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Executive Summary

In this final report, the Authority presents its final recommendations and findings for its inquiry into the *Chicken Meat Industry Act 1977 (Act)*. The Authority conducted the inquiry at the request of the Treasurer of Western Australia in February 2010. The Act requires that its effectiveness be reviewed every five years.

The Authority has examined how the Act currently operates and the issues affecting the chicken meat industry in Western Australia and nationally. In assessing the Act, the Authority has had to consider if there is a need for legislation for the industry in Western Australia. If so, the question is whether the Act should be retained in its current form, or amended or replaced; or if there are alternative legislative mechanisms available to achieve the objectives of the Act.

The Authority has been conscious that there must be a strong case to justify industry-specific legislation, with the benefits to society clearly outweighing the costs of the legislation.

The Act was introduced to “improve stability in the chicken meat industry” at a time when there had been rapid expansion in the chicken meat growing sector. In this industry, the production and processing of chicken meat is dominated by two large chicken meat processors, who control most stages of the production process, apart from the growing of chickens, which is contracted out to individual farms (growers). The Authority acknowledges that there are factors that create an imbalance in negotiating power in favour of the processors, including the limited opportunity for growers to switch to another processor, or to convert their significant capital investments to an alternative use. However, processors are also to some degree dependent on their growers to maintain reliable supplies of chicken meat.

The current legislation establishes a forum intended to facilitate collective negotiation and provide a means for mediation/negotiation and intends to improve the balance of bargaining power between growers and processors. The Act provides for the gazettal of an average price to growers, determined on the basis of a notional model of an efficient chicken growing operation, and mediation and arbitration through the Chicken Meat Industry Committee. The Committee constitutes two grower representatives, two processor representatives, two independents and an independent Chairman.

The Authority’s review of the chicken meat industry in Western Australia has shown that there are serious problems with the sector under the existing legislation.

- There has been little expansion in total growing shed area or total production over the past decade, while consumption in Western Australia has continued to steadily grow. In recent years the gap between production and demand has been met by interstate imports (currently, around 14 per cent of Western Australian chicken meat is imported). By comparison, there has been a significant expansion in the growing sectors and chicken meat production in other States, particularly South Australia and Queensland.
- There has been a breakdown in the relationships between growers and processors under the Act. Processors do not accept the validity of the notional model and claim that the Committee is biased in favour of the growers. They have abstained from participation in the determination of the gazetted fee.

The Authority also notes that production in Western Australia has been impacted over the past decade by: rising costs in Western Australia; increased efficiencies in growing and processing in South Australia; and transport efficiencies.

There are some strong reasons for the small number of processors in the sector, arising from the significant economies of scale in chicken meat processing, and economies from vertical integration of different stages of the supply chain. These factors can make it difficult for new processors to enter the market. In the absence of the Act, the market structure can be defined as a monopsony (few processors and many growers). This type of market will produce less chicken, at higher prices, than a competitive market with many processors and growers who are able to switch freely between processors.

The Authority accepts that collective bargaining can improve the position for growers, as it allows them greater input into the terms and conditions of their contracts. It can also potentially reduce the transaction costs associated with contract negotiations, and the costs of dispute resolution. In other States, some groups of growers gain authorisation from the Australian Competition and Consumers Commission (**ACCC**) to be allowed to collectively bargain with their processor. The Authority considers that it is likely that growers in Western Australia would be given authorisation by the ACCC for collective bargaining if they were to seek it.

In the draft report, the Authority considered that the costs of dispute resolution and arbitration were likely to be higher under authorised collective bargaining than under the current legislation. To examine this matter further the Authority has reviewed the experience of other States.

- Growers in other States either negotiate individually with the processors, or collectively under ACCC authorisations or notifications.
- No other State has legislation to determine a growing fee. Industry committees, where they exist, do not deal with matters relating to the growing fee.
- According to industry participants, negotiations between growers and processors are often difficult, although most growers have signed contracts. While there are a small number of long and costly legal disputes, the Authority has found that relatively few cases have been brought to formal dispute resolution or arbitration, given the number of growers.

Overall, the Authority considers that the price-setting functions of the Act, while favourable to growers, are detrimental to the industry as a whole. Change, either in the form of a restructuring of the Committee and the basis on which the gazetted fee is calculated, or by repealing the Act, is required.

In particular, the Authority considers that the current operations of the Act may act as a deterrent for future significant processing investment decisions, although it is one of many factors in such decisions.

The Authority also considered the administrative costs associated with the average price regime. While these are currently low, the administrative framework would need to be substantially modified if it is to be made to work effectively. This would include removing any perception of bias from the Committee, through the appointment of an independent professional arbitrator instead of the independent members, and the review and maintenance of the notional model by an independent consultant. These changes would significantly increase administration costs, and erase any advantages of the current approach over an alternative, such as authorised collective bargaining.

The Authority also examined whether there would be net benefits to regulating the minimum terms and conditions which should be provided for in growing agreements. The Authority considers it is likely that there are sufficient protections available to growers under normal commercial law in Australia to make such regulation obsolete.

The Authority notes that the current legislation is unlikely to improve the outcome for society from this market, with the main effect of the Act being to transfer income from processors to growers. Additionally, the Authority considers that the Act probably has a negative impact on efficiency over time (i.e. dynamic efficiency). The Authority notes that the Act makes differential pricing for new capacity, which would improve efficiency and potentially allow the industry to grow, less likely.

The recommendation of the Authority is therefore that the *Chicken Meat Industry Act 1977* be repealed.

The Authority wishes to thank all those who provided submissions and information to the inquiry. The Authority would also like to acknowledge Emeritus Professor Cliff Walsh from the University of Adelaide for his analysis, advice and peer review of earlier drafts.

Summary of Findings and Recommendations

Market Structure in the Absence of Collective Bargaining

- 1) Western Australia's market for broiler growing services is dominated by two buyers (processors) and growers have limited opportunity to switch between processors or convert their broiler growing infrastructure assets for alternative uses. This can be described as a market with monopsony buyers.
 - The market structure is driven mainly by economic factors that make it cheaper for chicken meat to be processed by a few large companies rather than by many processors.
- 2) Monopsony markets lead to production that is lower than the economically efficient level, and also lead to processors capturing as monopsony profits part of what, in a competitive market, would be returns to growers.
- 3) Price differentiation (the payment of each grower individually on the basis of their willingness to supply) can lead to an increase in output relative to a market where all growers are paid the same fee. However, it is unclear whether processors would be able to implement such a system.

Market Structure with Authorised Collective Bargaining

- 4) The ACCC has assessed the balance of power between processors and growers in other States and has in most cases authorised collective bargaining arrangements by growers, but not collective boycott rights.
- 5) If there were no *Chicken Meat Industry Act 1977*, Western Australian broiler growers would most likely receive ACCC authorisation for collective bargaining should they seek it.
- 6) Authorisation for growers to collectively bargain would provide growers with some degree of countervailing power in negotiations with processors, but not to the extent of creating a bilateral monopoly situation. The market would remain essentially monopsonistic.

Experience in Other States

- 7) Review of the experience in other States, where grower fees are not regulated, indicates that some of these regions (especially South Australia and Queensland) have shown considerable growth in their chicken meat growing sectors and that the incidence of formal disputes between growers and processors is low, given the large number of growers.

Independence of the Committee

- 8) There is disagreement between processors and growers regarding the validity of the mechanism for determining the average grower fee under the Act. This has led to a breakdown in the functioning of the Chicken Meat Industry Committee, with the processors no longer participating in the gazetted fee determination process.
- 9) If the Committee is to continue in a price-setting role, to remove any perception of bias it is important that any independent representatives on the Committee are appointed by an independent process, for example, a single independent professional arbitrator appointed by the Treasurer.

Efficiency of the Notional Model

- 10) The current system of average price setting is likely to substantially improve the growers' bargaining position relative to a market with authorised collective bargaining by growers, making the situation more like a bilateral monopoly.
 - The long-term efficiency impact of a bilateral monopoly over a monopsony market is unclear, with the main impact being a transfer of income from processors to growers.
- 11) The notional model aims to determine the costs of a notional efficient broiler operation. It is important that, if the price setting function of the Act is to continue, the model fee represents the fee that growers would be competing against in a market without the Act (the efficient new entrant).
- 12) If the growers are successful in negotiating a price close to their preferred bargaining position, then the impact on production (relative to a market with authorised collective bargaining) is unclear.
 - However, the Authority considers that the incentives under the Act to improve dynamic efficiency (i.e. to improve the productivity of the industry over time) are less than would be the case without the Act.
- 13) If the Act is to continue then the model should be reviewed and updated by an independent party (e.g. a consultant) appointed by the independent arbitrator to reflect the cost of an efficient new entrant.
- 14) The consultant should carefully examine useful asset lives in the model to ensure that growers are not compensated for the same asset more than once.
- 15) The Act requires clarification to reflect the actual relationship between the notional model fee, the gazetted fee and the average negotiated fee.
- 16) Current cost accounting could be used to value the efficient new entrant in a deregulated market, so can be used to value the notional efficient new entrant. However, the inputs to this calculation should not include an average of all existing growers.
- 17) The cost of this review and update of the model should be borne equally by the growers and processors.

Regulations on Participation in Growth Expansion

18) 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 regulations restrict entry into the growing sector and the manner of expansion of existing growers. This can reduce competition in the growing sector and hinder the rate of innovation and efficiency improvement in the industry.

Growth in Investment and Output

19) The Authority considers that the Act is likely to deter future processing investment in Western Australia, although it is only one of a range of factors that will influence investment decisions.

Impact of the Act on Imports

20) The Act is likely to have favoured imports over expanding local production, compared to what would be the case under authorised collective bargaining, by facilitating grower fees above the minimum efficient cost. However, higher costs in Western Australia, driven by the mining industry, are also likely to have played a role in reducing the relative competitiveness of chicken meat production in this State.

Impact on Retail Chicken Meat Prices

21) Any price efficiencies resulting from reforming the *Chicken Meat Industry Act 1977* are likely to be passed through to consumers in the form of lower prices.

Prescribed Form Agreements

22) Prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements as there are sufficient protections available under Australian contract law.

Administration Costs

23) Administration costs under the current regime are low, but would increase significantly if the fee model were to be independently administered and reviewed.

- These higher administration costs are likely to be similar to those under authorised collective bargaining arrangements.

24) Administration costs under individual bargaining would be higher than under collective bargaining, due to the duplication of administrative tasks.

Dispute Resolution and Arbitration Costs

25) The dispute resolution and arbitration mechanisms under the current legislation are low cost, but are not operating effectively. Appointment of an independent arbitrator to resolve disputes would be highly desirable, even though it would increase costs.

26) Dispute resolution under authorised collective bargaining arrangements or individual contracts requires independent, best practice dispute resolution processes in order to avoid substantial legal costs to industry participants.

Transaction Costs

27) It is likely that collective bargaining, under ACCC authorisation or through a legislative mechanism that includes an independent pricing model, would result in similar savings in transaction costs relative to individual agreements.

Differences in Productivity between Grower Groups

28) If an average price regime were to be retained, the model should allow for the determination of different average fees for each grower group to reflect the specific demand and supply conditions within each group.

Costs and Benefits of the Act Compared to Alternative Approaches

29) The benefits of the *Chicken Meat Industry Act 1977* are unlikely to outweigh its costs.

30) There are likely to be alternatives available for strengthening the bargaining power of growers, such as authorised collective bargaining, that would not have the costs associated with the Act.

31) The *Chicken Meat Industry Act 1977* should be repealed.

1 Introduction

The Treasurer of Western Australia gave written notice to the Authority, on 1 February 2010, to undertake an inquiry into the effectiveness of the *Chicken Meat Industry Act 1977 (Act)*.

Section 29(4) of the Act requires that the Minister cause the effectiveness of the Act to be reviewed five years after its enactment or continuation. The findings of the review are reported to the Minister, who shall not continue the Act unless he or she is satisfied that continuation is justified.

The Act was last continued on 31 December 2003 and is therefore due to be reviewed after 31 December 2008, with the review to be completed before the end of 2010.

The inquiry was referred to the Authority under Section 38(1)(a) of the *Economic Regulation Authority Act 2003*, which provides for the Treasurer to refer to the Authority inquiries on matters related to industries that are not regulated.

1.1 Terms of Reference

The Terms of Reference for the inquiry are presented in **Appendix A**. The Terms of Reference required the Authority to consider and develop findings on:

- how the Act currently operates, including what actions are taken under the Act by chicken meat growers, chicken meat processors and the Chicken Meat Industry Committee;
- the current issues affecting the chicken meat industry in Western Australia, including issues relating to the major processors being based in the eastern States and competition from interstate chicken meat;
- whether there is a need for legislation to improve stability in this industry, which was the object of the Act when enacted, or any other reason, or if the Act should be repealed; and
- if there is a need for legislation, whether the Act in its current form is effective in meeting this need or should be amended or replaced.

The Authority was required to give consideration to, but was not limited to:

- an examination of the chicken meat industry nationally;
- an examination of the relative negotiating power of chicken meat growers and chicken meat processors in relation to the terms of contract between them; and
- if any imbalance in negotiating power is found to exist, a consideration of whether any intervention is required or recommended to redress this imbalance.

In undertaking the inquiry, the Authority has recognised section 26 of the *Economic Regulation Authority Act 2003*, which requires the Authority to have regard to:

- the need to promote regulatory outcomes that are in the public interest;
- the long-term interests of consumers in relation to the price, quality and reliability of goods and services provided in relevant markets;

- the need to encourage investment in relevant markets;
- the legitimate business interests of investors and service providers in relevant markets;
- the need to promote competitive and fair market conduct;
- the need to prevent abuse of monopoly or market power; and
- the need to promote transparent decision making processes that involve public consultation.

1.2 Background to the Inquiry

The *Chicken Meat Industry Act 1977* was enacted to “improve stability in the chicken meat industry”. In this industry, the production and processing of chicken meat is dominated by two large chicken meat processors, who contract out the growing of chickens to individual growers.

The Act replaced the repealed *Chicken Meat Industry Act 1975*, and continued the Chicken Meat Industry Committee (“**Committee**”), which was established under the 1975 Act. The Committee, which is appointed by the Minister, may, among other things, determine the standard price to be paid by processors to growers, prescribe the form of agreement between processors and growers, and resolve disputes.

Previous reviews of the Act, required under section 29(4) of the Act, have been completed internally by the Department of Agriculture (in 1996 and 2003). A continuation of the Act has effect for a period of seven years.

1.3 Review Process

The recommendations of this inquiry have been informed by the following public consultation process:

- The Authority published an issues paper on the inquiry on 26 February 2010 and invited submissions from stakeholder groups, industry, government and the general community on the matters in the Terms of Reference. The due date for submissions was 9 April 2010.
- Four submissions were received in response to the issues paper, from:
 - The Western Australian Broiler Growers Association (**WABGA**);
 - Bartter Enterprises (who were taken over by Baiada, but are continuing to trade under the Bartter label);
 - Inghams Enterprises; and
 - The Department of Treasury and Finance.
- The submissions are published on the Authority’s website, www.erawa.com.au.
- The Authority published a draft report on 4 August 2010. Submissions on the draft report closed on 17 September 2010. One submission (Bartter Enterprises) was granted a two-week extension. Four submissions were received on the draft report, which are published on the Authority’s website:
 - WABGA;

- Inghams Enterprises;
- Bartter Enterprises; and
- The Department of Treasury and Finance.
- The Authority's Secretariat has met with representatives of the WABGA, Bartter Enterprises and Inghams Enterprises during the course of the inquiry to obtain evidence and to clarify the views of the parties.
- The Authority's Secretariat has also met with the independent members and Secretariat of the Chicken Meat Industry Committee.
- The Authority has consulted with its Consumer Consultative Committee (**ERACCC**).
- The final report for the inquiry was delivered to the Treasurer on 1 November 2010. In accordance with the *Economic Regulation Authority Act 2003*, the Treasurer then has 28 days to table the final report in Parliament.

In accordance with section 45 of the *Economic Regulation Authority Act 2003*, the Authority has acted through the Chairman and members in conducting this inquiry.

The Authority wishes to thank all those who provided submissions and information to the inquiry. The Authority would also like to acknowledge Emeritus Professor Cliff Walsh from the University of Adelaide for his analysis, advice and peer review of earlier drafts.

under controlled temperature and feed conditions. Some are harvested at 30-35 days old and the remainder at 55-60 days old.

- The chickens are transferred live to a processing plant, where they are slaughtered and processed into chicken meat. The meat may be sold to retailers or fast food companies, or may be further processed into chicken meat products.

Some growers produce free range chickens or certified organic chickens, which have access to an outdoor forage area once they are 21 days old (10 days old for certified organic chickens). Around four per cent of chicken meat produced in Australia is free range, and around half of this is certified organic. Target stocking densities for free range chickens are lower than for conventional meat chickens.² Birds that have been treated with antibiotics cannot be sold as free range or certified organic. For certified organic chickens, feed must come from certified organic production and the use of genetically modified products in feed is not permitted.

2.3 Industry Structure

The structure of the chicken meat industry in Western Australia is similar to that in other States across Australia, with a small number of processors responsible for most stages of the production of chicken meat, apart from the contracting out of broiler growing to individual growers. This suggests that this industry structure is independent of the Act.

2.3.1 Processors

The processing of chicken meat in Australia is dominated by two major companies, Baiada Poultry Pty Ltd and Inghams Enterprises, who process around 80 per cent of the chicken meat produced in Australia. In February 2009, the ACCC allowed the acquisition by Baiada of Bartter, the third-largest of the national chicken meat processors, following an undertaking by Baiada to divest some of its assets to La Ionica Poultry in Victoria. The processors own most of the assets in the production process, including parent breeder farms, hatcheries, feed mills, processing plants, and some broiler farms. In Western Australia, Baiada (as Bartter Enterprises) and Inghams account for around 80 per cent of the broiler chickens processed (see Table 2.1).

Table 2.1 Percentage of Broiler Chickens Processed in Western Australia by Processor

Processor	Percentage of Broilers Processed in Western Australia (%)
Bartter (Baiada)	42
Inghams	38
Mt Barker Free Range Chicken	9
Finesse Poultry	8
Other	3
TOTAL	100

Source: Inghams Enterprises submission on issues paper, p2

² Maximum stocking densities are 28-40 kg/m² for conventional chicken meat, 16-32 kg/m² for free range chicken meat, and 25 kg/m² for certified organic. Source: Australian Chicken Meat Federation Inc.

Table 2.3 State Shares of National Chicken Meat Production

State	Average Share of Total National Chicken Meat Production (Per Cent) ^(a)	
	1987-1997	2005-2010
Western Australia ^(b)	10.0	8.1
South Australia ^(c)	8.6	10.5
Victoria	25.6	28.7
New South Wales	41.1	34.5
Queensland	15.7	28.7

Notes and sources:

- (a) All data from Australian Bureau of Statistics, Series 72150.0, Table 18, unless otherwise indicated. Tasmanian production is negligible and is not included in the ABS total production figures.
- (b) See Bartter Enterprises submission on draft report, p16.
- (c) South Australian share calculated from ABS total production data and Bartter Enterprises estimate of Western Australian shares.

2.3.4 Retail Market

A further consideration is the retail market for chicken meat. Chicken meat may be sold fresh or further processed into frozen foods. The ACCC inquiry into grocery pricing in 2008 found that the two major supermarkets, Coles and Woolworths, account for around half the retail sales of fresh poultry (Woolworths around 30 per cent and Coles around 20 per cent) and independent retailers around 12 per cent.⁸ In Western Australia, the independent retailers are the IGA stores, which are mostly supplied by a single national wholesaler, Metcash. Action, Dewsons and Supa Valu stores have recently joined the alliance with IGA.

Other retailers of fresh chicken meat include butchers (around 18 per cent of sales), fast food stores (around 12 per cent), restaurants, catering services and institutions (e.g. hospitals, aged care homes).

The ACCC inquiry found that the major supermarkets, as the largest buyers, are able to exert some buyer power on processors.⁹ The supermarkets typically source their supplies through an annual competitive tender process and will switch between processors to secure the lowest price. Thus, there is potentially a high degree of competition between processors to secure supply contracts with the major buyers.

A further consideration is how sensitive the demand for chicken is to the retail price, and the price of other meats, such as pork, beef and lamb, that may be substitutes for chicken meat. Studies suggest that a one per cent increase in the price of chicken will result in a 0.3 per cent drop in the sales of chicken meat (as customers switch to other substitutes).¹⁰ However, demand for chicken appears to be less sensitive than other meats to changes in its own retail price and changes in the price of other meats.¹¹

⁸ ACCC (2008), *Inquiry into the Competitiveness of Retail Prices for Standard Groceries: Final Report*, p54.

⁹ *Op.cit.*, p244.

¹⁰ Griffiths, G. *et.al* (2001), "Previous demand elasticity estimates for Australian meat products", *Economic Research Report No. 5*, NSW Agriculture.

¹¹ *Op.cit.* The survey of demand elasticity studies showed that a one per cent increase in the price of beef, pork and lamb results in drops in demand of 1.2 per cent, 1 per cent and 1.4 per cent respectively.

2.3.5 Why has this Industry Structure Emerged?

The current structure of the chicken meat processing industry in Australia (i.e. a small number of large processors and large numbers of small contract growers) first emerged in the 1960s and was based on a chicken meat company model that originated in the United States.¹² While processors do own some broiler farms, a consultant's report to the NSW Farmers Association in 2001 states that:

Processors prefer contract growing because it frees up working capital for marketing and business growth rather than locking funds into farm asset infrastructure....Growers contribute approximately 40 per cent of the capital investments in the industry through ownership of farms, shedding and other facilities used in the growing of chickens.¹³

Other stages of chicken meat production are less capital intensive, with processing plants representing around 30 per cent of the assets in the industry, and breeding farms, hatcheries, feed mills and transport and distribution making up the remaining 30 per cent.

In addition to processing plants, processors often have their own feed mills, hatcheries and breeding farms. One reason cited for the involvement of processors in most stages of chicken meat production is that it is important for processors to have control over the costs and timing of all operations in the supply chain.¹⁴

The apparent reason that processors have little involvement in broiler growing is that the returns to processors from broiler growing would be lower than the returns for other stages of the supply chain, such as processing and further processing. Growers have substantial investments in land and capital that would make it costly for processors to buy out existing farms, and the management experience and time commitment of owner-managers would be difficult and costly to replace.

The structure of the industry in Western Australia reflects a common model internationally. Chicken meat industries in the other States of Australia, New Zealand, the United States and the United Kingdom are all based on an industry model involving a few large processors who have integrated most stages of production, but contract out the growing of chickens to relatively small growing operations.

While there are no legislative barriers to entry into the processing market, several factors can make it difficult for new, small processors to enter the market and compete with large processors, or for existing small processors to expand their operations.¹⁵

- There are likely to be considerable economies of scale associated with large processing plants and feed mills, which lowers the unit production costs, and favours large processors.

However, there has been a downward trend in all own-price elasticities over the past two decades (i.e. consumer purchases of a particular meat have become less sensitive to price changes in that meat).

¹² Source: Australian Chicken Meat Federation Inc.

¹³ The Allen Consulting Group (2001), *A Structural Adjustment Package for the NSW Poultry Meat Growing Sector*, p2. The report noted a gross revenue to contract farms in NSW of \$124 million.

¹⁴ ACCC (19 May 2004), *Determination: Application for Revocation of A90659 and its Substitution by A90888*, Inghams Enterprises Pty Ltd on its own behalf and on behalf of Tasmanian chicken growers, in relation to the collective negotiation of chicken growers' contracts in Tasmania, para.2.9.

¹⁵ Previous restrictions in the *Chicken Meat Industry Act 1977*, providing for the Chicken Meat Industry Committee to provide advice to the Minister as to the need for the establishment of new processing plants, and for the Minister to approve or refuse applications for processing plants, were removed from the Act following the review of the Act in 1997.

- Further, large buyers (supermarkets and fast food companies) are likely to prefer to deal with large processors, who, due to their size and control over different stages of the supply chain, are likely to be better able than small processors to supply high volumes of chicken meat, produced to the buyers' quality and production specifications, at a lower price.

New processors that have entered the market in recent years have tended to specialise in niche markets, such as free range or organic chickens.

2.4 History of the *Chicken Meat Industry Act 1977*

In the 1960s, following the entry of large US fast food companies into Australia, the chicken meat industry in Australia grew rapidly from mainly backyard production for personal use, to an industry which mirrors the current industry structure, with large processing companies and contract growers.

The rapid growth in the demand for chicken meat saw many new growers enter the market, at the same time as improvements in feed technology were raising production efficiency. This led to an overproduction of chicken meat, mainly in the eastern States, in the late 1960s.¹⁶ Rising production costs, with the introduction of modern large-scale heated sheds and a reduction in the wholesale chicken price increased uncertainty for growers regarding their future returns. Most State governments considered legislation as a means of stabilising their State's chicken meat industries.

In Western Australia, regulation in the chicken meat industry initially began with the formation of a Chicken Meat Advisory Committee through the *Chicken Meat Industry Committee Act 1975*, based on similar draft legislation in Victoria and South Australia. The Committee, consisting of grower and processor representatives and chaired by the then Director General of Agriculture, was tasked with agreeing upon a methodology to determine the average price to be paid by processors to growers. This was followed by 18 months of negotiation between growers and processors for an increase of 1.5 cents per bird. Although successful in their bid, this experience led Western Australian growers to approach the Government for assistance.¹⁷

The increasing integration of the chicken meat processors and the increasing dependence of growers on processors was recognised by Government at the time.¹⁸ Legislation in the form of the 1975 Act was considered as a way of placing:

...our industry in a safe place whereby growers can negotiate freely with the processors with what we might call an adjudicator – an independent officer from the Department of Agriculture – present as the seventh member of the committee.¹⁹

The bill for the *Chicken Meat Industry Committee Act 1975* was passed and the Committee established by the 1975 Act approved written contracts between growers and processors and provided a facility for arbitration. However, unresolved disputes between the two parties continued to occur and as a consequence stronger legislation in the form of the *Chicken Meat Industry Act 1977* was introduced.

¹⁶ Source: Second reading of the *Chicken Meat Industry Committee Bill*, Hansard, 6 May 1975, p2062.

¹⁷ Hansard (1975), Second reading of the *Chicken Meat Industry Committee Bill*, Extract from Tuesday 19 August 1975, p2067.

¹⁸ Ibid, p2242.

¹⁹ Ibid.

2.4.1 Intent of the Legislation

The *Chicken Meat Industry Act 1977* was enacted to:

...improve stability in the chicken meat industry, to repeal the *Chicken Meat Industry Committee Act 1975*, to provide for the continuation of the Chicken Meat Industry Committee, and for incidental and other purposes.²⁰

The Department of Treasury and Finance submitted that:

When introduced in 1977 it was clear that the major objective of the legislation was the stabilisation of the chicken meat industry following a large increase in consumer demand. In particular, the Act was established to provide broiler chicken growers with countervailing measures to match the market power of chicken meat processors. (Department of Treasury and Finance submission on issues paper, p2).

Growers have indicated to the Authority that one of the drivers for introducing the Act was that growers needed sufficient assurance of returns on their investments in order to obtain finance from banks. Another perceived problem at the time was that too many chicken growing sheds were being built, at the request of the processors, which was not financially viable for the chicken meat growers. The Act required that any new shedding be approved by the Chicken Meat Industry Committee.

Specifically the Act was introduced to:

- counteract an imbalance of bargaining power between processors and growers that resulted from the vertically integrated nature of the industry;
- promote stability in the industry;
- enable the Committee to determine the average price paid by processors to growers from which individual grower prices are negotiated;
- improve chicken growing conditions in the industry with all growing premises requiring to be approved by the Committee; and
- provide dispute resolution.

The chicken meat industry experienced relative stability for a while until the early 1980s, when:

...difficult market conditions and a surplus of growing area during 1980-82 caused relationships between growers and processors to deteriorate and culminated in termination notices being issued to a number of growers. (WA Broiler Growers submission on issues paper, p6)

In 1982, the *Chicken Meat Industry Amendment Act* was passed. This changed the 1977 Act by:

- altering the structure of the Committee;
- providing for issues to be decided by a majority of votes;
- removing the provision for outside arbitration;
- limiting appeals against Committee decisions to the Supreme Court; and
- providing for the registration and approval of chicken growing facilities.

²⁰ *Chicken Meat Industry Act 1977*, p1.

The Act was reviewed in 1989 by the Department of Agriculture and extended unchanged to December 1996. A further review was conducted as part of the National Competition Policy legislation review in 2000, the results of which allowed growers to opt out of the Act and also to appeal to the State Administrative Tribunal against any determinations made by the Chicken Meat Industry Committee. This and a subsequent review in 2003 are discussed in more detail below.

Bartter Enterprises submitted that one of the reasons for the introduction of the legislation was to protect existing growers at a time of declining production and that this was no longer relevant due to the current shortage of growing capacity.

Bartter Enterprises in recent years has been required to source additional grower capacity from new growers on top of existing farm shedding conversions/upgrades and natural expansion in order to meet local market demand resulting from continuing population growth thus ensuring market supply was achieved. This is contrary to one of the major points for establishment of the *Chicken Meat Act of 1977* meaning where grower returns were being negatively affected by declined throughput. (Bartter Enterprises submission on issues paper, p2)

2.4.2 Functions of the Committee

The Committee, as defined by the Act, is appointed by the Minister and comprises an independent chairperson, two representatives each of chicken meat processors and chicken growers, and an additional two independent members. The Committee meets twice a year and its functions are to:

- determine the standard price to be paid by processors to growers for broiler chickens;
- resolve disputes between processors and growers;
- set criteria to define an “efficient grower”, which is used as a condition for the entitlements of growers under the prescribed form of agreement between growers and processors;²¹
- approve facilities for the growing of broiler chickens and maintain records of these facilities;
- report to the Minister on any matters relating to the chicken meat industry that it considers relevant; and
- make recommendations to the Minister on regulations relating to the Act.

2.4.3 Regulations Under the Act

The *Chicken Meat Industry Act Regulations* set out the prescribed form of agreement between processors and growers, including the methodology for determining the standard price to be paid by processors to growers.

Other regulations, the *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978*, set out rules and procedures for how any increase in output by a processor should be shared between growers contracted to the processor. The purpose of these provisions is to ensure that all growers in the pool have the same opportunity for expansion and that grower farms in which processors have an interest are not favoured by

²¹ In defining the criteria for efficient growers, the Committee is required to take into account factors such as the productivity of growers, the standard price paid to growers, and the market for chicken meat.

definition in the Act of “intensive housing conditions”, and all commercial meat chickens, whether free range or shed reared, are kept in sheds for the first three weeks of their lives.

WABGA disputes the Department of Agriculture’s position that free-range chickens are not raised under intensive housing conditions and are therefore not subject to the Act. One of the submissions by a free range grower (a WABGA member) supports the WABGA position that free-range chickens are intensively housed, and therefore should fall under the Act.²⁸

The WABGA submission also attaches the advice from the Crown Solicitor’s Office to the Department of Agriculture in 2003 that the housing conditions of free range chickens could be defined as “intensively housed”, and that the legislation was probably intended to cover all commercial chickens (as there were no free-range chickens at the time). However, the Crown Solicitor’s Office concludes that the legislation is unclear and would need to be redrafted to remove the ambiguity.²⁹

Table 2.4 Number, Size and Affiliation of Main Chicken Growers in Western Australia

Grower Affiliation	Number of Growers		Total Shed Area (m ²)	
	Prescribed Agreements	Individual Contracts	Registered*	Not Registered
Inghams growers	17		182,770	
Baiada growers	13		131,694	
Finesse Foods	5		36,187	
Inghams company farm		1	18,190	
Bartter external grower		1		43,792
Mt Barker Chickens		5		n/a
Total	35	7	368,841	

Source: Western Australian Broiler Growers Association (WABGA, January 2010), *Cost of Production Model; and WABGA submission on Issues Paper*, pp12-13.

Notes:

* Growers under prescribed agreements are required to have their growing facilities approved and registered by the Chicken Meat Industry Committee. The shed area for the Inghams company farm is registered as the original Act required that the ratio of the shed area between processor-owned farms and contract growers be maintained.

2.5 How is the Act Currently Being Used?

The Chicken Meat Industry Committee meets at least twice a year, primarily to update the cost estimates in the cost of production model used to calculate the gazetted average price (currently set at 80.57 cents per bird).³⁰ The cost of production model is based on cost estimates of the inputs into an efficient notional broiler farm. The model is developed and updated in consultation with growers and processors and is available to all industry parties. The gazetted average price (or fee) is then used as an input into the negotiation of contracts between growers and processors. Payments to individual growers in a pool

²⁸ WA Broiler Growers Association submission on issues paper, individual grower submissions, Attachment 1.

²⁹ WA Broiler Growers Association submission on issues paper, individual grower submissions, Attachment 4.

³⁰ *Government Gazette*, 25 June 2010, p2887.

Table 2.6 ACCC Authorisations and Notifications of Collective Bargaining by Chicken Growers

Applicants	Application Lodged	Final Decision	ACCC Determination
Authorisations			
Victorian Farmers Federation on behalf of Victorian chicken grower groups applied for an existing collective bargaining authorisation to be replaced by a similar one.	18 Feb 2010	21 Apr 2010	Authorisation granted for further 5 years
Baiada Poultry and four other processors applied for separate authorisations for collective bargaining by consenting growers in Victoria.	22 Dec 2003	2 Mar 2005	Authorisations granted with conditions
Inghams applied for an existing authorisation for collective bargaining by its contract growers in Tasmania to be replaced by a similar one.	5 Dec 2003	19 May 2004	Authorisation granted for a further 6 years
Inghams applied for an extension for an existing authorisation for collective bargaining by its growers in South Australia.	3 Apr 2002	22 Jan 2003	Authorisation granted for further 5 years
Inghams and seven other processors in NSW applied for the growers for each processor to be allowed to bargain collectively.	8 Sep 2001	8 Oct 2002	Authorisation denied
Inghams applied for authorisation for collective bargaining by its growers in Tasmania	28 May 1998	17 Mar 1999	Authorisation granted
Notifications			
Tasmanian Chicken Growers Association notified on behalf of six chicken meat grower members for collective negotiation with processor Inghams	22 Apr 2010	6 May 2010	Notification allowed to stand
South Australian Farmers Federation notified on behalf of 18 South Australian chicken growers for collective bargaining with processor Inghams	27 Feb 2009	26 Mar 2009	Notification allowed to stand for 3 years

Source: ACCC website

outweigh the costs and those net benefits need to be unambiguously positive, with no alternative ways of more efficiently achieving those objectives.

3.2 Industry Structure without Collective Bargaining by Growers

As shown in section 2.3, the market structure for the growing of meat chickens in Western Australia, as in other States, is one that appears to have the following characteristics.

- There are a small number of dominant buyers of growing services (the large processors) and a relatively large number of sellers (the contract growers).
- The processors also maintain control of other upstream stages of the supply chain for chicken meat, such as the provision of breeding stock and feed.
- It is difficult for processors to raise the prices they charge to chicken meat retailers. This is because there are a small number of large retailers (supermarkets and fast food companies) that would be in a position to exert some market power over the processors, who would not wish to lose a large buyer of their output.

Given the structure of the industry, the question is whether the processors have market power relative to growers and if so, whether this places growers at a disadvantage in contract negotiations. If growers cannot switch easily to another processor, or to an alternative output, their bargaining power relative to processors in negotiating contracts could be weakened, so that they may have less input into the terms and conditions of their contracts.

However, it may be in the interests of growers, as well as processors, to have an arrangement whereby growers produce exclusively for one processor. On the one hand, processors need dependable large volumes of chicken meat and would therefore prefer to set up long-term contracts with competent growers. Growers also would want predictability about their future returns and would be willing to lock-in with one processor on a long-term basis, given sufficient returns on their investments. In addition, there are switching costs and risks to growers in moving to another processor.

The Authority noted in its draft report that some factors may limit the bargaining power of the processors, who have obligations to meet their supply contracts with retailers. It is difficult for processors to recruit new growers at short notice, or get existing growers to expand, due to the long lead time and difficulty in obtaining approvals (e.g. shire councils; health, safety and environmental approvals; obtaining water allocations). Further, it may not always be possible to increase the volume of imported chicken to meet any supply shortfalls. The loss of a grower could therefore put at risk a processor's contracted deliveries to retail customers and could adversely affect the commercial relationships between the processor and its retail customers, to the benefit of other processors.

Thus, to some extent there is a mutual dependence between growers and processors and it is therefore in the interests of processors to have a stable and sustainable growing sector that ensures reliability of supply. Processors who would like to expand production by their growers would need to offer contract terms and conditions that give the growers (and their financiers) sufficient confidence to invest in new capital.

3.2.1 Industry Views

Growers

Broiler growers represented by the WABGA submitted that there are a range of factors that place growers at a substantial disadvantage in contractual negotiations with processors.

First, growers submitted that they have limited options for shifting to different processors, due to the small number of processors.

In Western Australia the growers have limited options of changing processors in an effort to achieve a better deal with another processor due to the fact there is such a limited number of processors in this State. (WABGA submission on issues paper, Attachment 1, submission by Lanaubra Farms)

Further, the growers submitted that their capital investments are purpose built for the production of meat chickens and cannot be turned to alternative uses.

The contract broiler grower's farm facilities are designed for a very specific purpose which means that a grower has virtually no option to convert the farm to another industry. (WABGA submission on issues paper, Attachment 1, submission by Lanaubra Farms)

Our sheds cannot be used for any other purpose (WABGA submission on issues paper, Attachment 1, submission by W. McPhail and Sons)

The growers submitted that in order to make capital investments, they require long-term contractual security and a reasonable rate of return, which they claim has been provided by the Act.

The regulations were seen as security for our family to invest \$5m into capital that has no short to medium term alternative use (poultry sheds). (WABGA submission on issues paper, Attachment 1, submission by Terrigal Farm)

Lanaubra farms was able to finance and build the farm into a modern contract broiler grower operation because the Western Australian Chicken Meat Industry Act gives the growers the ability to negotiate a fair contract and price for the entire industry. The banks require the security of a long term contract and fair price negotiations between the growers and the processors before they will provide the finance to build modern contract broiler operations. A long term contract backed by the Chicken Meat Industry Act allows a family company to borrow enough money to upgrade farm facilities to meet the minimum standards that the processors...set. (WABGA submission on issues paper, Attachment 1, submission by Lanaubra Farms)

In addition, growers submitted that as individuals they do not have the financial resources to engage in legal disputes with processors over contract terms and conditions.

In all countries and States within Australia the major disputes are over price negotiation and contracts for growers. To resolve these disputes costs hundreds of thousands of dollars, with the costs in most cases being at the expense of the chicken farmer. (WABGA submission on issues paper, Attachment 1, submission by B J & R Enterprises)

The growers also submitted that there is often pressure from processors to reduce costs or to invest in further capital.

[Processors] can't cost recover from processing plants as workers are covered by labour laws, can't increase prices to their customers as Western Australia is unfortunate in that we have a duopoly with only the two major supermarkets and the easiest target therefore

is the contract broiler grower... (WABGA submission on issues paper, Attachment 1, submission by Raintree County)

If the processing company believes the grower's shedding needs upgrading to a certain level or certain equipment needs to be installed, and if this is not done his agreement may be terminated. (WABGA submission on issues paper, Attachment 1, submission by Nowergup Poultry)

[G]rowers have continually needed to go to the Chicken Meat Industry Act to get adjudication and resolution on increases in running costs and returns on investments and even then the growers have discounted the growing fee to help obtain an agreement with the processors. (WABGA submission on issues paper, Attachment 1, submission by ER and JF Terrace)

The growers also provided evidence that stocking density can be an issue, with the number of birds per square metre at times below the maximum density of the sheds. Growers have an incentive to achieve the maximum throughput for which the sheds were designed.

[T]here is no incentive for processors to resolve disputes especially related to the fee increases, density reduction or pool payment systems where processors can regain part of the growing fee. (WABGA submission on issues paper, Attachment 1, submission by ER and JF Terrace)

The site is 4.2 hectares or 10 acres with 5 convection sheds registered to house 120,000 broiler chickens, at present due to [processor] edicts we are only placing 106,000 chickens, 11.6% below registered and budgeted figures. (WABGA submission on issues paper, Attachment 1, submission by Colleen Broad)

Processors

Processors claim that there is no longer an imbalance of power between processors and growers. Inghams Enterprises submitted that:

The Chicken Meat Industry Act's intention in the 1970s was to correct what was seen as an imbalance in the negotiating power between large well resourced processors and small poorly resourced growers and in so doing bring stability to a fledgling industry. In the 1970s and 1980s the Act probably achieved this quite adequately.

Today the poultry meat industry in Australia is a stable and relatively mature industry. Growers are large and well resourced having ready access to the best financial and legal advice. Growers have strong networking at both State and national level through grower bodies and associations and as such have strong negotiating power. This increase in grower negotiating power and industry stability has been acknowledged in all other States by legislation being repealed or changed to eliminate involvement in fees and contracts. The legislation was seen by grower, processor and the industry as a whole as being anti-competitive and counter-productive. (Inghams Enterprises submission on draft report, p2)

Inghams Enterprises submitted that the relationship between processors and growers is one of mutual dependence.

Both the Processor and the Contract Grower have commercial pressures to conclude satisfactory negotiations and it is very much a question of mutual dependence. (Inghams Enterprises submission on issues paper, p4)

It is interesting to note that the trend in growing contracts in recent years has been overwhelmingly in favour of [individual non-collective] contracts and away from the CMIC and the CMI Act, confirming recognition by both parties of a strong mutual dependence between Grower and Processor. (Inghams Enterprises submission on issues paper, p2)

The processors dispute the claim that the balance of negotiating powers favours processors. Bartter Enterprises submitted that the growth of Mt Barker Chickens and Finesse Poultry in recent years has:

...created strong demand for shedding/growing capacity which in turn has led to a shortage of shedding/growing capacity. (Bartter Enterprises submission on issues paper, p2)

Inghams Enterprises submitted that:

[i]t is clear that the dynamic of our industry is shifting, and has indeed in other States shifted faster than Western Australia, from small inefficient family owned farming operations to large sophisticated tunnel shedding operations which are well resourced and have ready access to quality legal and financial advisers. (Inghams Enterprises submission on issues paper, p3)

Further, Bartter Enterprises submitted that there was effective competition in the processing sector in Western Australia and that regulation of the industry through the Act was not needed.

Bartter Enterprises supports the view that regulation of a market, such as through legislation, is not necessary and indeed can be counterproductive, in a market where full or effective competition exists. Full or effective competition it could now be argued is the case in Western Australia with 5 established processors operating including Ingham's, Bartter Enterprises (Baiada), Prestige Poultry, Mt Barker and Finesse. Mt Barker and Finesse in recent years have established their own chicken meat growing operations, established contract growing agreements, grown significantly in processing production numbers and given growers flexibility in growing arrangements... (Bartter Enterprises submission on issues paper, p2)

Other Views

The Department of Treasury and Finance submitted that the existing limits to processors' bargaining powers may be greater than that described in the 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."

The ACCC has noted that there is vigorous competition between processors. 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. (Department of Treasury and Finance, p9)

3.2.2 Authority Assessment

Relevant Factors in the Western Australian Chicken Meat Industry

The Authority considers that factors in the Western Australian chicken meat industry give rise to a market structure similar to those seen in other States.

The two major processing companies, Inghams Enterprises and Bartter Enterprises, dominate the processing sector in Western Australia, with over 80 per cent of growers contracted to one of these companies. There are barriers to entry into the processing sector which make it difficult for new processors to enter into the market, or smaller processors to expand operations, including:

- the high cost and economies of scale of large processing plants;
- the efficiencies gained by large processors by controlling different stages of production; and
- the preference for large retailers to sign supply contracts with large processors.

While some new processors have entered the market (such as Finesse Foods and Mt Barker Chickens), these have tended to be in niche markets, such as free range chickens, so it is likely that the dominance of the conventional broiler market by the two major companies could be expected to continue.

Growers are generally located near other growers who supply the same processor and reasonably close to processing plants (within 50 km). This is largely due to the improved logistics and reduced transport distances and costs for processors, who deliver feed, chicks and medicines to grower farms, as well as collect chickens for processing.

- The need for growers to be grouped relatively close together, as well as the small number of processors in Western Australia, makes it difficult for growers to switch their services to another processor.
- The Authority is aware that processors may also be reluctant to allow free movement of growers between processors – first, because growers can be difficult to replace; and second, because processors would be reluctant to get into a bidding war for growers in terms of growing fees.
- Further, the capital intensity and high degree of asset specificity in broiler growing operations makes it difficult for growers to switch to another output.

The Authority notes that the example of Finesse Foods shows that it is possible for growers to switch to another processor (two growers for Finesse were once Inghams growers and three are ex-Bartter growers) and for growers to be located at some distance from each other and the processing plant (the processing plant for Finesse Foods is in Bunbury while the growers are near Perth). However, the Authority understands that the situation for Finesse Foods is unusual and arises largely due to the processor having difficulty establishing growers in the Bunbury region, due to the planning requirements for broiler farms. The Authority therefore considers that existing growers will continue to be limited in their opportunities for switching to other processors.

Monopsony Markets

Given the small number of processors, and the difficulty that growers face in switching away from their own processor, then in the absence of regulation or collective bargaining

by growers, the market structure for chicken meat growing services could be described as a number of regional monopsonies – that is, regional markets in which a large number of sellers (i.e. broiler growers) sell their services to a single buyer (i.e. the processing company to which the growers belong).

The Authority accepts that growers are geographically tied to their particular processors, with little or no alternatives to sell their product, or utilise their assets for other production, although the transfer of five growers from the two large processors indicates that some alternatives exist, if only to a limited extent.

A feature of a monopsony is that the buyer (the processor) is able to choose a combination of input (growing services) quantities and price, because they are so dominant in this market that their purchasing decisions affect the price of the product. If a buyer wants more quantity, then they will have to offer a higher price to attract a new entrant (assuming that the cheapest production has already been exploited and there are no new technologies that might drive the cost of production down). This contrasts with a more competitive market, where the buyer is too small to have any effect on price, but would choose quantity to maximise profits as best they are able.

However, this does not mean that the processor has free reign over the prices and quantities purchased. The combination that they choose must be consistent with growers' willingness to supply services. If they set too low a growing fee (especially in the long run) the processors will not get the quantity that they need.

From an economic efficiency perspective, the problem with a monopsony arises because buyers frequently have to pay the same price to all suppliers, which will give a strong incentive for the buyer to purchase less than the social optimum level. The need to pay the same price for all inputs can happen for a range of reasons, such as maintaining the morale of workers or a (legislated or authorised) collective bargain. Consider the simple example of a single employer in a small town and its purchasing of labour, which is a classic example of a monopsony market (**Box 1**).

Box 1. Effect of a Single Price in a Monopsony Market

A monopsonist employer initially hires 1,000 workers at \$10 per hour. To attract another worker, the employer would have to pay him/her \$11 per hour. If the employer has to pay all its workers the same amount, then the hiring of an additional worker would not just cost \$11, but \$1,011 (\$11 for the additional worker plus \$1 for each of the 1,000 existing employees.⁴² If the employer will only employ more people if the value they contribute is at least equal to its additional cost, then this extra employee would need to generate \$1,011 for the business to hire them, extremely unlikely for someone in the market for an \$11 wage.

The above example is a fairly extreme one designed to illustrate the concept, but the general point is that a monopsonist's costs rise much faster than the market price. Applied to the Western Australian chicken growing market and an industry-wide fee for a single buyer (processor), if the existing market growing fee was 70 cents per bird based on 36.4 million birds,⁴³ but a processor with 100 per cent market share (to simplify the example) has to offer 72 cents per bird to attract a new entrant into the industry to

⁴² Ashenfelter, O.C., Farber, H. and Ransom, M. R. (April 2010), "Modern models of monopsony in labour markets: a brief survey", *Princeton University, Industrial Relations Section, Working Paper No. 554*, p3.

⁴³ Based on the 1996-97 reported level of WA production, the last year reported by the Australian Bureau of Statistics (ABS, Cat No. 7215.0).

produce another 500,000 birds per annum,⁴⁴ then the cost to the processor would be \$360,000 (0.72 times 500,000 birds) to the new grower plus \$728,000 (\$0.02 times 36.4 million birds).

In other words, given uniform pricing, the processor would have to pay more to existing growers than to the new grower and the true additional cost to the processor is actually \$2.18 per bird (((\$360,000 plus \$728,000) divided by 500,000 birds). This gives the processor a powerful incentive to restrict output until the additional cost per bird⁴⁵ equals the revenue they receive for that bird, so output is restricted to well below the level from an efficient outcome.⁴⁶

In contrast, if technologies exist to continually lower the cost of production, then the industry would expand as more efficient producers at the margin would lower the price of all existing production to processors.

A monopsonist can increase profit by paying each of its suppliers differently depending on the price that their suppliers are willing to accept (price differentiation).⁴⁷ If there is a group of suppliers who will keep producing despite a large fall in price, the buyer will attempt to separate them from growers who might reduce output by a large amount for the same change in price. The growers who are insensitive to price will be paid a lower price than the ones who are sensitive to price. Of course to do so, the monopsonist must be able to prevent arbitrage between suppliers. In practical terms, this could be implemented by offering growers individual contracts, which specify that a grower cannot discuss their fee with other growers.

Price differentiation would improve economic efficiency as it would reduce the cost to processors to offer expanded levels of production. In the example above, the per-bird cost to the processor to expand would fall from \$2.18 to \$0.72, giving the processor much more incentive to expand.

However, under price differentiation, growers that were offered and willing to accept lower prices would lose relative to the single price case, as some of their income would effectively be transferred to processors. Growers that need a high price to stay in business and investors considering joining the industry, would gain from such a system.

If price differentiation (through individual contracts) is possible in South Australia and not in Western Australia, it might partly explain why imported chicken meat can be competitive at seemingly high transport costs. Bartter Enterprises estimate the transport cost per bird as \$0.22.⁴⁸ This, given the average fee in South Australia of \$0.6712 per bird for Inghams growers,⁴⁹ should lead to a much larger price for imported meat than the grower fee of \$0.715 per bird (for tunnel shed growers), or even the gazetted fee of \$0.8057, even allowing for the larger bird size in South Australia and production efficiencies from Inghams' South Australian plant. However, given the single fee and regional monopsonist

⁴⁴ Approximately the number of birds in the Cost of Production model in January 1998.

⁴⁵ The *marginal factor cost* in economic terms. This results in a *deadweight loss* in the market; that is, a decrease in the total welfare to society.

⁴⁶ Wetzstein, M. (2005), *Microeconomic Theory: Concepts and Connections*, p555.

⁴⁷ In economics terms, this relates to the *price elasticity of supply*, or the percentage change in output (for the grower in this case) for a one percent change in price. If output is less sensitive to price (inelastic), then the buyer will pay them less because they will only reduce production by a small amount despite a relatively large change in price.

⁴⁸ Bartter Enterprises submission on draft report, p13. Note that it is processed chicken meat that is transported, not birds, so the transport cost has been calculated back into a "per bird" basis.

⁴⁹ Inghams Enterprises submission on draft report, p8.

buyers in Western Australia, the marginal cost of expansion could be much higher than import parity.

Growers have expressed concerns that, if they were unable to bargain collectively, processors could take advantage of the growers being locked in with their capital by driving down growing fees so that they are just enough to cover growers' operating costs, but not all of their capital costs. The Authority notes that this might be possible in the short term, but in the long-term it is not a sustainable tactic, as no new growers would enter the industry without sufficient returns.

Final Findings and Recommendations

Market Structure in the Absence of Collective Bargaining

- 1) Western Australia's market for broiler growing services is dominated by two buyers (processors) and growers have limited opportunity to switch between processors or convert their broiler growing infrastructure assets for alternative uses. This can be described as a market with monopsony buyers.
 - The market structure is driven mainly by economic factors that make it cheaper for chicken meat to be processed by a few large companies rather than by many processors.
- 2) Monopsony markets lead to production that is lower than the economically efficient level, and also lead to processors capturing as monopsony profits part of what, in a competitive market, would be returns to growers.
- 3) Price differentiation (the payment of each grower individually on the basis of their willingness to supply) can lead to an increase in output relative to a market where all growers are paid the same fee. However, it is unclear whether processors would be able to implement such a system.

3.3 Market Structure with Authorised Collective Bargaining

3.3.1 *ACCC Assessment of the Costs and Benefits of Collective Bargaining*

An assessment of how the market would function without the Act can be gained from ACCC assessments of applications for authorisation of collective bargaining by chicken meat growers.

In its various decisions on collective bargaining authorisations and notifications for chicken growers (see Table 2.6), the ACCC has in each case carried out a public benefit test comparing the benefits of collective bargaining arrangements with the detriments which could arise out of such arrangements. These assessments are based on an analysis of the relevant markets (for chicken growing services and for processed chicken meat) and whether there are market failures that can be alleviated by allowing collective bargaining.

Final Findings and Recommendations

Market Structure with Authorised Collective Bargaining

- 4) The ACCC has assessed the balance of power between processors and growers in other States and has in most cases authorised collective bargaining arrangements by growers, but not collective boycott rights.
- 5) If there were no *Chicken Meat Industry Act 1977*, Western Australian broiler growers would most likely receive ACCC authorisation for collective bargaining should they seek it.
- 6) Authorisation for growers to collectively bargain would provide growers with some degree of countervailing power in negotiations with processors, but not to the extent of creating a bilateral monopoly situation. The market would remain essentially monopsonistic.

3.4 Investment Hold-up

There is some economics literature that examines broiler markets where growers are highly dependent on their processor and growers' assets have low salvage value outside the contractual relationship.⁵⁴ Research suggests that in these situations:

- growers will be reluctant to make substantial new investments, because this will give processors increased bargaining power and could lead to a reduction in profits for growers; and
- processors may request upgrades and technological improvements as a condition of contract renewal, leading to a high degree of physical asset specificity for the growers, which may be used by the processor to induce higher effort from the grower without the need for higher compensation.

The above situation is an example of the “hold-up problem”, which is where two parties would be better off working together cooperatively, but do not do so, because one party fears that by entering into the contract they will increase the bargaining power of the other party and potentially reduce their own profits. Hold-up can result in investment levels which are below the socially optimal level.

In order for growers to have sufficient confidence to make capital investments, they require sufficient certainty that they will be able to recover those costs over a period of time, including a rate of return commensurate with the level of risk they are undertaking. It is possible that collective bargaining, by increasing the bargaining power of growers, can provide them with greater input into their contract terms and conditions, which would give them more confidence to make large capital investments.

⁵⁴ For example, Vukina, T. and Leegomonchai, P. (August 2006), “Oligopsony power, asset specificity and hold-up: evidence from the broiler industry”, *American Journal of Agricultural Economics*, 88(3):589-605. The article is based on a study of the American broiler industry, which has a similar structure to the Australian broiler industries, with small numbers of large processing companies and many small contract growers. The article found evidence to support the hypotheses that (1) the smaller the number of processors in an area (i.e. the less competition in the processing sector) the greater the tendency for growers to under-invest in housing facilities; and (2) in cases where there was a single processor, an increase in growers' asset specificity resulted in a decrease in grower compensation rates.

In a growing market investment hold-up is unlikely to be a problem. If new capacity is to be attracted to the industry, processors must offer new entrants sufficient assurance that the new entrant will be able to make a sufficient return on their investment over the life of that investment. Growers have expressed concern that returns promised initially by processors to encourage growers to invest will be later revoked when contracts are renegotiated (known as “bait and switch” tactics). However, while this behaviour might produce some short-term gains for the processor, if processors want to continually attract new production, then it is not a sustainable long-run strategy.

The Authority has noted that long-term contracts are available to some growers. The entry of large investment fund management companies into the chicken growing sector is a new development.

- The ProTen farm in Serpentine is one of six broiler farms across Australia managed by ProTen Ltd. ProTen farms have long-term growing contracts with Baiada, typically 15 years.⁵⁵
- Another example is Rural Funds Management Limited (RFM), which manages a portfolio of farming and agricultural enterprises for investors, including 16 broiler farms in NSW and Victoria. RFM has established 20 and 30-year broiler growing contracts with Baiada.⁵⁶

Another key point to make is that investment hold-up can also occur on the processing side of the market. In deciding whether or not to expand in the processing sector, processors face capital investment decisions that are expensive and long term (such as expanding, upgrading or building new processing plants). Once the plant is in place, if growers have sufficient bargaining power, then they could conceivably increase prices to the point where it is worth the processor keeping the plant operating, but at a rate of return much lower than anticipated at the time the investment decision was made.⁵⁷ Given that processors are likely to face more infrequent investment decisions than growers – but much larger in terms of industry impact – the impact on processors needs to be carefully assessed.

Currently, evidence suggests that Western Australian output is not expanding and is under significant pressure from interstate imports (see section 2.3.3). In such a situation, there is likely to be a reluctance to invest by both growers and processors. Rather than a hold-up issue, it could be a general reluctance to invest due to uncertainty about future production levels and returns.

3.5 Experience in Other States

In assessing the alternatives to the average price regime in Western Australia, the Authority has reviewed recent developments in other States, where chicken meat industry legislation is no longer applied. The Department of Treasury and Finance noted that:

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

⁵⁵ www.proten.com.au; *ProTen Ltd Consolidated Financial Statements for Year Ended 30 June 2010*, p18.

⁵⁶ www.ruralfunds.com.au

⁵⁷ Processors would be better off keeping the plant operating as long as they are covering their variable costs and some of their fixed costs, rather than shutting the plant down and covering none of their fixed costs.

The Code was developed in consultation with industry and has been incorporated into the Victorian Planning Provisions and all planning schemes in Victoria. Compliance with the Code is mandatory and applies to the planning, design, assessment, approval, construction, operation and management of broiler farms in Victoria. Since the introduction of the Code, 15 new farms have been approved.⁷⁰ Chicken meat production in Victoria has been increasing by around 2.5 per cent a year since 2004-05, although production in 2009 was reduced due to the loss of the Inghams processing plant in Somerville due to fire in January 2009.

Final Findings and Recommendations

Experience in Other States

- 7) Review of the experience in other States, where grower fees are not regulated, indicates that some of these regions (especially South Australia and Queensland) have shown considerable growth in their chicken meat growing sectors and that the incidence of formal disputes between growers and processors is low, given the large number of growers.

⁶⁹ <http://new.dpi.vic.gov.au/agriculture/animals-and-livestock/poultry/code-broiler-farms>

⁷⁰ Source: <http://www.getfarming.com.au>

sports salary negotiations. The two parties agree on the number of players in the league and then negotiate over player salaries.⁷³

Under such an arrangement, price differentiation between growers and/or groups of growers and a consequent potential improvement in economic efficiency, becomes less likely. Price differentiation might not be possible under ACCC-authorized collective bargaining, but is almost impossible under the Act.

In addition to a normal bilateral monopoly market is the role of the gazetted fee from the notional model which, depending on the level of fee determined, has the potential to significantly strengthen one of the parties bargaining position. There are then two key questions. Firstly, if the Act, particularly its price setting functions, is to continue, is the model efficient in the sense that it does not unduly favour one party or the other?

The second question is if the production (economic efficiency) impact of a bilateral monopoly relative to a monopsony is unclear at best, does the Government have an interest in favouring one party in the bargain for no net gain to society? These questions are examined below.

4.3 Independence of the Committee

If the average price regime which underpins the Act is to work effectively, it is essential that the average price be determined through equal input by both growers and processors.

The framework for determining the average price provides the opportunity for balanced input by both growers and processors. The composition of the Committee is aimed at equal representation by growers and processors. The model and the methodology for determining each parameter are documented, so that model inputs and the calculation of the growing fee can be scrutinised by any of the parties. One processor also has a broiler farm, so is familiar with the production costs. Similarly, growers and processors both have the opportunity to contribute to the review of the model every three years.

4.3.1 Industry Views

Inghams Enterprises have expressed the view that the Committee, because of its structure, cannot be considered to be independent.

Examination of the structure of the CMIC reveals that it is comprised of two processor representatives, two grower representatives, two independent representatives and a Chairman as required by the Chicken Meat Industry Act 1977. It is however important to note, that with regard to the two independent representatives, one is an Executive Officer of the Western Australian Farmers Federation (Inc), while the other is a farmer in the wheat belt and on the board of Regional Development Australia. It is Ingham's opinion (whilst in no way suggesting they act in any way that is inappropriate) that the aforementioned independent representatives cannot be deemed as independent as there are obvious conflicts of interest. (Inghams Enterprises submission on draft report, pp6-7)

Inghams Enterprises submitted that it has objected to the setting of the growing fee by the Committee and has voiced this objection by abstaining from voting on the gazetting of the growing fee and since October 2009 declining to nominate a representative of the company to the Committee.

⁷³ Wetzstein, M. (2005), op.cit., p561.

The Authority concludes that, in order to address these issues, it would be essential to remove any perception of bias regarding the determination of the average growing fee or dispute resolution by the Committee. This could be achieved by appointing an independent body or party (not associated with growers or processors) to review the model, re-develop the model (depending on the outcome of the independent review) and maintain the model.

Final Findings and Recommendations

Independence of the Committee

- 8) There is disagreement between processors and growers regarding the validity of the mechanism for determining the average grower fee under the Act. This has led to a breakdown in the functioning of the Chicken Meat Industry Committee, with the processors no longer participating in the gazetted fee determination process.
- 9) If the Committee is to continue in a price-setting role, to remove any perception of bias it is important that any independent representatives on the Committee are appointed by an independent process, for example, a single independent professional arbitrator appointed by the Treasurer.

4.4 Efficiency of the Notional Model

4.4.1 Industry Views

Growers

The WABGA submitted that the fee setting mechanism has encouraged cost efficiency in the Western Australian grower industry because the average fee is calculated using a cost of production model based on a notional farm which is an efficient broiler operation (with modern technology, a relatively large size and least costs of inputs).

Further, the WABGA submitted that the actual payments that growers receive are consistently lower than the gazetted average price (see Figure 4.1). The growers submitted that this is due to the further adjustment of the gazetted fee to take into account the growers' productivity relative to other growers in their group and other factors such as market forces.

The Growing Fee is determined by the [Committee] by determining a gazetted fee based upon a submission by the growers deemed as a 'notional fee', derived from a 'Notional Model' in accordance with the Act and Regulations. This in turn is then modified, based on the level of productivity of the grower's particular processor...and market forces that prevail, specifically loss of market share within WA or to an interstate processor. (WABGA submission on issues paper, pages 9 and 19)

Final Findings and Recommendations

Efficiency of the Notional Model

- 10) The current system of average price setting is likely to substantially improve the growers' bargaining position relative to a market with authorised collective bargaining by growers, making the situation more like a bilateral monopoly.
 - The long-term efficiency impact of a bilateral monopoly over a monopsony market is unclear, with the main impact being a transfer of income from processors to growers.
- 11) The notional model aims to determine the costs of a notional efficient broiler operation. It is important that, if the price setting function of the Act is to continue, the model fee represents the fee that growers would be competing against in a market without the Act (the efficient new entrant).
- 12) If the growers are successful in negotiating a price close to their preferred bargaining position, then the impact on production (relative to a market with authorised collective bargaining) is unclear.
 - However, the Authority considers that the incentives under the Act to improve dynamic efficiency (i.e. to improve the productivity of the industry over time) are less than would be the case without the Act.
- 13) If the Act is to continue then the model should be reviewed and updated by an independent party (e.g. a consultant) appointed by the independent arbitrator to reflect the cost of an efficient new entrant.
- 14) The consultant should carefully examine useful asset lives in the model to ensure that growers are not compensated for the same asset more than once.
- 15) The Act requires clarification to reflect the actual relationship between the notional model fee, the gazetted fee and the average negotiated fee.
- 16) Current cost accounting could be used to value the efficient new entrant in a deregulated market, so can be used to value the notional efficient new entrant. However, the inputs to this calculation should not include an average of all existing growers.
- 17) The cost of this review and update of the model should be borne equally by the growers and processors.

of excess capacity are lower returns to growers and the relatively low cost of making use of available spare capacity.

Despite substantial increases in farm size, industry production has stagnated over the past decade and imports have increased (Bartter Enterprises submission on draft report, p18). This suggests that the economies of scale encouraged by the Act do not increase productivity as much as the dynamic efficiency being obtained in chicken meat industries in other States without such regulation.

The Authority therefore considers that these regulations should be repealed.

Final Findings and Recommendations

Regulations on Participation in Growth Expansion

18) 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 regulations restrict entry into the growing sector and the manner of expansion of existing growers. This can reduce competition in the growing sector and hinder the rate of innovation and efficiency improvement in the industry.

4.6 Impact of the Act on Growth in Investment and Output

The Authority has received evidence from both growers and processors throughout this inquiry that there is a reluctance by growers to invest in new tunnel sheds. That is, there appears to be a hold-up issue in the industry, even under the current legislation (see section 3.4 for a discussion of investment hold-up). Another consideration is the impact of the Act on investment by processors.

4.6.1 Industry Views

Growers submitted that processors use their bargaining power in contract negotiations to try to get growers to convert to tunnel sheds, while growers are reluctant to make significant investments without contractual assurance of sufficient returns on those investments.

All of the Baiada farms [who switched to Finesse Foods] were under duress from the processor [Baiada] who indicated that their contracts would not be renewed unless they converted to tunnel. (WABGA submission on issues paper, p12)

A major expansion of the farm occurred in 2004 which involved replacement and extension of existing sheds and converting them all to tunnel ventilation. This was done at the request and pressure from the processor because the performance from naturally ventilated shedding was deemed by them to be not as good as tunnel ventilation shedding, hence anyone who hadn't converted by July 2010 wouldn't have their chicken growing contracts renewed.

Unfortunately if growers can't expand or convert to tunnel ventilation and contracts aren't renewed there is little use for existing poultry sheds and equipment, unlike other rural

Final Findings and Recommendations

Growth in Investment and Output

- 19) The Authority considers that the Act is likely to deter future processing investment in Western Australia, although it is only one of a range of factors that will influence investment decisions.

4.7 Growth in Productivity

Productivity growth in an industry is generally due to improvements in technology or processes. In broiler production, productivity growth can be measured, for example, by decreases in bird mortality, increased bird numbers and increased bird weight. Other productivity measures may be driven by consumer preferences or retailer demands; for example, the percentage of breast meat, or the number of marketable birds. Productivity improvements could be the result of improvements in housing facilities, feed quality, medicines, genetic stock, or management practices.

The pool payment systems set out in the contracts to growers provide some incentive for growers to achieve productivity improvements, as the payments structures reward growers who achieve higher productivity relative to growers who achieve lower productivity. The performance measures include some productivity indicators (such as feed conversion ratio, bird weight, mortality), but may not capture all of the productivity factors (e.g. percentage of breast meat).

Processors claim that their preference for tunnel sheds is based on the higher productivity of tunnel sheds compared to conventional sheds. It is easier to achieve accurate temperature control in a tunnel shed than in a conventional shed, and there is evidence that high temperatures can lead to a lower meat yield, in particular the breast meat.⁸⁸

This is not to say that tunnel sheds will always perform better than conventional sheds.

- WABGA provided comparisons to the Authority showing that, with good management, conventional sheds can achieve higher productivity than tunnel sheds, particularly if tunnel sheds are not stocked at their full capacity (see Table 4.4 below). The top pool payment for one of the grower groups is often achieved by a conventional shed owner.
- In the draft report the Authority noted that, based on the notional cost model, the move to tunnel sheds has not resulted in marked improvements in productivity, with a 29 per cent increase in input costs required to achieve a 24 per cent increase in the number of marketable birds. However, the Authority accepts that the measurement of productivity in chicken meat production is complex and that all productivity factors would need to be taken into account to draw any conclusions. Further, there is no data on productivity performance in other States to make any comparisons of the relative productivity of Western Australia. The Authority has therefore not further examined productivity for this report.

⁸⁸ For example, Daghir, N. J. (2009), "Nutritional strategies to reduce heat stress in broilers and broiler breeders", *Lohmann Information*, 44(1):6-12, which cites several other studies with the same finding.

Table 4.4 Average Productivity for Conventional Sheds and Tunnel Sheds in Western Australia and Nationally (June 2010)

	Conventional Sheds		Tunnel Sheds	
	WA Average	National Average	WA Average	National Average
Batch rate (per year)	5.66	5.37	5.66	5.57
Birds per square metre	16.05	17.40	20.15	19.57
Mortality (%)	4.75	4.85	4.75	5.60

Source: WA Broiler Growers Association

However, it is most likely that tunnel sheds will, on average, achieve better productivity than conventional sheds. Tunnel sheds provide a more controlled environment for raising birds than a conventional shed (assuming both are well functioning and well managed). New entrants and expansions to the industry are exclusively tunnel sheds and the notional model of an efficient new entrant is based on a large tunnel shed operation. Even if the move towards tunnel sheds is driven by the processors, this is because processors are of the view that this technology is the best means of achieving the requirements set by retailers.

The Act has not provided the contractual security or financial incentives needed by growers to invest in new tunnel shedding. Thus, to the extent that tunnel shedding improves productivity, this means that productivity improvements could have been higher if incentives to invest had been greater.

The Authority also notes that dynamic efficiency in an industry can be harmed if disproportionate levels of resources are directed by industry participants on improving their bargaining outcome, rather than on improving efficiency.

4.8 Impact on Imports

This section examines the relationship between the Act and the level of imports of chicken meat from interstate.

4.8.1 Industry Views

Bartter Enterprises submitted that the falling cost of importing chicken meat from interstate provides a limit to growing fees in Western Australia. Bartter submitted that the cost of transporting chicken from South Australia has fallen, from over 40c per bird in 1975 to a 10-year average from 2000-2010 of around 22c per bird, and that the current gazetted fee exceeded the landed cost of imported broilers from South Australia (Bartter Enterprises submission on draft report, p12-14)

Bartter Enterprises submitted that:

- Western Australia's share of national broiler production between 2005 and 2010 has decreased by 2.4% from the 1987-1997 average of 10.02%; and
- between 2008-2010, processors imported approximately 14.0% of all chicken meat consumed in Western Australia.

(MJA report, p2-3, attachment to Bartter Enterprises submission on draft report)

Final Findings and Recommendations

Impact of the Act on Imports

- 20) The Act is likely to have favoured imports over expanding local production, compared to what would be the case under authorised collective bargaining, by facilitating grower fees above the minimum efficient cost. However, higher costs in Western Australia, driven by the mining industry, are also likely to have played a role in reducing the relative competitiveness of chicken meat production in this State.

4.9 Impacts on Retail Chicken Meat Prices

A further question is whether a higher growing fee, if this were to result from the implementation of an average price regime, would be passed on to consumers in the form of higher chicken meat prices.

The ACCC has noted several factors which can limit the potential for collective bargaining arrangements to increase prices to consumers.

- If collective bargaining arrangements are non-compulsory, growers can choose to opt out of the arrangements (e.g. growers that are more efficient).
- If there is countervailing power in the retail market, processors are less able to raise their margins through higher wholesale prices than by lowering fees to growers.
- The chicken growing fee is a small proportion of the retail price.
- If there is an over-supply of chicken meat in the market, the bargaining power to growers is reduced and there is less scope for an increase in the growing fee.

The Authority considers that some of these limitations to the potential for increases to the growing fee, and therefore to chicken meat prices, are also likely to apply in Western Australia.

- Since the amendments to the Act following the National Competition Policy review in 1997, prescribed form agreements are not compulsory, and growers in Western Australia have the ability to enter into individual contracts with their processor. As indicated in Table 2.4, seven growers in Western Australia are on individual contracts.
- As discussed in section 2.3.4, there is a countervailing pressure on retail chicken meat prices due to a competitive retail sector, with large retailers able to exert some market power on processors.
- The bargaining power of growers is also limited by the potential for imports of chicken meat from interstate.
- The growing fee is small in relation to the retail price for chicken. The gazetted growing fee of 80.57 cents per bird is around 10 per cent of the retail price of whole chickens in the supermarkets, while the actual fee paid to growers of around 71.5 cents is less than 9 per cent.

Final Findings and Recommendations

Impact on Retail Chicken Meat Prices

- 21) Any price efficiencies resulting from reforming the *Chicken Meat Industry Act 1977* are likely to be passed through to consumers in the form of lower prices.

4.10 Prescribed Form of Agreement Between Processors and Growers

In the draft report, the Authority's draft finding was 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 prescribed form agreements provide a statutory basis for minimum terms and conditions in growing agreements, which can be referred to in dispute resolution by the Committee.
- There is sufficient scope to allow for variation in contracts between growers and grower groups to reflect individual circumstances.
- Further, growers can opt out of prescribed form contracts and enter into individual contracts with their processors.

The arguments for and against the prescribed form agreements mirror those associated with the average price regime.

- The growers are of the view that the prescribed form agreements provide them with some protection regarding the minimum terms and conditions of their contracts, supported by the dispute resolution and arbitration powers of the Committee under the legislation.
- The processors, on the other hand, maintain that the prescribed form agreements stifle innovation and efficiency improvements, in that they prevent other forms of contracts from emerging, which could have advantages over the prescribed form contracts. Further, the processors argue that the current dispute resolution framework is not sufficiently independent and is biased in favour of growers.

There is some scope for variation in prescribed form agreements. The Authority has compared the contracts offered to growers of both groups and notes that there is considerable variation between the groups in the terms and conditions of the contracts, and between individual growers, in how their payments reflect performance.

Any growers that are disadvantaged by the prescribed form agreement (for example, growers who are much more efficient than others in their group) can opt to enter into an individual contract.

The Authority's assessment of alternatives to the prescribed form agreements is on the basis of its earlier recommendations, that any dispute resolution mechanism under revised legislation would be independent.

would need to be independently reviewed to ensure that they meet best industry practice. Also, in line with earlier recommendations on the independent mediation and arbitration of disputes, the costs of resolving disputes in relation to legislated minimum contract terms and conditions would be higher than under the current regime.

A more important question is whether such protections are necessary, given the protections that are available in other legislation relating to business contracts. The Authority has sought advice on this matter, which has indicated that there are likely to be sufficient protections available under the *Trade Practices Act 1974* and the *Fair Trading Act 1999* for both growers and processors in their contractual dealings. The provisions in the prescribed form agreement reflect fairly standard terms and conditions that would be expected in a contract between growers and processors, so it is difficult to justify separate legislation particular to the chicken meat industry, compared with any other industries involving contracts between parties.

The Authority's view is that collective bargaining may be effective in providing growers with greater input into the terms and conditions of their contracts. There may also be a role for an industry-based committee to develop a code of conduct regarding the matters that should be addressed in contracts, but the Authority's view is that such a committee would not require government involvement or legislation.

The Authority's view, therefore, is that prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements, as there are sufficient protections available under Australian contract law.

Final Findings and Recommendations

Prescribed Form Agreements

- 22) Prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements as there are sufficient protections available under Australian contract law.

4.11 Administration Costs

The administration costs associated with the Act include the costs of Committee meetings (around twice a year) and the determination of the average price through the cost of production model.

- Administration costs of the Committee are minimal (less than \$1,500 per year) and are borne by the growers and processors, who fund the operations of the Committee.
- Data collection and updating of the cost of production model is carried out by the WABGA free of charge.
- The current Chairman and Secretary of the Committee are employees of the Western Australian Department of Agriculture and Food, so their costs are paid by the Department (around \$6,100 per year).

Final Findings and Recommendations

Administration Costs

- 23) Administration costs under the current regime are low, but would increase significantly if the fee model were to be independently administered and reviewed.
- These higher administration costs are likely to be similar to those under authorised collective bargaining arrangements.
- 24) Administration costs under individual bargaining would be higher than under collective bargaining, due to the duplication of administrative tasks.

4.12 Dispute Resolution and Arbitration Costs

The Committee can determine disputes arising out of prescribed form agreements and disputes in relation to the regulations on participation in growth expansion. Parties may apply to the State Administrative Tribunal to appeal against decisions by the Committee.

The most recent review of the Act, by the Department of Agriculture in 2003, reiterated the recommendations of the NCP review that the arbitration provisions in the Act be retained “as it is an efficient way to resolve disputes between growers and processors and makes it very difficult for aggrieved parties to challenge the arbitrator’s decision”.⁹⁰

4.12.1 Industry Views

Growers’ Views

The WABGA submission on the issues paper and individual growers’ letters as part of that submission showed particularly strong support for the arbitration and dispute resolution functions of the Act. The submission lists a range of disputes that have been dealt with by the Committee over the years. Individual growers submitted that disputes are often avoided due to the prospect of going before the Committee. The WABGA submission notes that the most recent review of the Act, by the Department of Agriculture in 2003, recommended that the dispute resolution and arbitration provisions in the Act be retained.

The growers are strongly supportive of the dispute resolution and arbitration provisions in the Act, which they claim have resulted in more industrial harmony, fewer disputes and lower legal costs when compared with other States that did not have similar legislation.

[T]his current legislation resulted in a dramatic decrease in disputes between processors and growers and improved industry stability. (WABGA submission on issues paper, p6)

In all countries and States within Australia the major disputes are over price negotiation and contracts for growers. To resolve these disputes costs hundreds of thousands of dollars, with the costs in most cases being at the expense of the chicken farmer. The Act in WA has always acted as a back stop thus expensive court cases have not been necessary. (WABGA submission on issues paper, Attachment 1, individual growers submissions, BJ & R Enterprises).

⁹⁰ Department of Agriculture (December 2003), *Review of the Chicken Meat Industry Act 1977*, p5.

- have stricter selection requirements than those established for the selection of independent Committee members, in that arbitrators may be agreed by both parties or appointed by the Institute of Arbitrators or Mediators Australia; and
- are bound by the principles set out in the *Commercial Arbitration Act 1985*.

Other Views

The Department of Treasury and Finance submitted that the current regime does not eliminate disputes:

[H]aving 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. (Department of Treasury and Finance submission on draft report, p14)

4.12.2 Authority Assessment

The Authority 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 model. This provides a deterrent effect on all parties against entering into disputes involving excessive demands that diverge too far from the model. As a result, the arbitration costs under the Act have been minimal.

However, if the deterrent effect of the gazetted fee is too strong (as claimed by processors), this can result in a fee that is too high (see section 4.4).

The Authority accepts that the current mechanism cannot be said to be effective if one party to the negotiations has withdrawn from the process. In line with the earlier recommendation to increase the independence of the Committee and the administration of a model, the Authority recommends that any dispute resolution through the Committee should involve the appointment of an independent arbitrator (e.g. by the Institute of Arbitrators and Mediators Australia). This would involve additional costs.

It is difficult to determine the level of disputes that would arise in the absence of the legislation. The Authority agrees with the ACCC assessment that the most likely outcome for growers, if there were no regulation of the industry, would be that they would be offered a standard form contract in which they would have little influence over the contract terms and conditions. Disputes would need to be resolved through dispute mechanisms specified in the contracts, or through the courts. Small growers may not have the same financial resources as processors to engage in costly legal disputes. However, collective bargaining arrangements can provide scope for the sharing of arbitration costs between growers.

The Authority has examined the experience in other States to determine the level of formal disputes and arbitration (either through industry committees or the court system). Evidence has been provided by growers regarding numerous disputes with processors over contract negotiation (which can often be long, hard fought and difficult) and grower payments, often involving delays in contract renewal or the threat of non-renewal of contract. However, the Authority has found that relatively few cases have been escalated to formal arbitration by industry committees or the courts, considering the number of growers in each State (see review of other States in section 3.5).

If the Act were repealed, the arbitration and dispute resolution processes would be those specified in individual contracts. It is essential that these are consistent with best industry practice and provide sufficient protection to growers regarding their returns and contract

terms and conditions. However, the Authority's view is that such provisions can be successfully agreed between grower groups and processors in contract negotiations and that collective bargaining by grower groups can help to ensure that grower concerns are addressed.

Final Findings and Recommendations

Dispute Resolution and Arbitration Costs

- 25) The dispute resolution and arbitration mechanisms under the current legislation are low cost, but are not operating effectively. Appointment of an independent arbitrator to resolve disputes would be highly desirable, even though it would increase costs.
- 26) Dispute resolution under authorised collective bargaining arrangements or individual contracts requires independent, best practice dispute resolution processes in order to avoid substantial legal costs to industry participants.

4.13 Transaction Costs

Collective bargaining, such as that provided by the Act, can lower the transaction costs associated with contract negotiations. Costs which would otherwise be incurred by each grower in individual negotiations with their processors are instead incurred once by the collective. The reduction in transaction costs associated with collective bargaining arrangements is one of the benefits cited by the ACCC in its decisions to authorise such arrangements for other grower groups.⁹⁴

The transaction costs associated with an amended legislative regime (incorporating an independent pricing model) is likely to be similar to that under an ACCC authorised collective bargaining arrangement, since both approaches involve collective negotiations by growers with their processor.

It is difficult to quantify the savings in transaction costs associated with the current legislation (or an amended legislation), relative to what they would be under a market without the Act and based on individual contracts. The benefits of lower transaction costs accrue mainly to growers, but also to processors. However, competition in the retail sector and market power by large retailers could result in some of these savings being passed through to consumers.

However, if the Act and Committee were reformed as suggested in sections 4.3 and 4.4, the administrative cost of the Act would increase dramatically. This would lessen the advantage of the Act over commercial mediation and arbitration on a case-by-case basis. The Authority has not examined the exact costs of each method, but the Act would likely retain some advantage, although a reduced one over the Authority's view in the draft report.

⁹⁴ For example, ACCC (21 April 2010) determination on collective bargaining by chicken meat growers in Victoria.

Final Findings and Recommendations

Transaction Costs

- 27) It is likely that collective bargaining, under ACCC authorisation or through a legislative mechanism that includes an independent pricing model, would result in similar savings in transaction costs relative to individual agreements.

5.1.1 Different Gazetted Fee for Different Groups

If there is a difference in productivity between the two main grower groups, an industry-wide average fee may not be appropriate. For example, productivity may differ between groups due to the quality of inputs by processors, such as feed, chicks, medicines, etc. In this case, an industry-wide average fee would disadvantage growers in the less efficient group, whose costs are higher than the efficient group. A “one size fits all” approach to collective bargaining can be anti-competitive in that it reduces the competition that could occur between grower groups. It can also discourage entry by new processors that do not have the economies of scale of the larger processors.

The 1997 review of the Act considered whether the industry level fee was appropriate and concluded that at the time there was little difference in productivity between the two groups of growers, with a maximum difference of 1 to 1.5 cents per bird. However, it was noted that the industry-wide average price could potentially impact on any third processor. The review therefore concluded that company level bargaining should be considered if the productivity of the two groups were to diverge significantly, or if there was the scope for a third processor to enter the market.

5.1.2 Price Flexibility

The capacity for processors to offer above the negotiated average fee should exist. This is because some growers are on land that is very valuable for other purposes (e.g. housing) and if only offered the negotiated average fee, might decide that they would be better off by leaving the industry and selling their land. However, if the cost of expanding production in a new operation is exorbitantly high, the processor might be better off to offer the existing grower above the adjusted gazetted fee to stay in production without affecting the rest of the group.

Final Findings and Recommendations

Differences in Productivity between Grower Groups

- 28) If an average price regime were to be retained, the model should allow for the determination of different average fees for each grower group to reflect the specific demand and supply conditions within each group.

5.2 Option 2: Repeal the Act.

The second, and processor preferred, option is to repeal the Act. The Western Australian industry would move towards the structure of those in other States with a mix of individual contracts and authorised collective bargaining.

- The growers would most likely seek and gain ACCC Authorisation to bargain collectively, which means an average price still might exist, which would give a bias against expansion.
- Nevertheless, with the backstop of the gazetted fee removed, processors may be able to offer higher fees for new capacity without affecting the price that they pay to the collective growers.

capital investments had been made, potential new growers considering entering the industry would become aware of these practices and the processors would fail to get the expansion they needed.

Final Findings and Recommendations

Costs and Benefits of the Act Compared to Alternative Approaches

- 29) The benefits of the *Chicken Meat Industry Act 1977* are unlikely to outweigh its costs.
- 30) There are likely to be alternatives available for strengthening the bargaining power of growers, such as authorised collective bargaining, that would not have the costs associated with the Act.
- 31) The *Chicken Meat Industry Act 1977* should be repealed.

5.4 Implementation Issues

The Authority notes that if the Act is repealed adjustment costs may be incurred, especially for those who have just entered the industry and have incurred high debts on the expectation of a revenue stream based on the prices derived from the notional model under the Act. The adjustment costs have been considered by the Authority in reaching its final recommendations. In making its decision the Authority has had to consider likely aggregate costs to society as a whole.

The Authority accepts the growers' argument that they have few alternatives for their production facilities. The Authority does note, however, that some growers own land that has considerable value as residential land. Nevertheless, the Authority accepts that not all growers have such options and it is possible that, if the Act is repealed, some growers could be financially disadvantaged during the transition.

However, the Authority notes that processors are dependent on growers and it is not in a processor's interest to force the price down so low that some technically efficient growers would leave the industry. If a processor were to drive price down to a level that bankrupted an indebted grower, the processor would have to replace that production, which, unless the grower were particularly inefficient, could be more expensive than the lost production.

The experience in South Australia, Queensland and Victoria has shown that, despite considerable grower concerns in these States preceding the move away from industry regulation, new contracts have been signed and new capital investment has been attracted to both the growing and processing sectors.

Appendix C. Glossary

ACCC	Australian Competition and Consumer Commission
Act	<i>Chicken Meat Industry Act 1977</i>
Authority	Economic Regulation Authority
CMIA	<i>Chicken Meat Industry Act 1977</i>
Committee	Chicken Meat Industry Committee
ERACCC	Economic Regulation Authority Consumer Consultative Committee
NCC	National Competition Council
NCP	National Competition Policy
TPA	<i>Trade Practices Act 1974</i>
USDA	United States Department of Agriculture
VFF	Victorian Farmers Federation
WABGA	Western Australian Broiler Growers Association