Government of **Western Australia**
Department of **Treasury and Finance**

Department of Treasury and Finance's
Submission to the

Inquiry into the

Chicken Meat Industry Act 1977

September 2010

Contents

Overview

On 5 August 2010, the Economic Regulation Authority (ERA) released a Draft Report discussing matters relating to the inquiry into the *Chicken Meat Industry Act 1977* (the Act) and calling for submissions from interested parties.

This submission outlines the Department of Treasury and Finance's (DTF) response to certain matters raised in the ERA's Draft Report as well as proposing other matters the ERA may consider as part of the inquiry.

Key draft findings and recommendations of the Draft Report include:

5) It is possible that the benefits of the average price regime in the *Chicken Meat Industry Act 1977* may outweigh the costs;

7) The benefits of prescribed form agreements established under the *Chicken Meat Industry Act 1977* are likely to outweigh the costs, as they can help ensure that minimum terms and conditions for growing contracts are met; and

8) The *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978* should be repealed, as the costs of these regulations are likely to outweigh the benefits.

These preliminary findings indicate an initial favourable assessment of the key provisions of the Act. Retaining specific industry legislation for the chicken meat industry is contrary to recent developments in other jurisdictions, and is inconsistent with the general trend to reform industry specific legislation following the National Competition Reform agenda of the mid-1990s to early 2000s.

In other jurisdictions, the removal or exemption from chicken meat legislation has tended to be accompanied by Australian Competition and Consumer Commission (ACCC) authorisations for collective bargaining arrangements for growers. As noted by the ERA, the West Australian legislation is best evaluated on the assumption that the alternative arrangement would be one in which collective bargaining by growers is authorised by the ACCC.

In light of developments in other jurisdictions, and the existence of alternative measures to address any imbalance in bargaining power between growers and processors, a compelling argument is required to justify retention of the Act. Retention of the Act should only be recommended if the ERA can demonstrate that the benefits of the Act clearly outweigh the costs.

On the basis of the information provided in the Draft Report, it does not appear that a compelling case for retention of the Act has been made.

There are a number of issues fundamental to determining the likely overall net benefits (or costs) of Act. These issues include: limits to processor/market power; the costs and benefits of the average price regime; and the extent and likelihood of costly disputes between growers and processors in the absence of the Act. These issues are discussed in this submission, and will require further examination in the ERA's Final Report.

A compelling argument is required to justify industry specific legislation

Given recent State Government initiatives to introduce regulatory reform in Western Australia, and the away from specific regulation of the chicken meat industry in other jurisdictions, any argument to the Act must be able to unambiguously demonstrate that the benefits of regulation outweigh the costs.

State Government initiatives to reduce the regulatory burden

The State Government has recently committed to a number of initiatives aimed at reducing the regulatory burden on businesses and consumers, while also improving the quality of new regulation.

In December 2008, the West Australian Cabinet approved a range of initiatives aimed at reducing the regulatory burden in Western Australia. These include:

- establishing a Red Tape Reduction Group consisting of two Members of Parliament to identify and report back to the Economic and Expenditure Reform Committee (EERC) on opportunities to reduce the burden of existing regulation on business and consumers;
- providing Ministers with the ability to refer specific regulation (via the Treasurer) to the Department of Treasury and Finance for targeted review and reporting back to the EERC; and
- the development and implementation of a best practice system of review, Regulatory Impact Assessment (RIA) process, of new and amending regulatory instruments.

If the Act was a new piece of legislation it would have to comply with the RIA process. This process has been designed to encourage careful consideration of the fundamental question regarding whether regulatory action is required or whether policy objectives can be achieved by alternative non-regulatory measures, with lower costs to the community and businesses.

The State Government has also committed to a number of important reforms through the Council of Australian Government's *National Partnership Agreement to Deliver a Seamless National Economy*. It is intended that this National Partnership Agreement will deliver consistent regulation across jurisdictions and address unnecessary or poorly designed regulation. The agreement also aims to facilitate the reduction of excessive compliance costs on businesses, restrictions on competition and distortions in the allocation of resources in the economy.

Less restrictive regulation of the chicken industry in other jurisdictions

The ERA found that the structure of the chicken meat industry in Western Australia is similar to that in other states across Australia.[1] New South Wales, Victoria and Queensland have Acts and regulations which relate to their chicken meat industries. The ERA found that these states have legislation in place which typically:

- facilitate negotiations between growers and processors;
- contain arbitration mechanisms; and
- establish committees to oversee the industry.

It is important to note that in no other Australian jurisdiction does legislation provide for the determination of an average fee that is to be paid to growers.

Despite the existence of the chicken industry legislation in a number of other jurisdictions, there appears to have been a trend away from using the provisions of this legislation, in favour of ACCC authorisation.

In Victoria, there has been such limited use of the Act in recent years that the Committee no longer operates. New South Wales recently completed a review of its chicken meat industry legislation, with the recommendation that a further review be conducted in order to determine the level of regulation required. The Queensland regime is currently being reviewed.

The Tasmanian chicken meat industry does not operate under any industry specific legislation. This is despite the fact that there is an Inghams processing plant located in Tasmania, which receives broiler chickens from three company owned farms and nine contract growers[2].

In South Australia, the *Chicken Meat Industry Act 2003* was repealed in August 2009, following a 2009 review by Department of Primary Industries and Resources of South Australia.[3] The review found that the provisions within the South Australian Act for collective negotiations on fees and contracts were not utilised by growers who instead, more often than not, opted for ACCC collective bargaining authorisations.

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[1] ERA (2010), p. 11.

[2] ACCC (2004), Determination on Application for Revocation of A90659 and its Substitution by A90888, p.7.

[3] Brown, N. Baldock, N. (2009), '*Chicken Meat Industry Act 2003*, Review of Operation', Department of Primary Industries and Resources of South Australia.

While the South Australian review recognised that some stakeholders believe that ACCC authorisations were less likely to provide two-way negotiation, it concluded that '*elements of requiring written negotiation agreements and inherent provision for mediation suggest that ACCC authorisation is likely to protect the interests of growers just as well as the Act*'[4].

The South Australian Review also found that '*given the sophisticated nature that the industry appears to be developing into, it is apparent that market forces and commercial strategies are required for the future, rather than restrictive government regulation*'[5].

National Competition Policy and regulation aimed at addressing asymmetric market power

The perception or existence of an imbalance of market power between growers and processors is common to many primary industries.[6] Many of these industries are dominated by a few large processors and a large number of growers. The issue of asymmetric market power between growers and processors was used historically to justify regulation in a range of industries across Australia.

For instance, addressing market failure caused by asymmetric market power between buyers of a commodity and commodity producers was one of the arguments used to argue for statutory single-desk marketing arrangements. Since the early twentieth century, single-desk arrangements were viewed as an appropriate protection mechanism for commodity producers in a domestic market as they facilitated a greater balance in market power[7]. As the sole purchaser of a particular commodity, it was argued that single-desk authorities had more bargaining power with processors and could bid up the prices paid to producers.

The Productivity Commission's Staff Research Paper, Single-Desk Marketing: Assessing the Economic Arguments[8], found that in most cases the potential benefits of single-desk arrangements can be achieved without the compulsion of a single-desk. It has been demonstrated through market deregulation that these benefits can be achieved in a competitive market. The deregulation of single-desk arrangements since the 1980's, such as in the Australian cotton and wine industries, resulted in an economic expansion in these industries.

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[4] Brown, N. Baldock, N. (2009), p.10.

[5] Brown, N. Baldock, N. (2009), p.8.

[6] Griffith, G. (2000), 'Competition in the food marketing chain', Australian Journal of Agricultural and Resource Economics, vol. 44, no. 3, pp. 333–367.

[7] Gropp L, Hallam T, Manion V (2000), 'Single-Desk Marketing: Assessing the Economic Arguments', Productivity Commission Staff Research Paper, p. xx.

[8] Gropp L, Hallam T, Manion V (2000).

The National Competition Policy reform agenda resulted in a move away from industry specific regulation in Australia. For example, in 2000 all Australian states repealed legislation governing the sourcing and pricing of drinking milk. The Australian milk industry is similar to the chicken meat industry in that there is evidence of asymmetric market power between dairy farmers and milk processors. The presence of this market power has been recognised by the ACCC with the authorisation of collective bargaining agreements in the milk industry.

Following the removal of industry specific legislation, the ACCC has approved collective bargaining arrangements in a range of industries including[9]:

- Australian dairy milk industry;
- Tasmanian vegetable growing industry;
- Victorian potato industry;
- Victorian dried vine fruit industry; and
- Queensland citrus industry

The existence of an alternative measure to address asymmetric market power

The fact that there is a potential alternative to the current regulation in Western Australia, in the form of ACCC collective bargaining authorisations, emphasises the need for a compelling argument to maintain the current arrangements.

To date, authorisations for chicken growers have been issued by the ACCC in Victoria, Tasmania and South Australia[10].

The benefits of collective bargaining relative to the current legislative arrangements in Western Australia are discussed further in this submission. However, it is worth noting that a number of the benefits of collective bargaining were cited by the Australian Chicken Growers' Council (ACGC) in the application for authorisation lodged by the South Australian Farmers Federation in 2009.

[9] ACCC (2005), 'Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries', p.508.

[10] ACCC website www.accc.gov.au

Benefits cited by the ACGC are listed below.

- Significant reduction in transaction costs for both growers and processors, assuming that the negotiation process is robust and there is a significant disparity between the capacity and knowledge base of the parties. Where expert advice is required there may be significant costs incurred which can be spread over a number of growers involved in the collective bargaining arrangement. Where no such arrangement exists this cost would be borne by individual growers.

- Greater access to information for growers, which allows them to be better informed on matters relating to the industry and the market place.

- Greater stability in the industry, with growers being more involved in determining contract terms and conditions. Such an environment engenders a greater sense of security and encourages ongoing long-term investment.

Is Regulation Necessary?

In terms of justifying the need for industry specific regulation, ERA draft finding 4 is particularly important.

'It is unclear how regulation could improve aggregate social welfare by increasing output by the growing sector, as output is determined by consumer demand. However, regulation could improve net social welfare by:

- *reducing the transaction costs and the costs of disputes and arbitration associated with grower contracts; and*
- *helping to overcome any potential hold-up problems in investment by growers and encouraging an optimal level of investment'.*[11]

A key element of this assessment, as noted by ERA, is the ability of the Act to limit the costs of disputes and arbitration associated with grower contracts. In the Draft Report the ERA found that:

'…*while there are protections already available to industry participants under the Trade Practices Act 1974 (TPA), these mechanisms are likely to involve higher dispute resolution and arbitration costs than under the current state legislation. The Authority will be seeking further information on the extent of legal costs under collective bargaining arrangements before its final report*'.[12]

Further research into the extent of legal costs under collective bargaining in the ERA's Final Report is supported.

There appear to be a number of factors which have the potential to limit, in the absence of regulation, the degree to which processors are able or willing to exercise their market power. Limits to processor bargaining power, may result in less costly disputes and arbitration.

Factors that may limit processor bargaining power include:

- strong competition in the processing industry;
- the growing number of processors in the West Australian industry;
- the considerable mutual dependence between processors and growers, and
- the ability for growers to exercise countervailing market power in any negotiations through ACCC authorisation of collective bargaining.

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[11] ERA (2010), p. v.
[12] ERA (2010), p. 60.

Limits to processor bargaining power

The ERA Draft Report describes a range of factors that contribute to market power held by processors in their negotiations with growers. While there is some discussion of the limits to processor bargaining power[13], there is also evidence to suggest that the existing limits to processor bargaining power may be greater than that described in the ERA Draft Report.

For instance, although there are a number of factors that tie growers to particular processors, there are also some examples of growers exercising countervailing power in their dealings with processors. The West Australian Broiler Grower Association (WABGA) noted that three growers left Inghams for Finesse Foods, following requests by Inghams for growers to convert their standard sheds to tunnel sheds.[14]

The ACCC has noted that there is vigorous competition between processors[15]. As well as competition between themselves, processors also face competition from alternative meat products at the retail level. The highly competitive nature of the chicken processing industry, and the mutual dependence between growers and processors, can potentially create incentives to facilitate grower and processor cooperation and limit damaging and costly disputes.

Evidence from the South Australian chicken meat industry suggests that the mutual dependence between processors and growers has been an important factor in facilitating strong industry performance. Prior to repeal of the South Australian legislation in 2009, there appeared to be minimal need for recourse to dispute resolution provisions of the South Australian Act.

'While there was some mention of disputes the overall impression was that, again due to market forces, any disputes which tended to be of an operational nature were negotiated at an early stage and resolved without the need to use mechanisms under the [SA Act]. The SA Act provides a safety net for growers, however similar measures are already provided under the dispute resolution provisions in the individual contracts or alternatively by action under the Trade Practices Act 1974'.[16]

[13] ERA (2010), p. 35.
[14] ERA (2010), p. 40.
[15] ACCC 2005, p. 244.
[16] Brown, N. Baldock, N. (2009), p. 12.

In addition, an ACCC collective bargaining authorisation can potentially provide growers with substantial bargaining power over processors. For example, the ACCC granted the Victorian Farmers Federation chicken growers authorisation to collectively bargain the terms and conditions of growing contracts with their processors. This determination also provided for growers to collectively boycott processors when negotiations break down. Collective boycotting allows growers to collectively refuse to accept new batches of chicks when negotiations collapse. However, collective boycotting is only to be used as a last resort.[17]

[17] ACCC (2005), 'ACCC to allow Victorian chicken growers to collectively bargain with processors', website: <http://www.accc.gov.au/content/index.phtml/itemId/656128/fromItemId/2332>

Average Price Regime

The ERA Draft Report states that:

"It is possible that the benefits of the average price regime in the Chicken Meat Industry Act 1977 may outweigh the costs."

The average price regime is one of the key measures in the Act intended to limit the market power of processors in their negotiations with growers. The average price regime is also unique in terms of the countervailing measures used in the chicken meat industry legislation in other jurisdictions.

The need for an average price regime was one of the fundamental differences in the submissions from the processors and growers to the ERA Inquiry.

In the Draft Report, the ERA has provided an assessment of the potential costs and benefits associated with the average price regime, with the preliminary finding that benefits of the regime may outweigh the costs.

Further evidence is required to support this finding in the Final Report. Potential costs that were not considered in the Draft Report need to be assessed. More importantly, it appears that the benefits of the average price regime may have been overstated. Some of the benefits in the ERA's assessment may be more appropriately attributed to the collective bargaining/dispute resolution provisions of the Act, rather than the price setting regime.

Costs/disadvantages of the regime

In addition to the costs listed in the Draft Report[18], additional costs that might be considered include:

- whether the average price regime is preventing the development of alternative contracts and pricing arrangements that may promote efficiency and innovation in the Western Australian chicken meat industry; and
- whether the average price regime is increasing the costs of national processors doing business in Western Australia relative to other jurisdictions.

In their submissions to the ERA's Issues Paper, both Inghams and Bartter expressed that the current situation in Western Australia had increased the cost of doing business relative to other jurisdictions.

[18] ERA (2010), p. 42.

Inghams claimed that the number of broiler chickens processed in its West Australian facilities was '*not a result of decreasing sales but rather a result of the Company's move to invest and expand its operations in other States…at the expense of Western Australia*'. One of the factors contributing to this investment decision is said to be '…*the anticompetitive and restrictive Legislation within Western Australia*'.[19]

Bartter also voiced their concern that '*anti competitive growing fee determination mechanisms have been in part a contributing factor to why one of the Western Australian larger processors has cut back local chicken meat processing production numbers and increased imports sourced from the eastern states*.'[20]

Further research into the efficiency and productivity affects of setting a notional price (as described draft finding 6) is supported.

Higher administration costs

The ERA found that the total administration costs of the Act are relatively small, with administration costs of the committee that could be passed on to consumers around $1500 per year[21].

These costs do not take into account the data collection and updating of the cost of production model by the WABGA which the ERA notes is provided free of charge. While these costs are provided free of charge, a more useful comparison would be to compare the administration costs associated with running and updating the model, with costs of negotiating contracts and grower prices in the absence of an average price setting regime.

Benefits/advantages of the average price setting regime

The ERA outlines a number of potential advantages of the average price setting regime (ERA 2010, p. 47). It is worth examining in more detail:

- the magnitude of these benefits; and,
- whether most of the potential advantages listed in the Draft Report could be achieved in the absence of the average price setting regime.

[19] Ingham (2010), 'Submission to the ERA Inquiry into the *Chicken Meat Industry Act 1977*', p. 3.
[20] Bartter (2010), 'Submission to the ERA Inquiry into the *Chicken Meat Industry Act 1977*', p. 2.
[21] ERA (2010), p. 45.

Improvement in the balance of power between growers and processors

The ERA attributes the average price setting regime to an improvement in the balance of power between growers and processors.[22] However, while it is possible the average price regime contributes to an improvement in the "balance of power", other aspects of the Act appear to play a more important role in achieving this outcome, namely:

- the ability to undertake collective bargaining by growers; and,
- the role of the Committee in adjudicating disputes.

It is worth noting that allowing collective bargaining, and establishing a committee or a regulated adjudicator, tended to be the main countervailing measures in other jurisdictions' regimes. Indeed, the ERA's discussion in this section appears to focus on benefits of collective bargaining rather than the actual price setting regime.

As has been noted previously, the benefits of collective bargaining might also be achieved through ACCC endorsed collective bargaining arrangements. The ACCC has enabled collective bargaining by grower groups in other jurisdictions, based on the view "that this would increase prices to growers to a level which would sustain efficient production in the long run".[23]

Given the importance of collective bargaining and Committee adjudication in addressing the "balance of power issue", additional information is required to support the ERA's claim that:

'..setting the average fee on the basis of the cost of production model is a strong tool for improving the negotiating power of growers'.[24]

Dispute resolution and arbitration

In terms of the benefits of resolving disagreements between growers and processors, it is important to make a clear distinction between the benefits derived from having an average price setting regime under the Act, and the benefits of having general dispute resolution mechanisms under the Act (that is, the Committee).

[22] ERA (2010), p. 47.
[23] ERA (2010), p. 47.
[24] ERA (2010), p. 47.

The ERA states that it:

'accepts that the dispute resolution and arbitration provisions in the Act are strong, as the "fall-back" position is the gazetted fee determined by the cost of production. This provides a deterrent effect on all parties against entering into disputes involving excessive demands that diverge too far from the model.'[25]

However, as noted in the Draft Report, having an average price regime does not eradicate disputes between growers and processors. Of the four recent disputes taken to the Committee for adjudication, two concerned the derivation of the average price model.[26]

Disputes would no doubt arise between growers and processors if other negotiating/price setting processes were in place instead of the regulated price setting regime. To the extent that cost savings from resolving disagreements exist under the Act, these appear to be derived more from the existence of having a clear dispute resolution and arbitration mechanisms, rather than from having an average price setting regime.

Lower transaction costs

The ERA notes that "collective bargaining, such as that provided by the Act, can lower the transaction costs associated with contract negotiations" (ERA 2010, p. 48).

As noted above, any benefits derived from collective bargaining under the Act need to be compared against the potential benefits available from pursuing collective bargaining through ACCC endorsement.

Other issues

In its Draft Report the ERA stated that '*Growing fees in Western Australia are similar to growing fees in other states*' (ERA 2010, p.55). As shown in table 2.5 of the ERA's Draft Report, many of these other states operate under collective bargaining agreements.

While the ERA found that the cost of production model used to set the average growing fee appears to be based on efficient production costs, it also found that the gazetted average price is significantly higher than the actual amount paid to growers. This is because the gazetted price is adjusted by a productivity factor for each grower, where more efficient growers will be paid more than less efficient growers. Payments within a pool of growers may then also be further adjusted to ensure that the difference paid to efficient and non-efficient growers is no more than a specified

[25] ERA (2010), p.48.
[26] ERA 2010, p. 48.

amount. Fees paid to growers may also be adjusted due to market forces, such as changes in the demand for chicken meat.

Figure 4.1 in the ERA's Draft Report illustrates the significant difference between the notional fee derived by the cost of production model, the gazetted fee and the actual fees paid by processors. This divergence between the notional fee and actual fee paid to growers brings into question why the Chicken Meat Industry Committee invests its resources into deriving this notional efficient cost of production price, if it is (consistently) significantly higher than what is actually achieved by growers.

Prescribed Agreement between Processors and Growers

The ERA Draft Report states that:

"The benefits of prescribed form agreements established under the Chicken Meat Industry Act 1977 are likely to outweigh the costs, as they can help to ensure that minimum terms and conditions for growing contracts are met."

The arguments for retention of the prescribed agreements centre on the protections they provide growers against any bargaining power enjoyed by processors. The ERA also notes that prescribed agreements provide a basis for dispute resolution and could potentially reduce the costs of disputes and arbitration.[27]

The potential limits to bargaining power have been discussed previously in this submission. The benefits from prescribed agreements must be assessed in light of the likely alternative of ACCC authorised collective bargaining.

The net benefits from maintaining prescribed agreements must clearly exceed any net benefits from ACCC authorised collective bargaining to warrant retention of this restriction.

[27] ERA (2010), p. 52.

Barriers to Entry into the Growing Sector

The ERA Draft Report states that:

"The Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978 should be repealed, as the costs of these regulations are likely to outweigh the benefits."

The ERA's recommendation for the repeal of *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978* is supported. The ERA's recommendation is consistent with the National Competition Council's 2004 National Competition Policy Assessment that '…*the requirement that incumbent growers have first right of refusal to meet growing capacity increases sought by processors is a potential restriction on the opportunity for new growers to enter into the Western Australian industry*'.

Conclusion

Given developments in other jurisdictions, and the existence of alternative measures to address any imbalance in bargaining power between growers and processors, a compelling argument is required to justify retention of the Act.

There are a number of issues that are important in determining the overall assessment of the Act. These issues include: limits to processor/market power; the costs and benefits of the average price regime; and the extent and likelihood of costly disputes between growers and processors in the absence of the Act. It is suggested that these issues be examined in greater detail in the ERA's Final Report.