PMC charges to merchants, which constitutes the farm-gate price plus washing, grading and packing
2. The price per tonne that the PMC pays to growers, minus any discounts, levies or corporate costs

Following this process, the merchant determines the wholesale ware potato price, including its margin, and the retailer determines the retail ware potato price, including its margin.

The PMC to Merchant price may be considered the 'cost of goods' at the wholesale level. Both merchants and retailers must apply a margin to their respective cost of goods to cover operational costs and ordinary profit. The ERA's extrapolation of historic price rises assumes a zero percentage margin earned at both merchant and retailer level which is illogical.

²⁶ Potato Marketing Corporation (2014), *Grower Payment Summary for 2013/14 and Annual Report 2013*

Indeed in the example provided by the ERA, the only conclusion which may be drawn is that a 38 percent increase in the PMC to Merchant price over the two year period from 2006 to 2008 resulted in a corresponding 17 percent increase at the retail level. That is, in simple nominal terms, an 18 percent per annum rise in the cost of goods at wholesale level resulted in a corresponding 9 percent per annum rise in the WA retail price, or approximately half of the rise in the cost of goods, not as the ERA states, a proportionately larger price rise.

Contrary to the view presented by the ERA, the corresponding change in retail prices that followed the increase in the cost of potatoes at the wholesale level indicates that overall, the combined margin at the wholesale and retail levels declined and the cost increase was not passed on in full to consumers.

No conclusions may be drawn from the data regarding the proportional split between margins earned by the retailer or merchant and therefore the source and beneficiary of any income transfer between those functions in the value chain.

AVC notes however that the example is taken from eight years ago, at the height of the economic 'boom' in Western Australia where input costs are highly likely to have spiked at all stages in the industry value chain.

Figure 2 below²⁷ (as depicted in AVC's report) illustrates the retail pricing trends in each major state since 2002 and clearly demonstrates a retail price spike across all eastern states potato markets during the time period identified by the ERA, noting that both the magnitude of the retail price spike in Western Australia and the overall retail price remained smaller than across the rest of the nation.

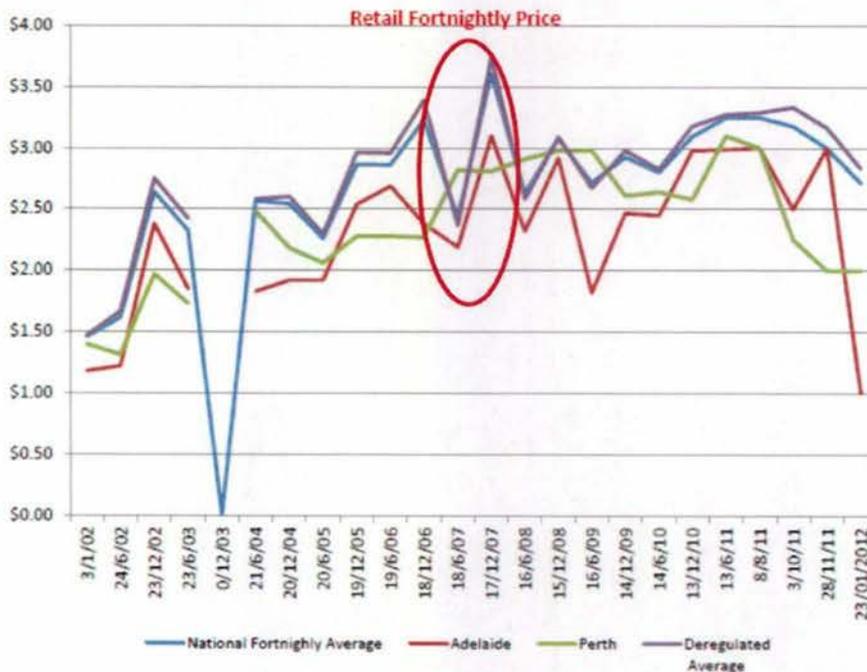


FIGURE 2: RETAIL FORTNIGHTLY POTATO PRICES

That the most recent example of a price fluctuation of any significance the ERA could identify was nearly a decade ago is considerably more relevant than the ERA's attempt to demonstrate any disadvantage to consumers, which cannot logically be concluded from the example.

²⁷ Freshlogic data

While insufficient data is presented to determine overall pass-through rates, the data presented contradicts the ERA's view of a transfer from consumers to growers.

AVC considers that the timing of the example provided by the ERA is inappropriate since it occurred almost a decade ago and a more recent assessment of market pricing mechanics would be appropriate.

While the PMC does not directly control retail potato prices in Western Australia, the prices it charges merchants and pays to growers do contribute towards retail prices in WA. It is reasonable to assume that if the PMC increased these prices, retail prices of fresh potatoes in Western Australia would also rise, although the extent to which they would rise would depend on merchant and retailer margins and the extent to which any cost increases or decreases were passed on to consumers.

However, average pool prices paid to growers by the PMC declined by 26 percent over the past six years²⁸, which contradicts the ERA's view that the PMC acts to transfer value from consumers to growers. Figure 3 below demonstrates the declining trend of per tonne prices paid by the PMC to growers.

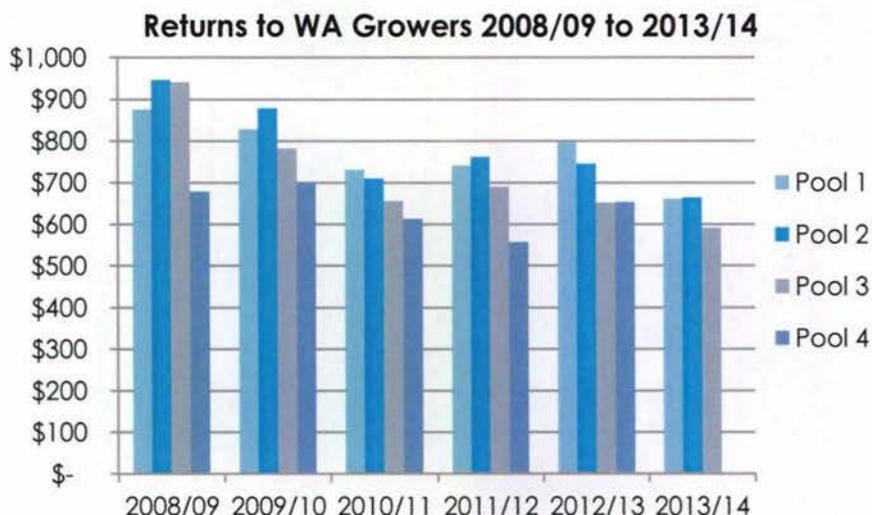


FIGURE 3: RETURNS TO WA GROWERS 2008/9 TO 2013/14

In its cost-benefit analysis the ERA has over-stated the expected pool prices which would be achieved in the current financial year as it applied CPI indexation to the recommended 2012/13 pool prices despite being aware that recommended pool prices from 2012/13 were not achieved, and there was no expectation that suggested higher prices may be achieved in 2013/14.

Actual data from the 2013/14 year demonstrates a 10 percent decline in pool prices from those actually achieved in 2012/13²⁹, or 15 percent lower than ERA's modelling assumption.

²⁸ Potato Marketing Corporation, *Annual Reports and Grower Payment Summary for 2013/14*

²⁹ Potato Marketing Corporation (2014), *Grower Payment Summary for 2013/14*

Grower Input Costs and Yields

The ERA's view that evidence presented regarding Western Australia's high cost environment is 'inconclusive' because 'the claim of a high cost of production is inconsistent with claims that Western Australia is achieving higher yields than in other states' is an illogical conclusion since one does not necessarily define the other.

For clarity, the cost of production is a function of the cost of the resources or inputs that are required to produce one unit of the product - in this case one tonne of ware potatoes. As explained in AVC's report, potato grower input costs vary across regions depending on a number of factors, including water availability and cost, fertiliser, fuel, labour hire, land, and other capital asset and technology acquisition and maintenance costs, as well as differences in production techniques for produce destined for fresh or processing markets.

Conversely, the production yield of a crop can be defined as the quantity of potatoes produced for a given quantity of inputs - in this case expressed as tonnes of potatoes per hectare of committed land. Production yield in the potato industry is determined by factors such as crop variety, seed age and quality, crop management practices and the cultivating environment. Indeed a significant component of the R & D invested by the PMC on behalf of growers is directed to improving crop management practices to maximise yields.

Retail Oligopsony

AVC disputes claims by the ERA that there is a reasonable balance in market power between wholesale sellers and buyers of ware potatoes in Western Australia if the PMC were to be removed from the market.

McKinna³⁰ concurs with the evidence presented by AVC and others in relation to the level of market power wielded by the major retailers in Australia that has materially changed the competitive landscape in which grocery producers operate.

It is important to note that the Australian Competition and Consumer Commission (ACCC) has instituted proceedings in the Federal Court of Australia against one of the two major supermarket chains alleging the retailer developed a strategy to improve its earnings by obtaining better trading terms from its suppliers and that the retailer engaged in unconscionable conduct in contravention of the Australian Consumer Law (ACL)³¹.

Misuse of retailer buyer power can be significant to the extent of distorting competition even if the retailer controls as little as 8 percent of the total market³². Together, the three major customers account for over 60 percent of wholesale potato sales in Western Australia, and Coles and Woolworths alone account for approximately three-quarters of Class 1 potato sales in WA³³. These statistics are supported by consumer research data which indicates that 76 percent of WA consumers usually purchase their potatoes from Coles or Woolworths³⁴.

³⁰ McKinna, D. et al.(2013), *Living with Supermarket Power*

³¹ Australian Competition and Consumer Commission, <http://www.accc.gov.au/media-release/accc-takes-action-against-coles-for-alleged-unconscionable-conduct-towards-its-suppliers>, 5 May 2014

³² Competition Commission (2000), *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*

³³ Statistics provided by Paul Graham at Market Strategy, 1 May 2014.

³⁴ Colmar Brunton (2012), *Project Spud*

Furthermore, the ERA's conclusion that the Western Australian potato market operates in isolation from the rest of Australia at the retail level is naïve and inaccurate. The three major customers in WA that the ERA refers to are Coles, Woolworths and IGA, which are the same three major customers that exist in each state across the nation, none of which are subject to purchasing or logistical barriers between states.

The dairy industry deregulation example cited by the ERA perfectly illustrates the major retailers' centralised buying power and lack of geographical barriers to transportation of perishable goods. However, AVC notes that the ERA provided no evidence to support its statement that the benefits of deregulation of the dairy industry exceeded the costs.

The ERA implies that lower costs to consumers is the only relevant measure of deregulation success or failure, however this is not the case; and there is no evidence to suggest that deregulation of the WA potato industry would result in lower prices to consumers, rather, given long-term retail price evidence in the east, the opposite may occur.

In the absence of the PMC, the major retailers could wield market power over merchants in order to extract greater discounts as has been observed in other industries and regions, however there is no evidence that these discounts would be passed on to the consumer. Rather there is evidence to suggest that the sustained extraordinary profits realised by Coles and Woolworths are derived principally from extraction of such discounts³⁵.

Even large growers are likely to be deterred from making product and process investments if the existence of buyer power prevents them making an adequate return to cover costs and as a consequence, product quality, variety, and innovation are likely to suffer; all of which is to the detriment of the consumer³⁶.

The ERA assumes that any impact of deregulation would be limited to income transfers from growers to the consumer, however the longer term effects of misuse of market power on the retail side are a shift in production and manufacturing offshore, which ultimately results in detriment to growers and consumers, the state and national economy, as well as loss of control around food security, biosecurity, environmental practices, pests, and diseases.

The ERA's claim that the PMC has considerable market power over the greengrocer and foodservice sectors is inaccurate, since the PMC does not interact with or control the price at which merchants sell produce to these customer groups. Conversely, the PMC's role as an intermediary ceases at the wholesale level and merchants determine wholesale prices directly with retailers. These customer groups would inevitably be worse off in the absence of the PMC.

The ERA's states that potato growers are gaining countervailing market power by forming alliances with wash packers, however any benefit to growers from doing so would be limited to lowering risk and would not constitute countervailing power with respect to the major retailers in real terms.

AVC notes that in the event of deregulation growers would attempt to form alliances with washer packers since farm-gate prices would, in theory, be determined by the merchant. However, in reality market power is held by the major retailers, and no merchant in Australia let alone Western Australia would be capable of exerting countervailing power against the

³⁵ Dobson, PW. (2005), *Exploiting Buyer Power: Lessons From The British Grocery Trade*

³⁶ Dobson, PW. (2005), *Exploiting Buyer Power: Lessons From The British Grocery Trade*

major retailers, hence it is likely that the major retailers would demand preferential pricing from merchants which would define the prices returned to growers.

Notwithstanding the likelihood of the above outcome, in the absence of the PMC, smaller customer groups such as greengrocers are likely to be disadvantaged as costs which are implicit in PMC to merchant prices and are not presently directly passed on at the wholesale level (e.g. transport, washing, grading and packing) would be passed through and smaller volume buyers would face proportionately higher costs.

Seed Potato Industry

The ERA devotes a considerable proportion of its analysis surrounding the ware potato industry to discussion of the seed potato industry, which, it concludes is being materially disadvantaged by the existence of the PMC.

It is unclear how the ERA arrived at this conclusion, particularly considering that the relevant industry body provided a written submission to the ERA that directly refutes this position. Indeed, the ERA cites the Western Australian Seed Potato Producers Committee (WASPP) in its report as follows:

'WASPP argued that the activities of the Potato Marketing Corporation had no negative effects on the Western Australian seed potato industry. WASPP noted the Potato Marketing Corporation's role in collecting information on all potato production and regulating ware potato production in Western Australia which has contributed to pest and disease control. In addition WASPP argued that the Potato Marketing Corporation's role in ensuring payments to ware growers who in turn buy seed from WASPP members has led to greater financial security for growers. The Potato Marketing Corporation, WASPP submits, is assisting industry development through the underwriting of new varieties; and further, the regulated system ensures the identification of growers such that levies are collected to fund research and development'³⁷.

The ERA discussion around the potential expansion of the export seed potato industry is illogical and is not supported by any credible evidence or grower data. To put the issue into context, Table 2 below illustrates the relative size of processing, ware and seed potatoes industries.

Processing Potatoes	FY 2012/13 (tonnes)	% of WA Total Potato Produce
Local	16,258	26%
Export	2,095	3%
Total Processing Potatoes	18,353	29%
Ware Potatoes (local)	41,693	66%
Seed Export	2,508	4%
Seed Local	554	1%
Seed Total	3,062	5%
Grand Total	63,108	100%

TABLE 2: WA PRODUCTION OF WARE, PROCESSING AND SEED POTATOES

³⁷ ERA (2014), Inquiry into Microeconomic Reform in Western Australia: Draft Report, p269

The seed export market comprises just 4% of the potato production in Western Australia, and the ERA has drawn a number of flawed conclusions in relation to potential opportunities, benefits and costs that it has subsequently erroneously applied to its cost-benefit analysis.

The tubers that the ERA refers to in its report that are prevented from being sold on the domestic ware market due to a lack of DME on behalf of the grower are typically not of sufficient quality to be sold on the ware market. It is unclear where ERA obtained its assumptions relating to prices of \$550 per tonne it assumed were achievable for oversized tubers or \$350 per tonne for failed seed crop, however these prices remain unsubstantiated.

The ERA states that '*over the past 5 years approximately 468 tonnes of seed crops have failed inspection*' and attempts to incorporate this cost into its cost-benefit analysis to the extent of \$5 million dollars per annum³⁸.

This is perverse, since it reflects a quality issue. Reject potatoes represent a proportion of all growers' produce in seed, processing and ware production and are simply a cost of doing business, and cannot be considered in the argument for or against the function of the PMC. The more improvements a grower is able to make in crop management and harvesting process, the higher the ratio of saleable produce to reject produce is likely to be observed and the higher the grower's resulting profitability, thus the incentive for the grower is clear.

Commentary by the ERA around the requirements for seed tubers to be disease free and any associated crop management practices are *fait accompli* that are not unique to the seed potato market and are irrelevant to both the discussion and the cost benefit analysis. The only relevance of maintaining a disease-free status points to the importance of the role currently undertaken by the PMC in this regard.

Further, the ERA makes reference to seed varieties sought by northern hemisphere countries that Western Australia does not currently produce. It is likely that these varieties are not produced in WA either because climactic conditions in Western Australia are not suitable for cultivation of those particular varieties or because sufficient R&D has yet to be invested in order to achieve suitable yields and quality from these varieties.

AVC considers that the entire discussion around seed potatoes is irrelevant to the argument around the role of the PMC, and any costs or perceived potential benefits associated with the seed potato industry do not belong in the ERA's cost-benefit analysis.

Further Considerations

Dairy Industry Case Study

The ERA claims that in the case of the Australian dairy industry '*while the adjustment was large, deregulation occurred because the net benefits of deregulation outweighed the costs*' however provides no evidence to substantiate that such benefits have been realised.

Ample evidence exists to challenge the notion that the deregulation of the dairy industry has resulted in the realisation of long-term benefit to consumers and productivity growth.

Following deregulation a number of firms left the industry while others increased the size and intensity of operations. The handful of remaining dairy processors found themselves

³⁸ ERA (2014), Inquiry into Microeconomic Reform in Western Australia: Draft Report, p281

competing to deliver the lowest quote for the bulk contract to Coles and Woolworths, and farm-gate prices plummeted as a consequence. Since this initial downward pressure on suppliers, the retailers' own brand of milk has remained relatively inexpensive, but branded fresh milk products are little different in price compared to other outlets, and the chains' retail margin on milk has expanded³⁹.

While it is acknowledged that a modest increase in productivity growth was realised post-deregulation, this has not sustained over time, and in 2007/08 the total factor productivity (TFP) fell to below 1988/89 levels as illustrated in Figure 4 below⁴⁰.

A more recent economic research study into the Victorian dairy industry (which accounts for 67% of Australia's dairy production) in 2012 concurred that dairy farm productivity growth has slowed, and demonstrated evidence of technological regress to the extent of 1.3% per annum⁴¹.

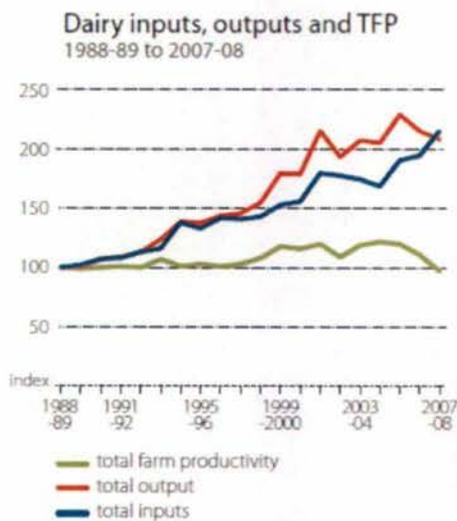


FIGURE 4: DAIRY TOTAL FACTOR PRODUCTIVITY 1988 - 2008

Regulatory Practice in Other Jurisdictions

In its analysis the ERA draws its conclusions based on the deregulated status of other grower produce industries in Australia. Many of these industries were deregulated in response to the National Competition Policy that was implemented in nearly two decades ago, which was based on supply-side driven microeconomic theory that is now at least forty to fifty years old.

The ERA does not retrospectively analyse evidence to confirm the extent of benefits realised by these changes and has simply assumed that they were in the public interest.

Australia was not the first developed nation to undertake such a market reform agenda, rather it followed in the footsteps of other regions including the United Kingdom, Europe and the USA. As such it has an opportunity to learn and profit from the findings of those other

³⁹ Jones, E. (2006), *The Australian retail duopoly as contrary to the public interest*

⁴⁰ ABARES, Nossal, K. and Sheng, Y. (2010), *Productivity growth: Trends, drivers and opportunities for broadacre and dairy industries*

⁴¹ Karanja, F., Gilmour, D and Fraser, I. (2012), *Dairy Productivity Growth, Efficiency Change and Technological Progress in Victoria*

regions, and make more informed decisions regarding appropriate regulatory practice in Australia.

The original terms of reference for the ERA's inquiry welcomed experiences from other jurisdictions, and examples were provided in AVC's report to illustrate that other developed nations had identified that a shift in market power had occurred away from traditional supply-side dynamics into the realm of the retailer, by virtue of increasingly high levels of retailer concentration. Australia has the highest level of retail concentration in the world⁴².

Substantial economic literature of appropriate recency is available to support the existence of misuse of retailer power in fast moving consumer goods, the most vulnerable sectors of which are perishable produce industries.

To that end, there is precedence and justification for the existence of industry bodies to coordinate a range of functions such as those undertaken by the Potato Marketing Corporation in Western Australia.

One such example is the Agriculture and Horticulture Development Board (AHDB) in the UK which is a statutory levy board, funded by farmers, growers and others in the supply chain and managed as an independent organisation (independent of both Government and commercial industry). The AHDB was founded in 2008 as an umbrella organisation during a market reform process which recognised the importance of individual industry bodies across the primary produce sectors and sought to align them.

The objectives of the AHDB are consistent across all industry sectors and include:

- increasing efficiency or productivity in the industry;
- improving marketing in the industry;
- improving or developing services that the industry provides or could provide to the community; and
- improving the ways in which the industry contributes to sustainable development

The industry sectors represented include pig meat, beef and lamb, commercial horticulture, milk, potatoes, cereals and oilseeds.

The UK Potato Council is the respective governing board for the UK potato industry and is charged with similar responsibilities to the PMC in Western Australia including with respect to collective marketing arrangements and R&D programs⁴³.

Examples of government regulatory intervention in the potato industry and other agricultural industries are not limited to the UK. The implementation of Common Agricultural Policy (CAP) in the European Union consists of a range of subsidies and government funding to improve the competitiveness and market orientation of the fruit and vegetable sector, reduce income fluctuations resulting from crises, promote consumption, and enhance environmental safeguard. Evidence also exists of funding for promotional and quality marketing campaigns to tap new and existing market opportunities both in the internal market and third countries⁴⁴.

⁴² IBISWorld (2012), *Supermarkets and other grocery stores in Australia*

⁴³ The Agriculture and Horticulture Development Board Order 2008, *Explanatory Document relating to the Potato Sector*, available from:

http://www.potato.org.uk/sites/default/files/%5Bcurrent-page%3Aarg%3A%3F%5D/98404_ahdbo_low_res.pdf

⁴⁴ USDA Foreign Agricultural Service, *EU Potato and Potato Products Annual 2013*



More locally in Australia, Potatoes South Australia reports receiving federal government support to undertake research and development into soil testing⁴⁵. As noted in AVC's report, the PMC does not receive such funding from government sources and self-funds its R&D, marketing and consumer education programs through grower levies.

⁴⁵ Potatoes South Australia (2014), *South Australian Potato Industry receives over \$400,000 in Federal Funding*



Appendices



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29 April 2014

To whom it may concern: Potato Marketing Corporation of WA (PMCWA)

In relation to the current review of the activities of the Potato Marketing Corporation of WA, I would like to make the following submission.

I am the Director of the Western Australian State Agricultural Biotechnology Centre, and Professor of Agricultural Biotechnology at Murdoch University.

The PMCWA recognised that there was a market failure in terms of R&D support for the WA potato industry, and in discussions with Professor David Morrison, DVC (R&D) of Murdoch University and Professor Michael Jones, Director of the WA State Agricultural Biotechnology Centre (SABC) at Murdoch University, the PMCWA and Murdoch University agreed to address this issue by co-funding the formation of Potato Research WA (PRWA), a one stop shop to address and solve issues of the potato industry in WA.

As a result, PRWA was established in 2013, and Dr Stephen Milroy was appointed as Manager of PRWA, based in the SABC. The need for a dedicated R&D organisation in WA was recognised for a number of reasons, including:

- The unique climate and conditions for growing potatoes in WA – potatoes evolved in the high Andes, at equatorial latitudes, ie essentially as temperate crops at constant daylength. WA has a Mediterranean climate and variable daylength, with sandy soils and much higher temperatures than where potatoes originated. All this means that potatoes grown in WA are at the extreme limit of their growth range, and so R&D specific for this environment is of vital importance
- There are special needs for irrigation, fertigation, pest and disease control for improving potato production in WA, to improve quality and yields
- The Department of Agriculture WA (DAFWA) has moved out of potato R&D
- Horticulture Australia (HAL) has stopped funding any potato breeding in Australia for Australian conditions, and has clearly failed to support any substantial R&D on the potato crop



- Given the challenges associated with changing climatic conditions, salinity, water quality and soil degradation in WA, there are a substantial number of growers who are in real need of help to increase their yields, quality and profitability

With these R&D failures and needs in mind, the establishment of Potato Research WA was a much needed and timely initiative, which as a joint venture with PMCWA is really getting into its stride. Research is already in progress on:

- Irrigation regimes
- Nutrient testing as a measure of crop health
- Testing for the presence of virus diseases (via facilities and involvement of Saturn Biotech, a company at the SABC)
- Studying conditions for cool storage of WA potatoes
- Developing agronomic packages to enhance yellow flesh production
- Investigating the potential for introduction of new potato varieties
- Establishing growers groups and sustainable farming projects
- Leveraging research funds (eg from national funding bodies)
- Developing an advisory manual for WA growers

In a de-regulated market there would be complete market failure in R&D support for potato growers – there would be absolutely no industry-wide R&D for the potato industry in WA, a loss of growers in WA, loss of the potential to expand seed potato exports, and increased importation of potatoes into WA. A key benefit that the PMCWA brings is that in addition to funding R&D, it provides a unique nexus between growers, researchers and agronomists such that R&D is translated into real world outcomes that benefit the industry and the State as a whole. In addition, I am also aware that the PMCWA is actively working with seed growers to facilitate the interaction between ware and seed growers and the development of the seed industry in WA.

From an R&D perspective, there is therefore a compelling need to retain the PMCWA, and to ensure the success of PRWA to underpin potato R&D in WA to maintain a productive and profitable potato industry in this State.

I would be happy to expand on these points.

Yours sincerely

Michael Jones

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Freshlogic data collection methodology Western Potatoes

Retail pricing

Retail pricing for potatoes is collected weekly for all five main states. Data is collected on all fresh potato product lines available through major supermarkets and processed to provide representative retail pricing. Analysis of this data identifies high volume product lines to provide valid market indicators. State level data includes:

- Product description and variety
- Per kg pricing
- Class, size and washed/brushed type
- Pack type

Wholesale pricing

Wholesale pricing is sourced from third party suppliers, collected through daily in-market wholesaler surveys. This data covers the vast majority of potato product lines, and is processed to identify weekly fresh potato pricing for all five main states. Analysis of this data identifies high volume product lines to provide valid market indicators. State level data includes:

- Product description and variety
- Per kg pricing
- Class, size and washed/brushed type
- Pack type

Promotional activity

Promotional activity is sourced through Freshlogic's proprietary Adwatch™ service, which collects data on press and catalogue promotions for major chain and independent food retailers in all five main states. Freshlogic supplies Western Potatoes with promotional data on potatoes, as well as other key carbohydrates including frozen potatoes, pasta and rice in order to profile the competitive environment. State level data includes:

- Promoting retailer and media type
- Promotional timing
- Product description, variety and brand
- Unit pricing (per kg or per each as advertised)
- Pack type

Consumer data

Consumer data included in quarterly reports are sourced through Freshlogic's Mealpulse™ consumer panel and associated DocketData™ system. Mealpulse™ is a proprietary panel of 3,000 households, which captures the food attitudes, buying behaviour, and consumption habits of Australian households for food eaten at home and away from home.

Mealpulse™ panel respondents forward their docket for the retail food purchases they made during the week they completed their online panel response. The data from these docket is captured and processed through a combination of scanning and in-house DocketData™ software. State level data includes Weekly household penetration, purchase quantity and spend per trip, and retail price paid.