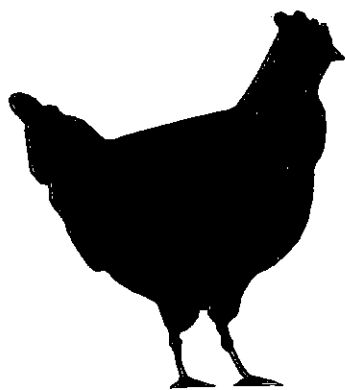


**REPORT OF THE CHICKEN MEAT
INDUSTRY REVIEW COMMITTEE
TO THE MINISTER FOR PRIMARY INDUSTRIES**

**REVIEW OF THE *CHICKEN MEAT
INDUSTRY COMMITTEE ACT 1976***



**WITH EMPHASIS ON THE SETTING OF
GROWER FEES AND ASSOCIATED
AGREEMENTS IN QUEENSLAND**

**A LEGISLATIVE REVIEW IN ACCORDANCE
WITH NATIONAL COMPETITION POLICY**

NOVEMBER 1997



**QUEENSLAND
GOVERNMENT**

DPI
QUEENSLAND
**DEPARTMENT OF
PRIMARY INDUSTRIES**



FOREWORD

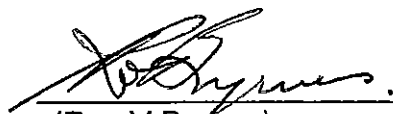
This Report has been prepared by the Chicken Meat Industry Review Committee in addressing the Terms of Reference as provided by the Honourable the Minister for Primary Industries, Trevor Perrett, MLA, as part of the program of reviews required under National Competition Policy guidelines.

The Review Committee, comprising an independent Chairman, representatives from the Chicken Meat Industry Committee (CMIC), processors, growers, an independent lawyer also representing consumers, a Government official from the Department of Primary Industries, and with an observer from Queensland Treasury, began the process of review in July 1997. It subsequently met on twelve occasions to discuss issues relevant to the Review and to consider submissions from members and other interested parties and individuals. The Committee has been mindful of the need to provide the industry with a framework within which it could build a sustainable future.

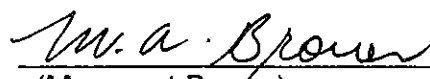
The Committee's findings are based on the outcomes of the public benefit test conducted in accordance with guidelines developed by the Government for such National Competition Policy reviews. The assessment is based on a comparison of a restrictive legislated option and a less restrictive legislated option with a deregulated industry state. While not being unanimous in its views with regard to the public benefit test outcome regarding the consequences of the selected options and recommendations, the need for amended legislation is recommended by all the Committee. Areas of dissent are emphasised within the Report and reservations will be reflected in a formal report by the Growers' Association to the Minister.

The assistance of officers from the Department of Primary Industries is gratefully acknowledged. The secretariat of the Committee (Mr Matthew Rintoul) was provided by the Department. The Public Benefit Test was undertaken by Mr. Ross Culpitt and Mr. Blair Bartholomew, as was the assembly and analysis of much of the data presented.

The Committee commends the Report to the Honourable the Minister.



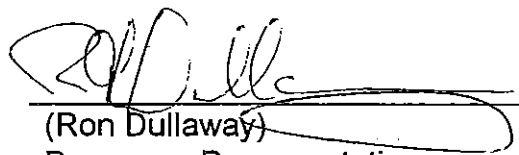
(Ray V Byrnes)
Independent Chairperson



(Margaret Brown)
Independent/consumer



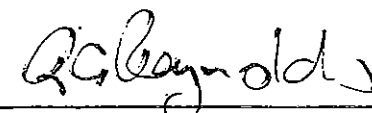
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Growers representative



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Processor Representative



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Chair CMIC



(Russ Reynolds)
Government Representative

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GLOSSARY OF TERMS

Australian Competition and Consumer Commission (ACCC)	The merger of the Trade Practices Commission and the Prices Surveillance Authority in 1995 formed the ACCC to ensure compliance with the Trade Practices Act 1974.
Chicken Meat Industry Committee (CMIC)	Industry Committee established under the Chicken Meat Industry Act in 1976 to act as a contract negotiation, price determination and dispute resolution mechanism.
Collective bargaining	The process by which a 'processor group' of individual growers would collectively undertake formal negotiations regarding contractual details.
Competition Principles Agreement (CPA)	A formal agreement reached by the COAG to apply the National Competition Policy.
Consumer surplus	The difference between what the consumer is prepared to pay for a good or service and what the consumer actually pays.
Council of Australian Governments (COAG)	A forum of state and territory governments that regularly meet to discuss policy.
Economic rents	The difference between the payments made to a factor of production and the minimum amount that must be spent to obtain the use of that factor.
Elasticity of demand	The percentage change that will occur to demand in response to a 1% change in price.
Elasticity of supply	The percentage change that will occur to supply in response to a 1% change in price.
Feed conversion ratio	The amount of feed consumed to produce one kilo of final chicken weight.
Greenfield development	A chicken growing farm that has been established on a previously undeveloped site.
Growing fee	An amount paid by a processor to a grower for the growing of chickens.
Horizontal integration	The acquisition of the operations of another processor (grower) by another processor (grower) at the same level in the production/marketing chain.

Increasing globalisation	The tendency for trade to become more international in its focus resulting from greater pressures towards domestic and non-domestic trade liberalisation.
National Competition Policy (NCP)	Formal policy framework endorsed by COAG designed to increase level of competitiveness in order to enhance the Australian economy.
Processor negotiating group	A formal group of growers established to negotiate growing contracts with a specific processor.
Producer surplus	The sum over all units of production of the difference between the market price of the good and the marginal cost of production.
Productivity	Increased output per unit of input or, production of standard size bird using inputs at less cost.
Public Benefit Test (PBT)	Cost benefit analysis designed to assess level of 'public benefit' accruing to the community as a whole associated with specific legislation and alternatives to that legislation.
Qualifying grower contract	Under the current arrangements, a grower with a current and valid contract, therefore enabling grower and processor to engage in commercial activity.
Quartile	A quarter of the ranked data.
Review Committee	The Queensland Chicken Meat Industry Review Committee.
Super Normal Profits	Profits that reflect the existence of, and occur as a result of, 'economic rents'.
Vertical integration	The acquisition by an industry participant of other aspects of chicken meat production and/or distribution at another point in the production/distribution chain.



SUMMARY

The chicken meat industry in Queensland is made up of 111 contract growers supplying three major processing enterprises, Inghams Pty Ltd, Steggles Limited and Golden Cockerel Pty Ltd. A key characteristic of the chicken meat industry is that growers are, in the main (apart from company farm operators) suppliers of technical on-farm services under contract to a processor. It is the processor who remains in ownership or control of large and vital parts of the production process including the growing birds, feed, the provision of technical and veterinary services and the uptake of live birds for processing.

The Queensland chicken meat industry, and contract growing in particular, has operated under state legislation since the introduction of the *Chicken Meat Industry Committee Act 1976*. This legislation provides for the Chicken Meat Industry Committee (CMIC) to approve contracts between processors and growers for the growing of meat chickens from day-old chicks to marketable age for processing. Another central role of the CMIC is to mediate on contractual disputes that may occur.

This CMIC Act provides a statutory framework for negotiations which, without the State legislative provisions, could be interpreted as an *anti-competitive restriction on business conduct*. This is because the CMIC recommends the fee, has the power under the Act to both negotiate and approve the fee, and mediate on contractual disputes. Growers benefit because the CMIC Act enables them to collectively negotiate as an industry block and so they gain countervailing power and minimise transaction costs. Processors benefit because one growing fee is common across the industry. They have knowledge of competitors' contracts, transaction costs are minimised and at least one major basis for competition, namely the growing fee, is eliminated.

As Section 51 of the *Trade Practices Act 1974* presently exempts activities specifically authorised by a State Act, conduct consistent with the provisions of the Act is authorised. However, on 21 July 1998 an amendment to Section 51 will take effect which will make such legislative authorisation ineffective. Consequently, the CMIC Act has been identified as one which is required to be reviewed in accordance with National Competition Policy (NCP) guidelines.

Increasing competition throughout the economy is a key to higher productivity and growth and is central to the Competition Principles Agreement (CPA) under which the NCP arrangements were endorsed by the Queensland Government along with other members of the Council of Australian Governments (COAG) in April 1995.

The NCP guidelines require that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs [as assessed by conducting a Public Benefit Test (PBT)]; and
- the objectives of the legislation can *only* be achieved by restricting competition.

If a net public benefit cannot be shown or the results of the PBT are inconclusive, the legislation is required to be amended to remove restrictions.

In meeting the NCP Terms of Reference, the Chicken Meat Industry Review Committee (the Review Committee) was required to identify at least one restrictive legislative state and an unrestrictive state. For each option, including for the deregulated state, it was required to develop an accurate description of the likely market structure and to describe the economic/financial status of all affected groups. Central to deliberations was the influence and effect the CMIC had on competition and what costs accrued to the 'community as a whole', rather than just on industry participants as a result of the legislated industry structure.

A Discussion Paper was prepared and together with an invitation to make a written submission, was extensively circulated to all interested individuals and organisations. The Review Committee received fifteen formal submissions from a variety of individuals and organisations, including major processors and contract growers. These submissions and the expert views of the Review Committee members were utilised to identify a series of options that varied (by differing degrees) from the current regulated state to a less restrictive case, to a least restrictive legislative case and an unrestrictive deregulated environment. The characteristics of each of these different states were analysed and are summarised in Table 1.

The current legislative framework was considered to be unduly restrictive. Consequently, having regard to the submissions received and its own deliberations the Review Committee rejected the options of either strengthening the current CMIC Act to enable current practices to continue or retaining the current Act and modifying practices of the CMIC to ensure practices are authorised. Significantly, this was the common view of both Inghams and Steggles, the Queensland Chicken Growers Association and, with reservations, by the CMIC itself.

In accordance with the Committee's Terms of Reference and Queensland Treasury methodology, a Public Benefit Test (PBT) was conducted on the two other specific options identified as desirable by the Committee (Options 6.3a and 6.3b respectively) as contrasted to the unrestrictive case (Option 6.6).

The majority of Review Committee members concluded that the PBT identified a net cost to the community as likely to result from implementation of the less restrictive Option 6.3a. In general, the costs incurred by the community as a whole, principally in the form of higher retail prices compared to the unrestrictive case, out-weigh the benefits of the restrictions. Specifically, the higher retail prices are associated with the restrictions which allow above normal profits to be earned by the contract growers. The resulting reduction in consumer welfare is significantly greater than the savings in transaction costs. These transaction costs/savings resulted from the ability to undertake collective negotiation which reduced bargaining and decision costs and search, information, policing and enforcement costs. Both growers' and processors' submissions had highlighted the importance of minimising these costs.

TABLE 1. CHARACTERISTICS OF REGULATORY STATES CONSIDERED.

ATTRIBUTE	CURRENT LEGISLATION	LESS RESTRICTIVE LEGISLATION (OPTION 6.3A)	LEAST RESTRICTIVE LEGISLATION (OPTION 6.3B)	UNRESTRICTIVE CASE (OPTION 6.6)
1. Guidelines for agreements (minimum conditions)	CMIC sets	CMIC sets	CMIC and/or industry bodies recommend	Industry bodies recommend
2. Examination of agreements to ensure guidelines followed and approval of agreements	CMIC examines and approves	CMIC vets agreements but no approvals	None	No vetting or approval and there is the ability to have flexible fee arrangements
3. Requirement for a <u>written</u> contract	Compulsory	Compulsory	Compulsory	None
4. Collective bargaining negotiation process between processors and growers	CMIC sets common agreement for all	Individual processor negotiating groups	Individual processor negotiating groups	None without ACCC authorisation
5. Ability to opt out of individual processor negotiating groups	none	Yes with 'transparency' of contract	Yes	Not Applicable
6. Determination of the initial growing fee and other contract conditions for new contracts (for a negotiating group or individual for a given period)	CMIC approves fee for all contract growers	Processor or individual grower negotiating groups with recourse to mediation & determination by independent tribunal or arbitrator	Market determined between processor and grower negotiating groups or individual growers	Market determined between processor and individual grower
7. Mediation of disputes relating to existing contracts, excluding growing fee adjustments	CMIC role and determination	CMIC or like body	CMIC appointed mediator	Courts
8. Arbitration of disputes arising from negotiation of new contracts, including disputes relating to the growing fees	CMIC role	Independent arbitrator	None	None
9. Determination of disputes under existing contracts, including those relating to batch payments	CMIC role	CMIC appointed independent arbitrator under legislation	CMIC appointed independent arbitrator under legislation	Courts
10. Determination of disputes relating to growing fee adjustments under existing contracts	CMIC role	CMIC or like body	Formal mediation & arbitration under legislation (not CMIC)	By agreement

Economic rents earned by contract chicken growers represent the value of future super-normal profits. In other words, a purchaser of a growing farm would be able to pay more for assets with a 'real' value less than the purchase price. This gain to the growers is a transfer from consumers, via the processors, because consumers are asked to pay a higher price than would be asked in a perfectly competitive market. The best estimate the Committee could derive, based upon capital valuations supplied by the Growers' Association and the CMIC Model data, was that in aggregate Queensland consumers of chicken and chicken meat products could be potentially better off by up to \$3.26 million per annum. On the other hand the possible reduction in the actual cost of growing chickens following deregulation constitute an efficiency gain and not a transfer between industry groups. How much further this average cost could be reduced by the relaxation of entry restrictions and restrictions on contract transferability is not expected to be significant. However, a redistribution of output amongst growers should lead to a fall in average costs resulting from the redistribution of growing contracts from poorer performing growers to better performing growers. It should be noted that in the aggregate these previously listed factors represent around six cents per kilo on all chicken meat sold in Queensland.

Again using the industry data, it is estimated that in an unrestrictive state, in the aggregate, current growers of chicken could be worse off by an amount of \$2.27 million per annum. This represents a decline in average annual farm incomes of approximately \$20,000. This follows from the predicted fall in the growing fee as a result of competition and removal of rents, and further falls in the growing fee subsequent to productivity improvements and industry restructuring. Potential new growers would find it easier to enter the industry as property values would decline, and processors of chicken meat are expected to be better off by approximately \$295,000 as a result of savings in non-grower live bird costs subsequent to restructuring of the industry.

However, in the opinion of the CMIC and the Grower's representatives, Option 6.3a will not lead to a net cost on the community. These members disagree with the methodology and the data used to ascertain the benefits and costs of this particular option. Specifically, they claim insufficient consideration was given to non-quantifiable factors such as public health and safety, industry stability and investor confidence in conducting the PBT. They noted that prior to the introduction of the current legislation in 1976, the industry was characterised by numerous time consuming and costly disputes between growers and processors. It is the view of the CMIC and the Growers that this 'industry harmony' since 1976 has been responsible for promoting investor confidence in the industry and the achievement of substantial falls in the real price of chicken meat through the attainment of productivity gains. If further deregulation were to result in a reduction in live bird costs, potential consumer gains would be captured by major chicken retailers and chicken meat processors thereby reducing the benefits to the community of any price reduction. They note that there currently exists a significant degree of flexibility in the determination of growing fees beyond the direction of the CMIC which has not been taken into account in the analysis. Also, the current CMIC Act does not prevent processors from discriminating in favour of better and against poorer performing growers in the pursuit of lower growing costs.

As the costs in the less restrictive state were greater than the benefits, the majority of the Review Committee considered that it was necessary to examine whether the least restrictive legislative Option 6.3b provided a public benefit. It was shown to have the benefits of reduced transaction costs similar to Option 6.3a since it also provides for a collective bargaining process of negotiation between processors and growers. The legislation would also have an external dispute resolution mechanism to address disputes relating to compliance with existing contract conditions. However, in contrast to Option 6.3a this option does not lead to costs on consumers since it is less restrictive and allows any potential fall in growing fees and productivity gains to be realised through competition in the determination of the growing fee. This mechanism would mean that the CMIC would not negotiate growing fees, or participate in dispute resolution on growing fees or adjustments to growing fees and would not approve or disapprove contracts. Collective negotiation would not be compulsory. Individual growers and processors could undertake negotiations beyond the scrutiny of their specific processor negotiating groups.

The majority of the Review Committee concluded that a net public benefit would exist from implementation of the least restrictive option, namely Option 6.3b, and therefore enabling legislation should be introduced. Specifically, the Review Committee recommends that the *Chicken Meat Industry Committee Act 1976* be redrafted so that the amended legislation allows a process of collective negotiation between processors and growers. It would also be the intention of this legislation that an external dispute resolution mechanism be identified to address disputes relating to compliance with existing contract conditions. A minority of the Committee concluded that the amended legislation should also allow arbitration in the initial determination of new contracts (ie.. the periodic renewals of contracts) including the growing fee.

LISTING OF KEY FINDINGS AND RECOMMENDATIONS.

Chapter 1.

The Queensland Chicken Meat Review Committee considers that the PBT here undertaken meets the requirements of the CPA and was used to quantify the net benefits of a potential legislative option which restricts competition. The framework adopted is that a legislative option needs to be justified in that the benefits of the restriction to competition to the wider community as a whole outweigh the costs, and that the net benefit cost situation for that option is greater than for both the deregulated case and for other restricted competition states.

Chapter 2.

The Review Committee concluded that the current legislative framework is unduly restrictive. Consequently, the options of either strengthening the current CMIC Act to enable current practices to continue (Option 6.1) or retaining the Act as currently written and modifying practices of the CMIC to ensure practices are authorised (Option 6.2) were rejected.

The options of either Industry Authorisation (Option 6.4) and Individual Processor Authorisation (Option 6.5) by the Australian Competition and Consumer Commission (ACCC) were considered as potentially providing a temporary arrangement to enable the setting of a fee and a dispute resolution mechanism in the manner proposed in South Australia. However, the Review Committee notes that application to the ACCC for any authorisation is a matter for the industry and consequently is outside the scope of the Committee's deliberations.

The Committee concluded that in accordance with its Terms of Reference, the 'options' to be considered and the subject of a Public Benefit Test (PBT) in accordance with Queensland Treasury methodology, were to be the less restrictive legislated state (ie. Option 6.3a) and the least restrictive legislated state (ie. Option 6.3b). These two options were compared with an unrestrictive state (ie. Option 6.6).

Chapter 3.

The Review Committee accepted the existence of a significant 'negotiating power differential' which would normally exist when an individual grower enters contractual arrangements with a processor.

Recommendation 3.1.

Consequently the Committee recommends overcoming this imbalance through legislation which provides countervailing power.

Chapter 3 cont.

The Committee concluded that the setting of fees is a contractual issue and that the ability of the CMIC to set or approve a growing fee is inappropriate and inconsistent with NCP guidelines.

Recommendation 3.2.

The Committee recommends that the power of the CMIC to set or approve a growing fee not be included in any amended or new legislation.

Transaction costs pose an important issue in the chicken meat industry. Indeed it is the level and impact of these costs that give rise to many of the concerns of growers. While processors are concerned about the level of search and information costs in a deregulated environment; growers are more concerned about bargaining, decision, policing and enforcement costs. However, the transaction costs involved in policing and enforcement can be minimised if an appropriate regulatory but non-restrictive environment is in place. Such an environment would do much to allay the fears of growers about unequal bargaining and enforcement powers. The Committee concludes that transaction costs will be greater in a deregulated state.

Recommendation 3.3.

The Committee recommends that transaction costs be minimised with 'an appropriate regulatory but less restrictive environment' which allows for growers' groups to collectively bargain with their processor, such as would occur under both Option 6.3a and Option 6.3b.

Central to many submissions received including those of the CMIC and the QCGA, has been the importance of a formal mechanism of dispute resolution.

Recommendation 3.4.

The Committee recommends the inclusion of a dispute resolution mechanism to address disputes relating to contractual obligations, performance and adjustments to growing fees under existing contracts.

Recommendation 3.5.

Consequently the Review Committee recommends that an independent body be identified that will assist in the mediation and arbitration of disputes between growers and processors relating to existing contract provisions.

However, an independent body established to arbitrate in the determination of growing fees as a base fee for new contracts will lead to 'price setting' intervention by a third party. Even if market forces are required to be taken into account this will restrict competition relative to the unregulated case.

Chapter 4.

The Committee recognised that the pooling system does provide a degree of incentive for efficiencies in growing chickens. However, a more appropriate payment system would be one that more closely reflects grower performance in terms of costs per kilogram delivered to the processing plant.

Consequently, the Committee expects that its recommendations will allow for more flexibility in contract conditions, determination of the growing fee, and in processors being better placed to penalise poorer performance and provide greater rewards to better performing growers.

Chapter 5.

The Committee has accepted the processors' position, namely that a less restrictive environment would promote efficiencies which would assist in countering domestic competition from other meats and imported chicken meat. The capacity of the processor to achieve least cost production of chickens through individual contract negotiation and increased flexibility is likely to improve with a move to a less restrictive environment.

Recommendation 5.1.

Consequently the Committee recommends the adoption of a less restrictive legislated industry structure.

Chapter 6.

The Committee appreciates that increased efficiencies have resulted in comparatively high levels of chicken meat consumption primarily due to declining real retail prices of chicken. Gains in efficiencies can be further attained with a move away from the industry based grower fee determination to a less restrictive environment. However, transaction costs, the maintenance of a degree of 'rents' and retail market behaviour could reduce potential efficiencies and gains to society generally. Another important factor is the lack of countervailing power in the growing sector without collective negotiation.

Recommendation 6.1.

Consequently, the Review Committee recommends the adoption of a less restrictive but legislated industry structure that promotes potential industry efficiencies and gains to society.

Chapter 7.

The Committee acknowledged that the adoption of the less restrictive legislative option (6.3a) would require it to satisfy the PBT by providing net benefits to the community.

However, the PBT identified that there was a net cost to the community of the less restrictive Option 6.3a. The costs incurred by the community as a whole, principally in the form of higher retail prices compared to the unrestrictive case, out-weigh the benefits of the restrictions. The higher retail prices are associated with the restrictions allowing above normal profits to be earned by the contract growers. The resulting reduction in consumer welfare exceeded the savings in transaction costs. These savings resulted from the ability to undertake collective negotiation which minimises bargaining and decision costs, and search, information, policing and enforcement costs.

Dissent was expressed by representatives from the CMIC and Growers regarding the methodology and the data used to ascertain benefits and costs. In acknowledging the need to move toward less regulation they view Option 6.3a as appropriate. Specifically, they contend that the inclusion of collective negotiation and compulsory arbitration on growing fees and other contract conditions for new contracts will not result in Option 6.3a failing the PBT.

However, in the view of the majority of the Review Committee the PBT has indicated that Option 6.3a leads to a net cost to the community by the maintenance of restrictive practices. Consequently, as Option 6.3a did not satisfy the PBT, the Committee, by majority, rejected this option and identified an alternative option, Option 6.3b, for review.

Chapter 8.

The least restrictive legislative option, namely Option 6.3b, was similar to Option 6.3a with the essential difference that no arbitration (or mechanism for setting the growing fee when it failed to be determined by negotiation) is provided for during initial contract negotiation. Option 6.3b was subsequently shown to provide a net public benefit and hence satisfies the PBT criterion. It was shown to have the benefits of reduced grower rents, potential productivity gains and lower transaction costs. These gains arise in part since it provides for a collective bargaining process of negotiation between processors and growers. It would also be the intention of this legislative option that an external dispute resolution mechanism be identified to address disputes relating to compliance with existing contract conditions and determination of disputes relating to the adjustment of growing fees during the period of existing contracts.

In contrast to Option 6.3a this option does not lead to costs on consumers. Transfers from consumers to growers in the form of super normal rents could not be said to result from such legislation. Further, the very substantial transaction costs which would arise in a totally deregulated state are avoided.

Chapter 8 cont.

Recommendation 8.1.

Consequently, the Committee recommends that legislation consistent with Option 6.3b should be introduced. Specifically, the Review Committee recommends that the Chicken Meat Industry Committee Act 1976 be redrafted to provide for:

- *a process of collective negotiation between individual processors and their grower groups; and*
- *an external dispute resolution mechanism to address disputes relating to contracts, including growing fee adjustments during existing contracts but excluding the negotiation of initial contract conditions.*

The Committee concluded that if Option 6.3b were adopted the gains from the move to a less restricted environment would flow while adjustment costs will be minimised. Moreover, the collectively agreed actions of processors and growers would ensure that adjustments were not so severe as to cause industry displacement or instability. Therefore, the Committee considers that a transition arrangement would not be necessary.

Chapter 9.

Recommendation 9.1.

Because the least restrictive legislative (Option 6.3b) case still has collective bargaining provisions it may be argued that this process and contracts resulting from this structure would be in potential breach of the TPA beyond 21 July 1998. Consequently, the Committee recommends that explicit TPA exemption authorising this conduct be included in the amended CMIC Act.

Chapter 10.

Recommendation 10.1.

The Review Committee acknowledges that the option continues to exist for industry bodies to seek authorisation from the ACCC. The Committee declined to recommend any action in this regard because it concluded that such action would be outside of its Terms of Reference.

1. BACKGROUND

1.1 The chicken meat industry in Queensland

The chicken meat industry in Queensland is substantially made up of 111 contract growers supplying three major processing enterprises, Inghams Enterprises Pty Ltd, Steggles Limited and Golden Cockerel Pty Limited. Golden Cockerel Pty Limited are also supplied by company farms and through corporate arrangements through Darwalla Milling Company Pty Ltd and Woodlands Enterprises. There are a number of smaller processing establishments which purchase live birds from Darwalla or Woodlands for their own processing.

The chicken meat industry is a unique primary industry in that growers are, in the main (apart from company farm operators) suppliers of technical on-farm services under contract to a processor. It is the processor who remains in ownership or control of large and vital parts of the production process; including the growing birds, feed, the provision of technical and veterinary services and the uptake of live birds for processing.

The chicken meat industry is characterised by a small number of processors which are supplied with chickens by a large number of growers. Processors need to have chickens available at all times to meet demand for a high quality product.

The industry is founded on high volume and low profit margin. Industry stability is largely dependent on the successful negotiation of contracts including the price paid by processors to growers.

1.2 The Act to be reviewed

The Queensland chicken meat industry (contract growing) has operated under the direction of state legislation since the introduction of the Queensland *Chicken Meat Industry Committee Act 1976*. When introduced on 3 June 1976 it was clear that its major purpose was the stabilisation of the chicken meat industry and the establishment of a Chicken Meat Industry Committee (CMIC).

Prior to the introduction of the Act the chicken meat industry in Queensland was characterised by continued disagreement between growers and processors. The major issues were what constituted a fair and equitable return to growers in terms of the growing fee paid for broiler chickens, and the terms and renewal of formal growing contracts. This scenario was not unique to Queensland but common to most other states. In response, the Australian Agricultural Council in 1974 proposed that model legislation regulating certain activities within the industry be drafted for all states. All states (excluding Tasmania) enacted chicken meat legislation which included the establishment of an industry/negotiating committee.

The intention of Queensland's *Chicken Meat Industry Committee Act 1976* was to provide the industry with a mechanism for discussion and negotiation of the growing fee in an orderly manner. The desire was to let the industry determine its own pricing arrangements without the overt interference of government and to leave the industry as unfettered as possible.

The functions of the CMIC are provided at Section 16(1) of the Act and are as follows:

- a) to set guidelines for the assistance of processors and growers in drawing up agreements;
- b) to examine agreements;
- c) to approve agreements satisfactory to the Committee;
- d) to mediate in disputes between processors and growers (including disputes as to the assessment of amounts payable under agreements);
- e) to negotiate prices between processors and growers;
- f) to advise the Minister on any matter relating to the chicken meat industry referred to it by the Minister;
- g) such other functions as are prescribed.

The *Chicken Meat Industry Committee Act 1976* provides a statutory framework for negotiations which, without the State legislative provisions, could be interpreted as collusive behaviour, or an *anti-competitive restriction on business conduct*. This is because Section 20 of the Act requires that a processor shall not receive, and a grower shall not supply, broiler chickens except in accordance with the terms of an agreement in writing between the grower and the processor which has been approved by the Chicken Meat Industry Committee.

As Section 51 of the *Trade Practices Act 1974* presently exempts activities specifically authorised by a State Act, conduct consistent with the provisions of the Act is authorised. However, on 21 July 1998 an amendment to Section 51 will take effect which will make such legislative authorisation ineffective.

This legislation only provides for arrangements between processors and growers for the growing of meat chickens from day-old chickens to marketable age for processing. There is no direct impact as a result of this legislation on the marketing of meat chickens by processors to retailers or direct to the consumer. The growing fee paid by the processor to the grower represents around 10% of the retail price for a fresh chicken. It is also noted that there is little evidence of any direct relationship between market fluctuations in the retail price of chicken and variations in the growing fee as provided for under the legislation.

1.3 The National Competition Policy (NCP) Framework

The Queensland Government is undertaking this Review of the *Chicken Meat Industry Committee Act 1976* to meet its commitment under the Competition Principles Agreement (CPA). The Review was conducted in terms of the required criteria with a view to assessing the costs and benefits of any restrictions on competition proposed for continuation in legislation and considering alternate means of achieving the required outcomes.

The CPA under the NCP arrangements was endorsed by members of the Council of Australian Governments in April 1995. This agreement commits the Queensland Government, by the year 2000, to review and reform where necessary any legislation which restricts competition.

Central to National Competition Policy principles, recent Queensland government initiatives require that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs [as assessed by conducting a Public Benefit Test (PBT)]; and,
- the objectives of the legislation can *only* be achieved by restricting competition.

The Queensland Chicken Meat Industry Review Committee considers that the PBT here undertaken meets the requirements of the CPA and was used to quantify the net benefits of a potential legislative option which restricts competition. The framework adopted is that a legislative option needs to be justified in that the benefits of the restriction to competition to the wider community as a whole outweigh the costs, and that the net benefit cost situation for that option is greater than for both the deregulated case and for other restricted competition states.

1.4 The Review Committee and its Terms of Reference

A NCP Chicken Meat Industry Review Committee was formed with its membership, at the invitation of the Minister of Primary Industries, comprising representatives of all sectors of the industry, the Government and independents. The Committee was comprised of the following representative members:

<u>Sector</u>	<u>Representative</u>
Independent Chair	Mr Ray Byrnes
Independent Member	Ms Margaret Brown
Processors (Steggles Ltd)	Mr Ron Dullaway
Growers	Mr Gary Sansom
CMIC	Mr Merv Stubbins
Government	Mr Russ Reynolds

An Officer from the National Competition Policy Unit, Queensland Treasury (Mr Laurie Trueman) attended meetings in an adviser capacity regarding NCP matters.

At its first meeting, the Committee received and noted its Terms of Reference. These are detailed at Attachment A.

1.5 Process of the Review

At its first meeting, the Committee agreed to the following process for reviewing the *Chicken Meat Industry Committee Act 1976*.

- Assess the previous recent review of the legislation and industry structure.
- Call for submissions from all interested organisations and individuals. This process was assisted by the drafting and distribution of a comprehensive Discussion Paper and the publication by advertisement in several regional and metropolitan newspapers of the purpose of the Review and the availability of the Discussion Paper.
- Identify possible industry structure alternatives for general comment through the drafting and distribution of the Discussion Paper.
- Having regard to the National Competition Policy (NCP) guidelines, including completion of a Public Benefit Test (PBT), draft a formal Final Report for the Minister.

In summary, for each option identified, the Review Committee developed an accurate description of the likely market structure and described the economic/financial status of all affected groups.

A copy of the Discussion Paper and an invitation to make a written submission was sent to 108 chicken growers identified by the Queensland Chicken Growers' Association. Eight of these were not members of the Association.

A further list of 137 recipients was compiled which included the Chief Executive Officers of specific local authorities (such as Redland Shire Council, Ipswich City Council etc.); specific State Members (such as the Members for Moggill, Tablelands etc.); the Leader of the Opposition; the Shadow Minister for Primary Industries; DPI counterparts in other states; and Directors General of specific Queensland Departments such as Department of Training and Industrial Relations, Department of Environment and the Department of Tourism, Small Business and Industry.

The Queensland Consumers' Association and other organisations such as the Australian Wheat Board, Australian Conservation Foundation and the Australian Workers Union were each sent a copy of the Discussion Paper and invited to make a submission.

During the course of the Review the Committee received fifteen formal submissions from a variety of individuals and organisations, including major processors and contract growers. This includes submissions from the Chicken Meat Industry Committee, Queensland Chicken Growers' Association, Steggles Limited and Inghams Enterprises Pty Ltd., as well as a number of contract growers. Summaries have been provided below.

The Committee met on twelve occasions between 7 July and 1 December 1997 inclusive.

During the course of deliberations Mr Alan Ducret, Regional Director (Queensland), Australian Competition and Consumer Commission (ACCC), made a brief presentation to the Review Committee on the ACCC's role in relation to 'authorisation' of anti-competitive behaviour; the conditions which must be met before authorisation is granted; the process for applying for authorisation; and some of the specific circumstances of the granting of authorisation in the case of Inghams' chicken growers in South Australia.

2. ANTI-COMPETITIVE RESTRICTIONS AND OPTIONS FOR CONSIDERATION

2.1 The restrictions derived from the Act

The key functions of Section 16 of the *Chicken Meat Industry Committee Act 1976* are to set guidelines for agreements, examine and approve agreements, mediate in disputes, and negotiate prices (growing fees). However, it needs to be noted that no power is conferred by the Statute to enforce these activities.

Section 20 relates to Agreements between growers and processors. It confers on the CMIC extensive powers to regulate agreements between growers and processors, but again provides no direct power of enforcement. The Section places an obligation on processors not to receive and growers not to supply chickens other than in respect of an agreement approved by the CMIC. The CMIC has the power to approve or reject and refer back an agreement to the parties.

Section 21 deals with disputes between growers and processors on the terms of an agreement. The CMIC has the responsibility to hear parties to a dispute and to determine the issue. Again there is no specific power of enforcement.

2.2 Regulatory Options Identified

During the course of deliberations, and without limiting the scope of the Review, the Committee identified six possible options for detailed consideration. These appeared in section 6 of the Discussion Paper and are numbered as they appeared in the Discussion Paper.

In this report, the terms restrictive state and unrestrictive state, refer to the presence, or absence, of legislative or regulatory arrangements which restrict competition. Legislation or regulations are often necessary to enhance market performance or lower the "costs of doing business". If a state contains legislation or regulations that do not restrict competition it is considered to be an unrestrictive state for the purpose of this Review.

Options involving legislation

- | | |
|---------------|---|
| Option | 6.1. Status Quo |
| | 6.1.1 Strengthen Act to enable current practices to continue |

The maintenance of the *Chicken Meat Industry Committee Act 1976* in its present form, together with the practices that have grown up within the CMIC and the industry beyond July 1998, may result in contracts between growers and processors being in breach of Part IV of the *Trade Practices Act 1974*. To retain these arrangements beyond July 1998 a Public Benefit Test would need to establish that legislation was required and that, of the restricted options, this was the one to deliver the most favourable community benefits.

6.1.2 Retain CMIC but modify practices

This option recognises that perhaps not all of the competition restricting practices of the current CMIC are essential. In particular, it might be that the CMIC continues to provide a statutory framework for negotiations between chicken meat processors and contract growers; recommends guidelines for and approves individual contracts between a grower and a processor; but does not negotiate or set any fees between processors and growers. The role of mediation in disputes would also continue.

Option 6.2. CMIC 'recommended floor price' model

This option would involve the CMIC recommending a 'floor price' growing fee. Such an arrangement would not prevent individual growers negotiating a final fee with processors, but it would provide some industry guidance on appropriate fee levels.

The arrangement would require that there was a benefit to the public which outweighed any detriment caused by a lessening of competition. The onus would be placed on the Review Committee to establish that such a "public benefit" existed. In its Rural Guideline of August 1989, the TPC agreed that this type of arrangement would enhance the bargaining position of growers both by establishing a "floor" price and by removing some of the uncertainty about the price other growers were receiving.

The CMIC could continue to provide a statutory framework for negotiations between chicken meat processors and contract growers for mediation in disputes. However, the CMIC would not negotiate prices between processors and growers, and need not recommend guidelines for or approve individual contracts between a grower and a processor.

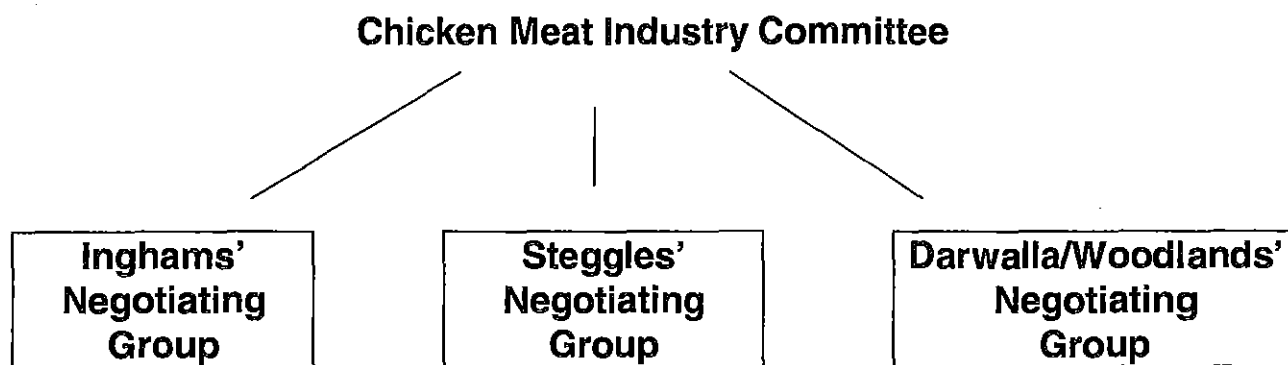
The concept of greater industry self management relies upon an enhanced contractual arrangement being put in place by the CMIC, working under the authority of the *Chicken Meat Industry Committee Act*. This concept appears to be consistent with the thrust of those initiatives recommended by Kidston. This option could develop to a point where it would provide a trigger for the Minister to initiate action to repeal the *Chicken Meat Industry Committee Act*.

Option 6.3a. Legislative Industry Committee with Processor Negotiating Groups (hereafter referred to as the 'less restrictive' case)

Under this model as recommended by the Queensland Chicken Growers' Association and endorsed by Inghams, a two tiered system would replace the current single tier structure. The top tier would consist of a committee with a similar composition to the existing CMIC. The functions of this committee will, however, be significantly different to the existing CMIC. The second tier would consist of individual processor negotiating groups convened and operating under guidelines to be incorporated as a regulation to the CMIC Act.

Under the present configuration of the Queensland industry the structure would be as outlined in Figure 2.1.

Figure 2.1 Two Tiered Industry Structure Model



The regulated state which would result from the implementation of the selected option is characterised by the following:

- the creation of a number of individual processor based negotiating groups responsible for negotiating the detailed terms and conditions of growing contracts, including growing fees;
- the settlement of disputes with respect to contract negotiation, including fee determination, by independent arbitrator;
- negotiation of one or more payment options available to all qualifying growers;
- the negotiation of special contractual arrangements between a processor and individual or groups of growers outside the collective negotiations;
- the new CMIC would also act as the convening body for the establishment of processor negotiating groups, to set guidelines for the assistance of processor negotiating groups in drawing up agreements;
- the retention of the CMIC as a forum to resolve or clarify issues of a general nature not related to determination of the growing fee arrangements between processors and their grower group(s). For example the CMIC could be used for:
 - dispute resolution for matters referred by the processor negotiating groups including those matters relating to pool payments, feed quality, weight assessment and live bird pick up arrangements;
 - ensuring the transparency of all contracts; and
 - the preparation and dissemination of information on the essential components of growing contracts and the provision of advice on appropriate methods for estimating costs and determining growing fees.

The essential difference between this proposal and the existing regulatory structure is that, for the former, the growing fee and contract details would be negotiated at the processor level either collectively or by individual growers or groups of growers. Hence, growing fees and contractual details may differ among and within processing groups and may more closely reflect the particular features of the group including farm size, stocking densities, batch frequency, market requirements, processor requirements, etc.

Importantly, the CMIC will not be required to approve any negotiated agreement within any processor group. Specifically, arrangements between processors and individual or sub-groups of growers (ie outside the collective arrangements) will not require CMIC approval.

This is the model currently being proposed by the Ingham's growers, with the support of the processor, in South Australia.

Option 6.3b. The 'least restrictive' option

During deliberations a further option was identified, namely a minimally restrictive environment where contracts between individual growers and processors are bargained as above. However, there would be no recourse to an independent arbiter and hence no price setting influence other than from 'the market'. The CMIC could continue but have no role in final approval of contracts or dispute resolution, but could provide advice in growing fee determination, contractual guidelines and financial standards.

The CMIC Act would be amended, thereby eliminating any unnecessary restrictions and any possible inconsistency with TPA. To the extent that any restrictions are necessary they would be specifically authorised to have the benefit of the exemption under the Act post July 1998. However, a dispute settlement/arbitration system would be retained or established in legislation to address disputes relating to contractual obligations and performance. However, it would not deal with disputes relating to the determination of growing fees and contract conditions.

The essential difference between Option 6.3b and Option 6.3a is that under Option 6.3a there is provision for arbitration to settle disputes regarding contract conditions for new contracts. Further, under Option 6.3a some independent party would be the 'price setter' and this could reflect other than market realities. There is no such provision in Option 6.3b.

This would involve the further reduction of the role of the CMIC but maintain the processor negotiating groups similar to those in Option 6.3a. Specifically Option 6.3b would be characterised by:

- the creation of a number of individual processor based negotiating groups responsible for negotiating the detailed terms and conditions of growing contracts, including growing fees. An independent body would address dispute resolution matters referred by the processor negotiating groups relating to existing contracts but excluding those matters relating to specific initial contractual matters;
- the negotiation of one or more payment options available to all qualifying growers;
- the negotiation of special contractual arrangements between a processor and individual or groups of growers outside the collective negotiations; and
- the settlement of disputes with respect to contract matters, including fee remuneration, by an independent arbitrator.

This would constitute a regulated (ie. legislated) yet unrestrictive environment, and would provide for the same environment as occurs under 'authorisation' in South Australia. Due to its similarities to the previously listed option, Option 6.3a, for the purposes of this paper this option will be described as Option 6.3b.

Options involving deregulation

Option 6.4. Industry 'Authorisation' by ACCC

This option would involve the processors and the Queensland Chicken Growers Association (QCGA) jointly applying to ACCC for 'authorisation' to collectively negotiate contracts, including growing fee determination.

Negotiating the guidelines for contracts and the components of the growing fee would be done at industry level. However, any negotiations relating to an actual fee or specific contracts would be done with individual processors by the appropriate association representatives. A grower could opt to negotiate independently with their processor.

Option 6.5. Individual Processor 'Authorisation' to allow QCGA to recommend a growing fee/Ingham's model

This option would involve the QCGA (or any similar body formed by growers) recommending a growing fee. Such an arrangement would not prevent individual growers negotiating a different final fee with processors, but it would provide some industry guidance on appropriate fee levels.

The TPA would prohibit an agreement among growers to adopt a set fee. In other words, the recommended growing fee must be just that - a recommendation.

Such an arrangement could be 'authorised' by the Australian Competition and Consumer Commission (ACCC) provided:

- (a) There are 50 or more parties to the agreement. The QCGA currently has a membership in excess of 50 people; and
- (b) The arrangement resulted in a benefit to the public which outweighed any detriment caused by a lessening of competition. The onus would be placed on the Review Committee to establish that such a "public benefit" existed.

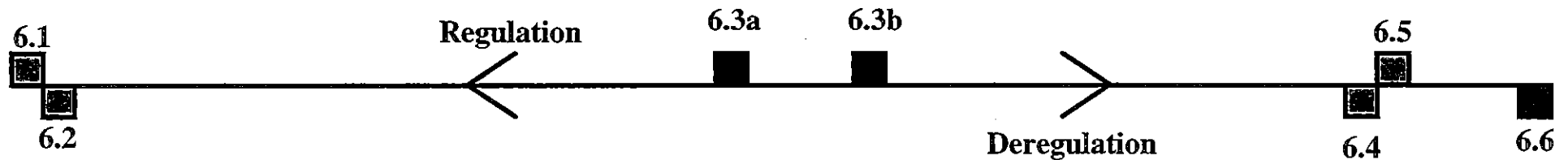
A processor and its contracted growers could seek authorisation from the ACCC to allow them to negotiate contract terms and conditions including a growing fee. It should be recognised that such arrangements will only be authorised for a limited period of time - up to five years. This would be similar to the situation in South Australia between Inghams and its growers.

Option 6.6. The 'unrestrictive' case: No Legislation or Authorisation

In the absence of government regulation, industry participants (particularly growers) may seek to engage in some form of joint action to correct the disparity of bargaining power flowing from the industry structure. Consideration of regulatory and deregulatory options therefore requires some consideration of the impact of the TPA on industry based agreements not protected by Queensland Government legislation.

A summary of the options is given in Figure 2.2. This graph indicates the varying degrees of regulation needed to support the various industry structures as described in the listed options.

FIGURE 2.2 DEGREES OF REGULATION AND LEGISLATED SUPPORT FOR INDUSTRY STRUCTURES



Option 6.1 - Status Quo: rejected by Review Committee as breaching TPA.

Option 6.2 - CMIC recommend floor price model: rejected by Review Committee as breaching TPA.

Option 6.3a - Legislated Industry Committee with Processor Negotiating Groups: this being central to the QCGA's submission and the option being studied in the PBT.

Option 6.3b - The 'least restrictive' option: identified by Review Committee as being similar to Option 6.3a but having potential of providing 'public benefit'.

Option 6.4 - Industry Authorisation: excluded from consideration due to Review Committee determining beyond scope of Review. However, this option is central to Steggles' submission as achieving a move to a less restrictive operating environment and still being an option to industry members regardless of Final Report's outcome.

Option 6.5 - Individual Processor Authorisation: excluded from consideration due to Review Committee determining beyond scope of deliberations.

Option 6.6 - Deregulation: all submissions rejected this option although this option used in PBT according to Terms of Reference.

Specifically, as Option 6.1 reflects the maintenance of the status quo (and hence the current legislation) this option appears at the extreme left of the graph. As Option 6.6 reflects the total repeal of the legislation in favour of a deregulated environment, this option appears at the alternate extreme of the graph. The other alternatives are situated between these two extremes.

2.3 Arguments for regulatory options presented in submissions

The submissions received by the Review Committee reflected varying degrees of support for change from the current regulated state to a more deregulated environment.

Steggles Limited

This view is one where more 'flexibility' leading to 'a closer relationship with growers in which appropriate new investment is encouraged and rewarded'.

Specifically, the industry structure recently adopted in South Australia is described as providing "... a viable, fair and competitive industry model for ...Queensland ...". This involves the replacing of the legislation with an 'authorisation' from the ACCC to permit collective negotiations between individual processors and their respective growers and representative committees. This authorisation is designed to temporarily permit possible anti-competitive commercial behaviour with the intention of assisting the industry to reach a completely deregulated environment within a specific time-frame.

However, reports from South Australia suggest that grower/processor relationships have not been as harmonious as they seem to have been for a number of years and this relationship has further deteriorated since it was announced that the legislation may be repealed. Growers are still currently lobbying to have some form of legislation retained.

The ACCC has indicated that the recent authorisation granted in South Australia to Inghams' and its growers (with a Steggles application currently under consideration) has been overtly designed to assist the industry to adjust from a regulated to a deregulated environment within a five year period. The similarities between the South Australian industry pre-authorisation and the contemporary Queensland industry are marked. Subsequently the Committee drew on the processes involved and the consequences of South Australia's contemporary industry structure to assist in formulating recommendations.

Inghams Enterprises Pty Ltd

Inghams' have a view that a move to a less restrictive environment is necessary to attain efficiencies within the domestic industry and hence provide a mechanism to defeat competition from non-domestically sourced chicken meat.

Specifically, Inghams support the previously described ACCC authorisation in South Australia as providing the industry with a desirable structure to meet contemporary challenges. However, Inghams' believe that contracts authorised by the ACCC due to anti-competitive elements can be 'renegotiated' beyond the five year expiry date. This would appear inconsistent with the intention of the ACCC.

A second industry structure put forward by Inghams is that contracts and fees are negotiated on a processor/grower basis and not an industry basis. An industry body would exist to monitor contracts but would not have the authority to approve contracts and determine fees.

In summary, the major concern is with the setting of fees and Inghams believes that by pursuing a legislated structure consistent with Option 6.3a these concerns will be addressed. Specifically:

'Providing a legislated structure provides, in principle, a similar outcome as the ACCC authorisation in SA, then Inghams are fully supportive of such a structure.' (p.4)

QCGA

The QCGA's submission "... has recognised that the current legislation requires substantial amendment to enable compliance with NCP ..." and has supported a legislated industry committee similar to that outlined above as Option 6.3a.

However, the functions of this newly proposed 'committee' would be to negotiate between specific processor negotiating groups and growers and approve and set guidelines for the establishment of contracts. Issues such as the setting or recommending of a growing fee would not be the responsibility of the committee. Further, only if requested by and following the agreement of the processor negotiating groups would this committee make recommendations as to the appointment of industry conciliators for the resolution of disputes.

CMIC

The CMIC believes the current Act has provided an environment conducive to industry stability and growth, but has also recognised that there are significant pressures for change. If the CMIC were to continue under the current legislation it is proposed that it provide guidelines for the development of contracts rather than being directly concerned with the approval of each contract. This would provide contract processors and growers with a level of 'flexibility' and would ensure the maintenance of a dispute resolution mechanism which has introduced stability to the industry.

The CMIC believe that deregulation would not be successful as it would provide an environment that is not conducive to the maintenance of capital investment by growers and processors and would have detrimental consequences for continued efficiency and competitiveness being achieved.

The CMIC believes that some form of legislation should exist to:

- ensure a stable industry environment to maintain investment and technological adoption levels;
- address perceived market imbalance between processor and grower;
- ensure competitiveness of chicken meat against alternatives; and
- ensure the industry's substantial employment levels.

Therefore, the CMIC supports (with reservations) Option 6.3a.

Woodlands

This submission reflects the view that the current legislation should be maintained for the 'stability' of the industry, but that growing fee negotiations could be less centralised and more industry focussed. The role of the CMIC acting as initial arbitrators in cases of disputes is also seen as important in insuring this 'industry stability'.

Darwalla

Darwalla note that contemporary 'industry stability' has resulted from the introduction of the current legislation in 1976. Future expansion of the industry can only be achieved through improving farm densities and increasing 'through-put'. This can be achieved through improvements in the contract system done on either an individual farm or processor basis.

Other Submissions

The Committee also received various submissions from individual contract growers and other interested individuals. These submissions mostly voiced a view that the industry pre-1976 (and before the establishment of the current legislation) was unstable due to the absence of countervailing powers, and conflicts between growers and processors were common. They support the view that there is a significant degree of competition between growers, and the existence of the CMIC provides an environment conducive to financial and technological investment. Generally, these submissions value the maintenance of the CMIC and if change were to occur, they support Option 6.3a.

2.4 Alternative Regulatory States to be examined in the PBT

Under the Queensland Treasury NCP Public Benefit Test guidelines for legislative reviews, it is a requirement to clearly delineate the 'without change' and 'with change' states. These are then used to identify impacted groups and to assess and quantify the major impacts of any restriction on competition. For the purposes of this Review the 'without change' state will actually involve some change from the existing regulatory arrangements and could be more correctly defined as the 'less restrictive' option'. There is little support for the retention of the existing arrangements after a number of alternative regulatory/legislative arrangements were considered by the Review Committee. The 'without change' or less restrictive option described below is the option under review.

The Review Committee concluded that the current legislative framework is unduly restrictive. Consequently, the options of either strengthening the current CMIC Act to enable current practices to continue (Option 6.1) or retaining the Act as currently written and modifying practices of the CMIC to ensure practices are authorised (Option 6.2) were rejected.

The options of either Industry Authorisation (Option 6.4) and Individual Processor Authorisation (Option 6.5) by the Australian Competition and Consumer Commission (ACCC) were considered as potentially providing a temporary arrangement to enable the setting of a fee and of dispute resolution in the manner proposed in South Australia. However, the Review Committee notes that application to the ACCC for any authorisation is a matter for the industry and is outside the scope of the Committee's deliberations.

The Committee concluded that in accordance with its Terms of Reference, the 'options' to be considered and the subject of a Public Benefit Test (PBT) in accordance with Queensland Treasury methodology, are to be the less restrictive legislated state (ie. Option 6.3a) and the least restrictive legislated state (ie. Option 6.3b). These two options were compared with an unrestrictive state (ie. Option 6.6).

The essential difference between the selected arrangements and the existing regulatory structure is that, for the former, the growing fee and contract details would be negotiated at the processor level either collectively or by individual growers or groups of growers. Hence, growing fees and contractual details may differ among and within processing groups and may more closely reflect the particular features of the group including farm size, stocking densities, batch frequency, market requirements, processor requirements, etc. Importantly, the CMIC will not be required to approve any negotiated agreement within any processor group. Specifically, arrangements between processors and individual or sub-groups of growers (ie outside the collective arrangements) will not require CMIC approval.

It may be that most of the arrangements recommended under the selected regulatory option could be implemented under the existing legislation. While the Act empowers the CMIC to "negotiate prices between processors and growers" it does not empower it to set a standard growing fee across the whole industry. It is the current requirement that all agreements between processors and growers must be "approved by the Committee" in conjunction with their fee determination arrangements including collective negotiation, which is deemed to be anti-competitive and the subject of this Review.

To some extent the selected option will formalise, in legislation, the growing fee determination process which is currently in place, except that contract negotiation will take place in a more decentralised manner. It appears that the determination of the growing fee will continue to be based on a cost-plus pricing model approach using representative farms. However the farm model will be specific to the farms involved in the negotiating group. Consequently, growing fees and any fee adjustments for productivity, quality or other specific processor requirement (ie the current liveweight and feed conversion adjustment factors) will more closely reflect the variability in costs across the industry and the specific requirements of each processor.

In terms of the actual level and distribution of live bird costs and growing fees which will result from the proposed regulatory arrangements, much will depend on such factors as; the structure of the representative farm models used in the fee determination process, the way in which market growth is allocated among existing and/or new growers; the degree to which existing contracts are freely transferable between growers; and, the scope for entry of new growers.

Under the selected option, it is proposed that with regard to the determination of growing fees and other contractual details, disputes be referred to independent arbitration. However, the criteria under which the arbitrator operates, and on which his/her decisions are based, will clearly impact on outcomes of the proposed arrangements.

The proposed arrangements are centred around the use of collective bargaining, albeit in a decentralised way, to determine growing fees and other contract details. Such arrangements clearly involve price fixing and may also be seen to be exclusionary. Hence the effect may be to lessen competition among growers for the supply of contract growing services. Consequently, in accordance with the Competition Principles Agreement, such legislative arrangements need to be subjected to a PBT to assess whether such restrictions on competition are in the public interest.

The deregulated state would most likely be characterised by individual contracts between growers and processors. Provisions of the CMIC Act provide for the negotiation of growing fees by the CMIC and require that all agreements between growers and processors be approved by the CMIC (at least in theory) would be repealed.

While the CMIC in its present form would no longer exist, a dispute settlement/arbitration system would be retained in legislation to handle disputes relating to contractual obligations and performance. However, the CMIC (even in its new form) would not deal with disputes relating to the determination of growing fees and contract conditions.

2.5 Are there impacts in moving to a different state ?

In terms of the level and distribution of live bird costs and growing fees which will result from the proposed regulatory arrangements, much will depend on such factors as: the structure of the representative farm models used in the fee determination process; the way in which market growth is allocated among existing and/or new growers; the degree to which existing contracts are freely transferable between growers; and the scope for entry of new growers.

Under the current regulatory arrangements, and equally under the regulated states under review, there are no legal restrictions on processors with regard to the allocation of existing contracts or the supply arrangements with respect to market expansion. However, a number of factors tend to reduce the processors' ability to achieve either a redistribution of existing contracts and/or an allocation of market growth to more efficient growers (ie. those able to produce at a lower total live bird cost per kilogram of chicken meat).

In the deregulated state, increased processor flexibility with regard to the allocation of contracts for current output and for market growth is likely to result in an increased share of output going to new entrants.

Chicken Meat Processors

The Review Committee has identified a number of ways in which deregulation of the industry could impact on processors. These impacts include:

- reduced processor incurred live bird costs;
- increased transaction costs; and
- possible increase in the costs of maintaining food safety and chicken meat quality standards.

Reduced processor live bird costs

Two factors tend to significantly reduce the processors' ability to achieve a redistribution of existing contracts or market growth to more efficient growers; namely the pool payment procedure and the power of the CMIC to approve or sanction existing or new contracts.

In the deregulated state, the capacity of the processor to achieve the least cost production of chickens through individual contract negotiation and increased flexibility with regard to the supply of market growth is likely to be improved. The impact on processors resulting from this improvement is a reduction in the average live bird costs currently met by processors including feed costs, bird health services, field services, etc.

Increased transaction costs

As discussed earlier, in a deregulated state processors will be faced with an increase in search, bargaining and information costs. Again, all or some of these costs will be reflected in the price paid by consumers of chicken meat and chicken meat products.

Potential chicken meat processors

The Review Committee agreed that the restrictions identified in the legislation and the practices which have grown up with its implementation have not restricted the entry of new chicken meat processors and hence no impacts on this group have been identified.

Consumers of chicken meat

The combination of a lower growing fee and greater efficiency in the production of chickens in a deregulated state is likely to result in a decline in the retail price for chicken meat and chicken meat products. The extent of such a decline will depend on the degree of competition among wholesalers and retailers of chicken meat and chicken meat products. However the expected lower retail price will be offset, to some extent, by higher grower and processor transaction costs.

A prior assessment of the likely impact of moving from the 'existing' state to the 'less restrictive', 'least restrictive' and the 'unrestrictive' states was undertaken by the Review Committee. The methodology employed was a simple consensus approach because the primary purpose was to identify key factors to be considered and indicative expectations of members. These items could then be developed in detail in later sections of this report. Results are summarised in Table 2.1

TABLE 2.1 INDUSTRY CHARACTERISTICS UNDER ALTERNATE REGULATORY STATES

Industry Characteristic	Existing	Option 6.3a (less restrictive)	Option 6.3b (least restrictive)	Option 6.6 (unrestrictive)
Contract Growers Level of Output (million birds)	52	52	52	52
Live Bird Costs				
• growing fee (c/bird)	48	49	44	44
• processor costs (c/bird)	175 ¹	173	172	172
Transaction Costs	\$20 000	\$12 000	\$12 000	\$110 000
Enforcement & Regulation				
• Food Safety (risk)	100%	100%	100%	105% ²
• Quality (risk)	100%	100%	100%	102-105% ²
• Environmental	100%	100%	100%	95% ³
Industry Stability				
• Continuity/variability	100%	100%	100%	90-100%
• Technological adoption	100%	100%	100%	100%
• Financial Viability/ Bankability	100%	100%	100%	75%

1 Based on cost shares given in processor's industry data sheet as presented in Table 4.1.

2 This indicates an increase in 'risk' and therefore a cost to the community.

3 This indicates a cost to the community with a decrease in environmental quality leading to an increase in costs of enforcement of regulations.



3. ROLES OF CMIC IN CONTRACT NEGOTIATION, CONTRACT APPROVAL AND DISPUTE RESOLUTION

3.1 The Current Situation

The Queensland chicken meat industry has operated in a quasi regulated environment since 1976 with the passage of the *Chicken Meat Industry Committee Act*.

The industry is founded on a high volume low profit margin and as such, industry stability is dependent on the successful negotiations of the price paid by processors to growers and the reliability in throughput or batch placements.

Given the high cost of establishing a chicken meat operation, including sheds, plant and equipment (average approximately \$1.2 million in Queensland), growers see the existence of a growing agreement as an important factor providing for protection of their livelihood and industry stability.

The current conduct of the CMIC (particularly regarding issues relating to the setting of growing fees and the approval of agreements between growers and processors) is potentially anti-competitive and (unless exempted as at present) contravenes the TPA. As Section 51 of the TPA presently exempts activities specifically authorised by a State Act, exercise by the CMIC of its powers under the Act and conduct consistent with the provisions of the Act are authorised. However, on 21 July 1998 an amendment to Section 51 will take effect which will make such legislation ineffective.

Therefore, the mechanism by which contracts between growers and processors are negotiated has featured prominently in the Review Committee's deliberations.

3.2 Countervailing Power

Central to the CMIC's submission (and many submissions from individual growers) has been the need to address the perceived 'power differential' or 'market imbalance' between growers and processors, and the importance of overcoming this potential imbalance through legislation and the establishment of organisations such as the CMIC.

In the absence of the CMIC the existence of a large number of growers and a small number of processors could place processors in an advantageous bargaining position. In the early 1970's negotiation of the growing fee between individual processors and individual growers was not always satisfactory. The problem associated with the fee paying structure was exacerbated by increasing grain prices and an increasing trend toward vertical and horizontal integration by processors. During the 1970s there was a move towards a system of payment based on performance indicators.

It has been consistently argued by grower representatives that deregulation of the industry along the lines suggested above (ie. the deregulated state) would expose growers to unequal market power in contract negotiations with processors. It is further argued that exercise of that market power by processors, at least in the short to medium term, would cause growers to receive grower fees which would be below that which would prevail if that market power did not exist.

Determining whether processors would be in a position to exert market power, whether they would exercise that power, and the magnitude of the economic effects of use of market power, is crucial in assessing the impact on growers towards deregulation. Indeed the implications of alleged unequal market power in terms of industry output, industry costs and processor profitability have never been clearly identified.

In their submission to this Review and in submissions to ACCC determinations in South Australia, growers have argued that, in the absence of collective contract negotiations, growers would be at a distinct disadvantage with respect to fee negotiations and other matters. Inghams and Steggles, on the other hand, argue that exercise of market power by processors would not be in the best interests of either processor, and further state that no processor occupies a monopsonistic position (one buyer only and many sellers) except for Steggles in North Queensland.

The Review Committee accepted the existence of a significant 'negotiating power differential' which would normally exist when an individual grower enters contractual arrangements with a processor.

Recommendation 3.1.

Consequently the Committee recommends overcoming this imbalance through legislation which provides countervailing power.

3.3 CMIC's need to approve contracts?

The intention of the *Chicken Meat Industry Committee Act 1976* was to provide the industry with a mechanism for discussion and negotiation on the growing fee in an orderly manner while leaving the industry as unfettered as possible. It was recognised at the time that the provisions of the TPA could prohibit the negotiation of the growing fee between processors and growers without the existence of a legislative umbrella.

The overt intention of the CMIC Act was (with reference to the first reading of the Bill):

"...to leave the industry as unfettered as possible whilst at the same time providing a forum for discussion and negotiation".

"Because of its nature it is essential that the industry retain the maximum degree of flexibility to enable it to cope with rapidly changing market situations".

Currently the CMIC is involved in approving 'agreements' between processors and growers and procuring a 'determination' to disputes (including those regarding grower fees). However, the issue of the setting of grower fees commenced with the establishment of the CMIC.

It has been proposed in the QCGA submission that a revised version of responsibilities of the CMIC be to:

- act as the convening body for the establishment of Processor Negotiating Groups;
- establish minimum standard criteria for the assistance of Processor Negotiating Groups in drawing up agreements;

- approve agreements submitted by Processor Negotiating Groups in accordance with the provisions of the Act;
- set non-financial standards on such matters as the CMIC determines are in the best interests of the industry;
- recommend financial standards on such matters as the Committee determines are in the best interests of the industry. However, such standards shall not be binding on any party and under no circumstances shall the CMIC be authorised to set or recommend rearing fees either for the State as a whole or for individual groups or individual growers;
- only if requested by and following the agreement of Processor Negotiating Groups, to mediate in disputes between processors and growers of that negotiating group (including disputes as to the assessment of amounts payable under agreements) and, if requested, to make recommendations as to the appointment of industry conciliators or experts for the resolution of disputes;
- advise the Minister on any matter relating to the chicken meat industry referred to it by the Minister;
- act as an industry forum for the dissemination of information and the determination of general industry strategy, for example: to facilitate the transfer of growers between groups, to consider planning and environmental issues and to act as the interface between industry and government (State, Federal and Local) and other non-governmental authorities.
- review and make recommendations to the Minister on matters pertaining to Regulations to the Act; and
- such other functions as may be agreed. (Attachment 1)

As a consequence the growers have maintained that any contract that exists must be 'transparent' and be scrutinised by the CMIC or similar body to ensure that the terms and conditions of the contract are not in any way detrimental to the grower (who is party to the contract) or the other growers. However, the process of the 'revised' CMIC maintaining its role of approving agreements would appear to contravene the TPA 1974.

Further, it has also been proposed by the Review Committee during deliberations that it is important individual growers and processors have the ability to negotiate and formalise contracts beyond the influence of the CMIC and the processor negotiating groups. Discussed was the anti-competitive consequences of negotiations being conducted exclusively through processor negotiating groups and having negotiations beyond this mechanism being in contravention of legislation. As a result the Review Committee has noted submissions from processors who have listed their desire to see a move to a less regulated environment.

The Committee concluded that the setting of fees is a contractual issue and that the ability of the CMIC to set or approve a growing fee is inappropriate and inconsistent with NCP guidelines.

Recommendation 3.2.

The Committee recommends that the power of the CMIC to set or approve a growing fee not be included in any amended or new legislation.

3.4 Information and Transaction Costs

Transaction costs are costs other than the money price incurred in trading goods or services. Before a mutually beneficial trade can take place, at least one party must determine whether there are indeed trade opportunities available and then negotiate the terms of trade. Other than simple "cash on the barrelhead" transactions, modern exchange involves the drawing up of contracts or agreements to cover such matters as warranties or guarantees for quality, options for future purchases at a guaranteed price, prepayment for delivery, etc. Negotiations for such a detailed contract may themselves be prolonged and costly in terms of time, travel expenses, legal costs and so on. Also, after a trade has been agreed upon, there may also be significant costs involved in monitoring or policing the other party. These *search and information costs, bargaining and decision costs and policing and enforcement costs* are the main sorts of transaction costs.

Transaction costs pose an important issue in the chicken meat industry. Indeed it is the level and impact of these costs that give rise to many of the concerns of growers. While processors are concerned about the level of search and information costs in a deregulated environment, growers are more concerned about bargaining, decision, policing and enforcement costs.

However, the transaction costs involved in policing and enforcement can be minimised if an appropriate regulatory but non-restrictive environment is in place. Such an environment would do much to allay the fears of growers about unequal bargaining and enforcement powers.

Nevertheless, the deregulated state, as defined earlier, is likely to result in increased transaction costs. Specifically, growers will incur an increase in bargaining and decision costs, and processors will experience an increase in search and information costs in addition to higher bargaining and decision costs. The requirement for *individual* grower contracts in the deregulated state will therefore result in extra grower and processor costs which must be covered like all other costs involved in chicken production.

Transaction costs pose an important issue in the chicken meat industry. Indeed it is the level and impact of these costs that give rise to many of the concerns of growers. While processors are concerned about the level of search and information costs in a deregulated environment; growers are more concerned about bargaining, decision, policing and enforcement costs. However, the transaction costs involved in policing and enforcement can be minimised if an appropriate regulatory but less restrictive environment is in place. Such an environment would do much to allay the fears of growers about unequal bargaining and enforcement powers. The Committee concludes that transaction costs will be greater in a deregulated state.

Recommendation 3.3.

The Committee recommends that transaction costs be minimised with 'an appropriate regulatory but less restrictive environment' which allows for growers' groups to collectively bargain with their processor, such as would occur under both Option 6.3a and Option 6.3b.

3.5 CMIC role in dispute resolution

Currently, either party to an agreement may apply to the CMIC for its determination of a dispute concerning a term, stipulation or condition of an agreement. The CMIC must hear both parties on the matter in dispute and must endeavour to determine the issue, and members are entitled to receive fees, allowance or expenses.

Whilst the CMIC has a significant facilitation and mediation role, it has no power of enforcement. This was the intention of the Government when the legislation was passed by the Parliament in 1976.

It has been argued that the success of the CMIC in resolving the few disputes that have occurred during its inception has been due to the inclusive nature of the CMIC and its efforts to ensure time and cost effective resolutions.

It has been proposed by QCGA that the CMIC's role be modified. Specifically;

'Processor negotiating group disputes may be referred by the CMIC to an appropriate arbitration process.'

and

'... if requested by and following the agreement of Processor Negotiating Groups, to mediate in disputes between processors and growers of that Negotiating Group ...'

and

'...if requested, to make recommendations as to the appointment of industry conciliators for the resolution of disputes....'

No financial detriment has been identified in the Public Benefit Test as to the 'enforcement and regulation' aspects of agreed contracts being transferred from the CMIC to an external dispute resolution mechanism.

The poultry meat market in Queensland is very competitive (as compared to other meat industries) due partly to the stability promoted by the mechanisms which the CMIC have provided.

This stability through reduced disputation between grower and processor has directly led to achieving improved price competitiveness, as well as an environment in which both processors and growers can invest in new facilities.

The CMIC believes that the role of dispute resolution is still of extreme importance and that, although there is pressure towards a more deregulated environment, this role will have significant benefits for all parties concerned if it is to remain in the future. This may include a move directly concerned with the approval of each contract.

Central to many submissions received and the submissions of the CMIC and the QCGA has been the importance of a formal mechanism of dispute resolution.

Recommendation 3.4.

The Committee recommends the inclusion of a dispute mechanism to address disputes relating to contractual obligations, performance and adjustments to growing fees under existing contracts.

Recommendation 3.5.

Consequently the Review Committee recommends that an independent body be identified that will assist in the mediation and arbitration of disputes between growers and processors relating to existing contract provisions.

However, an independent body established to arbitrate in the determination of growing fees as a base fee for new contracts will lead to 'price setting' intervention by a third party. Even if market forces are required to be taken into account this will restrict competition relative to the unregulated case.

4. GROWER FEE ARRANGEMENTS, POOLING SYSTEM AND PRODUCTIVITY

4.1 Grower Fees

Grower fees are those fees paid to growers by processors. The grower fee to be paid by processors is set by the CMIC for a six monthly period (January to June and July to December) each year.

The industry has a typical primary industry profile of a relatively large number of grower operations supplying and relying upon a small number of processors for the disposal of their production. Processors supply only to growers contracted to them, with numbers of chickens supplied to growers fluctuating with market supply and demand and the availability of day old stock.

The contracted growers have no certainty of continued involvement beyond the period of the current agreement. The growing contract, currently for an initial 2 year period, has a provision to be renewed annually. The growers, because of their contract with one processor, are not free to operate competitively in respect to offering their services to other processors. However, providing the grower complies with the notice provision in the contract (6 months), the grower can transfer to another processor - but in practice this rarely occurs. The grower does not have any real flexibility to transfer into other farming operations because of the specialised nature and high capital cost of chicken facilities.

It is recognised that most of the arrangements recommended under the selected regulatory but less restrictive option could have been implemented under the existing legislation. However, whether because of the existence of the CMIC and the Act, or decisions by the interested parties, these legislative arrangements have not been utilised. Practices which have been adopted within the industry have suggested a restrictive role engendered by some action of the CMIC, whereas the CMIC as a body has not been an active party to the formulation of such practices. The adoption of this method of operation has led to the conclusion that the CMIC Act has been implemented to a degree beyond the intention of the original legislation. This is not to say that the role of the CMIC in arbitrating prices as outlined in the Act, nor that the approval of contracts between processors and growers would not be restrictive.

What occurred was that there existed a general form of contract examined and approved by the CMIC on an industry basis. This agreement was subject to an annexure dealing with payment adjustments which the CMIC did not examine or approve, whether required to by the Act or not. The result was that the practices adopted were significantly more restrictive than the operation of the CMIC required. Growing fees negotiated between processors as a group and growers as a group were acknowledged by the CMIC and formed the base for price determination. However, this base price was not a 'standard growing fee' across the entire industry and did not constitute the price which must be paid by a processor for each chicken grown.

The Review Committee concluded that the CMIC did not view these legislated practices as being restrictive.

4.2 The Pooling System and Productivity

The chicken meat industry is a unique primary industry as growers are not independent operators supplying a product at their discretion. They are, in the main (apart from company farm operators) suppliers of technical on-farm services under contract to a processor who remains in ownership or control of a large and vital part of the production process, namely the growing of animals, feed, the provision of technical and veterinary services and the uptake of live animals for processing.

A commercial chicken meat industry has been in place for approximately 35 years in Queensland. During that period, the industry has been subject to increasing efficiency which now results in more chicken meat being produced in a shorter period of time than previously.

Most contracts provide for a system of payment to growers which guarantees that a certain average growing fee will be paid. Recommended growing fees currently reflect the average fee paid to specific pools within a particular processor's group of growers. Pooling arrangements are specified in Addendum's to the Growing Contract. A processor may have several pools of growers and their particular average weight will determine the fee received.

An individual grower's payment will be above or below the average growing fee depending on whether the flock's performance was above or below the average performance of all flocks within the grower's pool and grown during the same period. In other words, a grower will benefit by being paid more (bonuses or premiums) if they can produce a flock of heavier birds in a shorter period and using less feed than the average of all flocks produced in the same period. The system is structured so that efficient growers receive somewhat higher returns. The question that arises is whether these premiums are sufficient reward for superior performance, and conversely, whether the poorly performing growers are at a sufficient disadvantage relative to the better growers?

Growers are paid an agreed payment per live bird taken up for processing. This fee varies with performance efficiency in growing service. Deductions apply for failure to meet efficiency criteria with premiums paid for superior performance efficiency. The contribution of total live bird costs to the total delivered meat cost is summarised in Table 4.1.

TABLE 4.1 .DELIVERED COST OF CHICKEN MEAT, PERCENTAGE SHARES

<i>Cost Component</i>	<i>% of Delivered Meat Costs</i>
Growing Cost	14%
Other Live Bird Costs *	51%
Processing Costs	21%
Sales, Distribution and Administration Costs	14%
Total	100%

(* Note: Other live bird cost comprise day old chick, feed, pick-up and other associated costs. Growing costs represent 21% of live bird meat cost, and 14% of total delivered meat cost. This is equivalent to around 10% of the retail price of chicken meat).

(Source: Processors' Industry Data Sheet 1997)

Steggles have promoted the issue that efficiencies have been attained in areas which contribute to the cost of a chicken at the farm gate - excluding growers fees.

Efficiencies in production have been repeatedly mentioned in Committee deliberations as the key to ensuring continued competition with other meats and to address threats posed by imports. Consequently, central to the Committee's deliberations has been agreement as to the desirability of processors having the potential to reward those better performing growers in order to maintain consistency in growing weights (in accordance with their customers' requirements), and promoting efficiencies in production in the medium to long term.

Central to Steggles' submission was the view that industry must continue to improve efficiencies in all areas of growing arrangements and the costs associated with them; ie.. feed costs, chick costs and grower fees.

'In Steggles view (p.4) the industry structure which has been adopted in South Australia is a viable, fair and competitive industry model for the Queensland chicken meat industry.'

This involves the replacement of state industry based legislation with ACCC authorisation to permit collective negotiations between processors and their respective growers and representative committees.

'...the granting of authorisation (see Chapter 10) enabling the growers to negotiate collectively with Steggles may increase the efficiency of the negotiation process and enable Steggles and growers to contract on terms suitable to a deregulated environment ...'

Steggles does not support immediate deregulation in the absence of authorisation by ACCC as this would lead to a 'dislocation in the functioning of the market'.

Inghams appreciate the ACCC authorisation in South Australia as one of promoting the commercial relationship (including addressing dispute resolution issues) between processor and growers without the overt involvement of government. However:

'... we understand (p.4) the growers see this (ie.. Option 6.3a) as preferable to an Authorisation through the ACCC with a five year limitation ...'

and

'Providing a legislated structure provides (p.4) similar outcomes as the ACCC authorisation Inghams are fully supportive of such a structure.'

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Efficiencies in production have been repeatedly mentioned in Committee deliberations as the key to ensuring continued competition with other meats and to address threats posed by imports. Consequently, central to the Committee's deliberations has been agreement as to the desirability of processors having the potential to reward those better performing growers in order to maintain consistency in growing weights (in accordance with their customers' requirements), and promoting efficiencies in production in the medium to long term.

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'... we understand (p.4) the growers see this (ie.. Option 6.3a) as preferable to an Authorisation through the ACCC with a five year limitation ...'

and

'Providing a legislated structure provides (p.4) similar outcomes as the ACCC authorisation Inghams are fully supportive of such a structure.'

The Committee recognised that the pooling system does provide a degree of incentive for efficiencies in growing chickens. However, a more appropriate payment system would be one that more closely reflects grower performance in terms of costs per kilogram delivered to the processing plant.

Consequently, the Committee expects that its recommendations will allow for more flexibility in contract conditions, determination of the growing fee, and in processors being better placed to penalise poorer performance and provide rewards to better performing growers.

5. IMPACTS ON PROCESSORS

5.1 Industry Characteristics

The chicken meat industry in Queensland is made up of 111 contract growing farms owned by 108 contract growers supplying three major processing enterprises, Inghams Enterprises Pty Ltd, Steggle's Limited and Golden Cockerel Pty Limited (see table 5.1). Golden Cockerel Pty Limited are also supplied by company farms and through corporate arrangements through Darwalla Milling Company Pty Ltd and Woodlands Enterprises. There are a number of smaller processing establishments who purchase live birds from Darwalla or Woodlands for their own processing.

TABLE 5.1. QUEENSLAND INDUSTRY DATA 1997

<u>Processor</u>	<u>No. of Contract Growing Farms</u>
Inghams	54
Steggles	51
Golden Cockerel	6
Total	111

(Source: Queensland Chicken Growers Association)

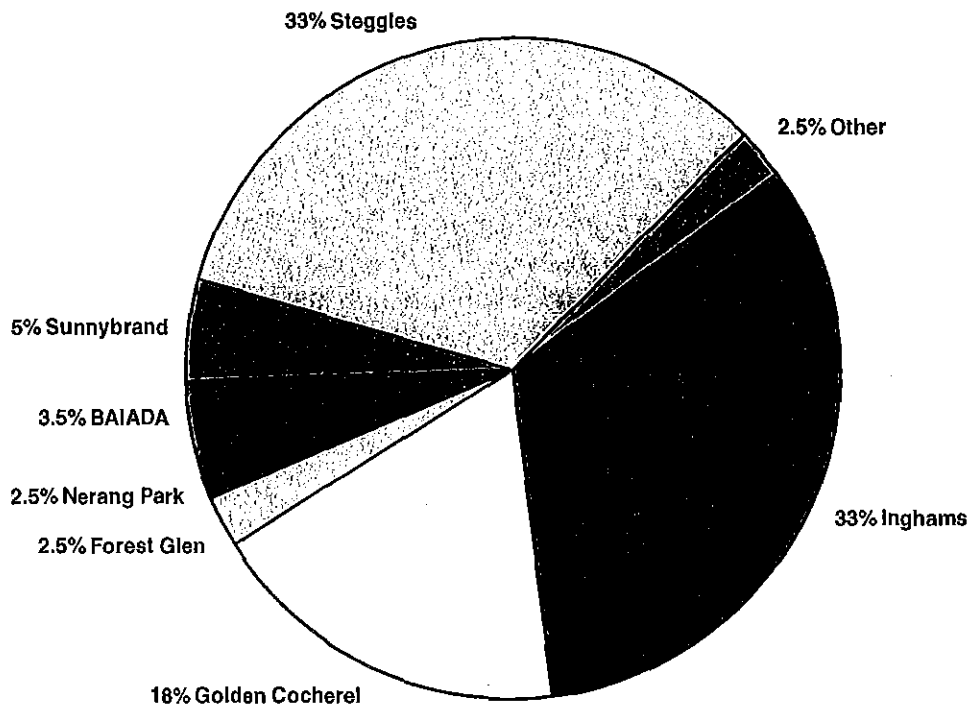
South East Queensland's geographic locality makes it viable for product to be sourced from northern New South Wales. Processors also have the ability to transport chicken meat to other states. Large retail organisations also have the ability to transport substantial volumes of frozen and fresh chicken meat from processors located in other states.

Chickens enter the Queensland market from Baiada, a major producer in the Tamworth region of northern NSW, from Sunnybrand in the Byron Bay area, from Barthers of Griffith NSW and a number of other NSW companies. This flow of product is more pronounced during periods of relatively high supplies in the NSW market. Queensland market shares, by company are shown in figure 5.1.

Each of the three major Queensland processors also supply product into the northern NSW markets. Some Queensland chicken meat is also supplied into the Northern Territory, especially to the Darwin market.

The industry is concentrated in the south east corner of Queensland with eleven growers in North Queensland, reflecting the market driven geographic relationship between growing and processing operations.

FIGURE 5.1...CONTEMPORARY QUEENSLAND RAW CHICKEN MARKET SHARES: BY COMPANY



(Source: Processors' Industry Data Sheet 1997)

In 1997 the growing sector is producing 67 million birds in Queensland, accounting for an estimated 19.5% of Australian production. The shares of chicken meat slaughtering in Queensland by company are summarised in Table 5.2. At wholesale prices production was valued at greater than \$150 million (at farm gate) and capital investment in the average farm is approximately \$1.2 million. The capital value of contract farms would thus be around \$133 million.

TABLE 5.2 .PROCESSORS' SHARES OF QUEENSLAND CHICKEN SLAUGHTER 1996

<u>Processor</u>	<u>Chickens Slaughtered</u>
Inghams	27 million
Steggles	24 million
Golden Cockerel	12 million
Other	4 million
Total	67 million

(Source: Queensland Chicken Growers Association)

Note: It is estimated that 52 million chickens (ie. 78%) were sourced from contract growers with the remainder sourced from company farms.

Processing operations in Queensland account for an estimated 2020 permanent and casual staff (on a person year basis). Capital investment is estimated at \$216 million in respect of the capital value of abattoirs and breeding farms, as well as the value of chickens, feed and medicines supplied to contract growers and processor chickens held as stock in trade.

5.2 Company versus Contract Farms

The major processors, who in the main, have structured their operations in Queensland on chickens supplied by contract growers, depend on a reliable supply of quality product to provide throughput for their operations and to service their markets.

The major processors have had the option to arrange supply of product through company farms but the majority have opted for the contract grower system. One reason for this relates to the large capital outlays (many in excess of \$1 million) required to establish grower facilities. It is therefore reasonable to assume that contract growing has proved a viable alternative for processors and that it is in the interest of processors to maintain contract growers in a viable position to ensure the long term maintenance of that relationship.

The key feature of the chicken meat industry is therefore that both growers and processors depend on each other for business survival.

5.3 Impact of Increasing Globalisation of the Industry ?

Processors feel that issues such as responding to dynamic consumer preferences and the reviewing of domestic production and trading practices in light of threats from imports is a central initiative of their business responsibilities. In other words, they are continually facing challenges and risk to a significant level.

In a report entitled "The Australian Chicken Meat Industry - *International Benchmarking*" (a report commissioned by the Australian Chicken Meat Federation and funded by the processing and growing segments of the industry, and the Commonwealth and Victorian Departments of Primary Industries), the topic of the internationalisation of the Australian industry was a central issue. According to the Report:

'Consumption of Australian poultry meat has increased steadily over the years as the industry has consistently achieved superior real price reductions to the consumer over the competing meats of beef, sheepmeat and pork.' (p.3); but

'In spite of the magnitude of the (Australian) industry's cost challenge (ie.. internationally comparable cost structures), the combined forces of international competition, domestic de-regulation and Uruguay Round world trade policy commitments (including the likely relaxation of quarantine) makes it imperative that the industry embark on a program of positive structural change to seek further productivity enhancement and bring down its cost base more closely to the United States' level.' (p.4).

This Review was conducted against a background of increasing globalisation of the chicken meat industry making it imperative that the domestic industry embark on a program of positive structural change to seek further productivity enhancement and decrease costs to:

- realise export opportunities (currently only approximately 2% of Australian production is exported); and,
- defeat import competition (both cooked and frozen chicken meat products from countries such as the US and Thailand).

The governments of the United States, Denmark, Thailand and New Zealand have all requested a relaxation of Australia's quarantine controls on imports of chicken meat. Imports of cooked chicken meat subject to scientifically based protocols are allowed as from November 1997. According to Hafi et al. (1994):

'The level of imports of chicken meat depends on the extent to which changes to the present quarantine regulations would allow exporting countries access to the Australian market. Industry sources claim that once imports are allowed they would grow to 20% of domestic consumption (around 90 000 tonnes a year) in a short period. This is because of the high volume and low profit margin nature of overseas export orientated industries. Thai poultry exports to the Japanese market reached 20% of Japanese consumption within a few years'. (Larkin 1991; Fairbrother 1992).

and

'The United States, assisted by its Export Enhancement Program, may land product in Australian ports at relatively lower prices, while Denmark which has an export subsidy program may also start to export chicken meat to Australia.' (Australian Business Monthly 1992)'.
(Hafi et al. 1994, p.41)

With the pressures from non-domestically sourced chicken meat constituting a contemporary challenge to the industry, the need to decrease costs is seen as an imperative and is featured predominantly in both Inghams' and Steggles' submissions. Inghams stated:

'... we no longer see the negotiation of fees or contracts on an industry basis as relevant and, in fact, see such a basis as one that is holding back and, in some cases, preventing efficiencies to be attained. If the Australian broiler industry, and in particular the contract growing of chickens, is to become world competitive, then the industry must move to operate in a less restrictive environment.'

(Submission p.3)



Central to the submission made by Steggles was the issue of the need for a more 'flexible' and less legislated industry. Specifically, less regulation will maintain the industry's growth rate through:

- promoting a closer professional relationship between grower and processor which will encourage greater investment within the industry;
- providing a greater range of different contractual arrangements to accommodate different growers' needs; and
- promoting efficiencies to counter domestic competition from other meats and imports of chicken meat.

This more 'flexible' industry may provide the greater scope for new and existing growers to enter into negotiations with other processors they are not currently contracted to - and for processors to do likewise. The Review Committee has determined that the ability to do this does exist under current legislation.

The Committee has accepted the processors' position, namely that a less restrictive environment would promote efficiencies which would assist in countering domestic competition from other meats and imported chicken meat. The capacity of the processor to achieve least cost production of chickens through individual contract negotiation and increased flexibility is likely to improve with a move to a less restrictive environment.

Recommendation 5.1.

Consequently the Committee recommends the adoption of a less restrictive legislated industry structure.

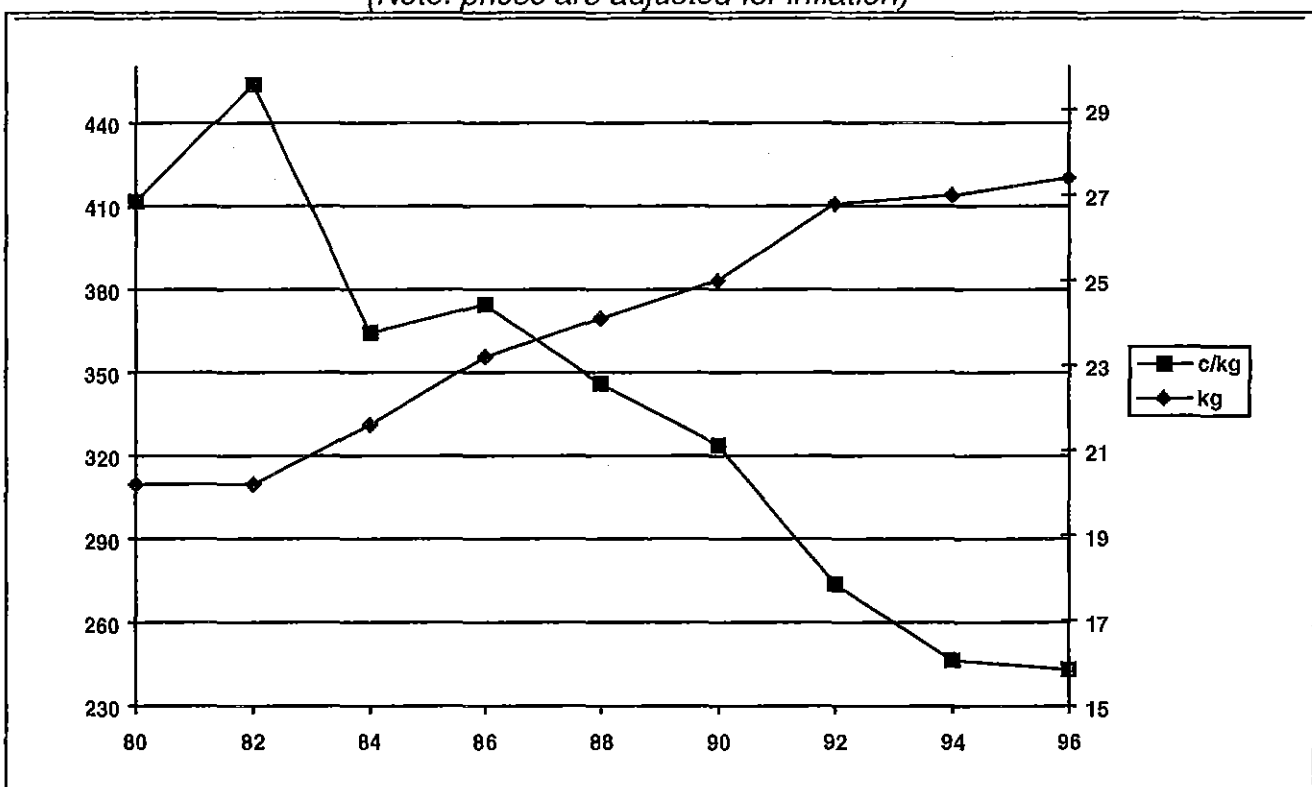
6. IMPACTS ON CONSUMERS AND ECONOMY GENERALLY

6.1 History of increasing competitiveness

There has been the classical demand response of increasing consumption associated with declining real retail prices of chicken (see Figure 6.1). This steady decline in retail prices has been enabled by efficiency gains resulting in lower unit costs of production. A major source of these lower unit costs has been the increasing efficiency of converting feed into chicken meat and so decreasing times on feed. Genetic improvement along with efficiency gains in all aspects of the growers' and processors' operations has been the source of these gains.

FIGURE 6.1. AUSTRALIAN PER CAPITA CONSUMPTION AND RETAIL PRICES OF CHICKEN MEAT

(Note: prices are adjusted for inflation)



(Source: ABARE Australian Commodity Statistics 1996)

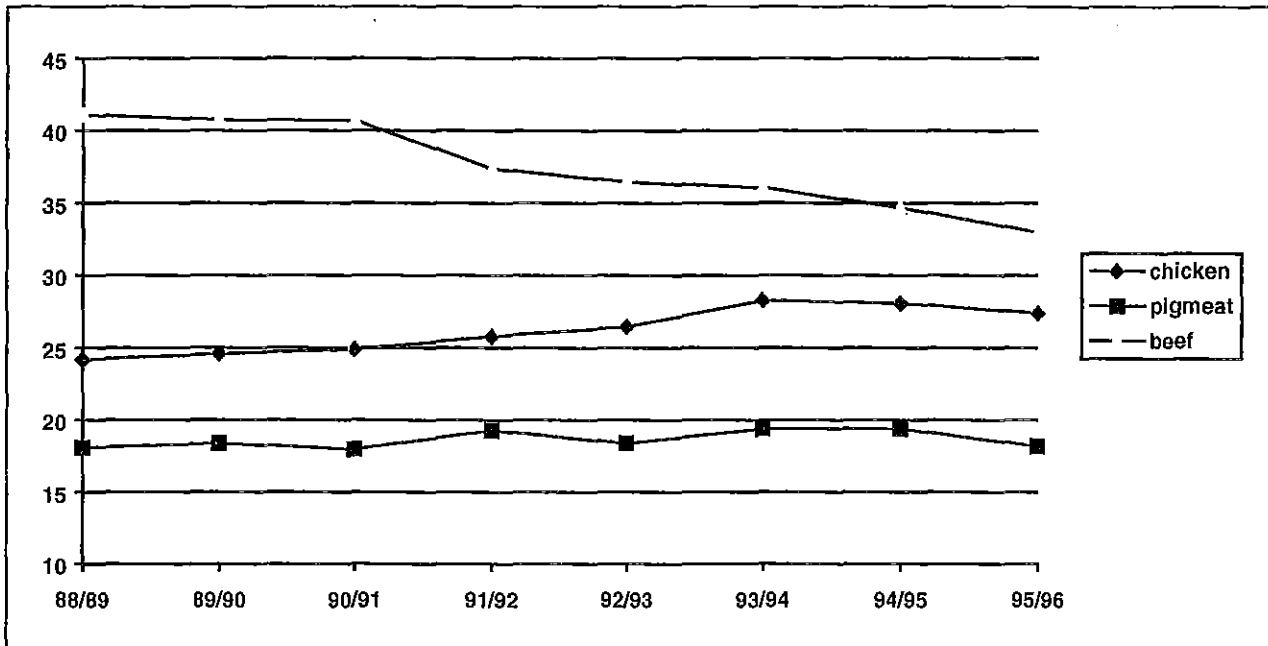
The above views correspond to those of the South Australia (Chicken) Growers (1996) who, in response to Inghams' application for the 'authorisation' of contractual growing arrangements in accordance with moves toward a deregulated industry, stated :

'the efficiencies in production evidenced in this graph have been achieved by:

- increased volume and productivity;
- increased efficiencies at all levels; and,
- decreased margins.'

Also indicated is the increase in the consumption of chicken meat (see figure 6.2) due to the fall in price of chicken meat compared to other meats.

FIGURE 6.2 AUSTRALIAN PER CAPITA MEAT CONSUMPTION (KG)



(Source: ABARE 'Outlook 97')

The existence of super normal profits or 'rents' accruing to growers would also put upward pressures on the retail price of chicken meat by increasing the price of each bird delivered to the processor.

Nevertheless, even if such rents did occur the industry (as is indicated above) is still competitive and consumption is still rising compared to other meats. However, these amounts tend to reflect the distorted value to growers of their contractual arrangements with processors. These rents would be indicative of a loss in the form of a loss of consumer surplus, an efficiency loss to the industry and a loss to society generally due to the current contractual arrangements.

Theory would dictate that the combination of a lower growing fee and greater efficiency in the production of chickens in a deregulated state, is likely to result in a decline in the retail price for chicken meat and chicken meat products. The extent of such a decline will depend on the degree of competition among wholesalers and retailers of chicken meat and chicken meat products. However the expected lower retail price will be offset, to some extent, by higher grower and processor transaction costs.

During deliberations the Committee concluded that a decrease in the cost associated with chicken meat production would only be partially passed on to the consumer. The Committee determined that the pricing transmission mechanisms employed by retail outlets are multi-faceted and go beyond mere immediate price considerations to encompass such issues as consistency in weight and quality, and inter-linking promotional support over a considerable period of time on both a state and national level. Therefore, the Committee determined that if the price of chicken meat decreased by 10 cents it would be realistic to infer that only a 5 cent reduction would be passed onto the consumer. This would be consistent with the marginal behaviour of entities in the marketing chain.

Increased costs incurred in the enforcement of environmental regulation with a move towards a non-restrictive state would be borne by society generally. Risks associated with quality and food safety have been deemed by the Review Committee to also increase as a result of the non-restrictive state. Further, the financial viability (ie. the attractiveness for financial institutions to support the industry) and continuity of the industry would be, to a degree, jeopardised.

However, the Review Committee has determined that the legislated industry structures identified in Options 6.3a and 6.3b would both provide consistency with the previously identified criteria.

The Committee appreciates that increased efficiencies have resulted in comparatively high levels of chicken meat consumption primarily due to declining real retail prices of chicken. Gains in efficiencies can be further attained with a move away from the industry based grower fee determination to a less restrictive environment. However, transaction costs, the maintenance of a degree of 'rents' and retail market behaviour could reduce potential efficiencies and gains to society generally. Another important factor is the lack of countervailing power in the growing sector without collective negotiation.

Recommendation 6.1.

Consequently, the Review Committee recommends the adoption of a less restrictive but legislated industry structure that promotes potential industry efficiencies and gains to society.

7. PUBLIC BENEFIT TEST ASSESSMENT ON MOVING TO THE LESS RESTRICTIVE REGULATORY STATE (OPTION 6.3A).

7.1 Introduction to public benefit test methodology

To implement the selected option and to introduce the necessary legislation it will need to be demonstrated that such action is in the public interest. Under the NCP PBT guidelines this means that the impacts, of restricting competition as detailed above (ie. the less restrictive legislated state) both positive and negative, on any affected group must be identified and, where possible, valued in dollar terms. The main affected groups include:

- existing contract chicken growers
- potential contract chicken growers
- chicken meat processors
- potential chicken meat processors
- consumers of chicken meat.

As indicated above, adoption of the selected option as the (modified) regulated state would require legislative authorisation of anti-competitive conduct, principally the use of collective negotiation to determine processor-wide standard growing fees and payment arrangements. In addition, legislative authorisation would need to be sought for any powers given to the processor based negotiating teams to approve agreements between processors and sub-groups of growers.

The Competition Principles Agreement specified two criteria for assessing whether anti-competitive legislation is in the public interest. Firstly, the benefits of the restriction have to outweigh the cost to the community, and secondly, the objectives of the legislation are only able to be achieved by restricting competition. The second criterion was addressed by the Review Committee earlier in deliberations.

In this report, the terms regulatory state and non-regulatory state, refer to the presence, or absence, of legislative or regulatory arrangements which restrict competition. Legislation or regulations are often necessary to enhance market performance or lower the "costs of doing business". If a state contains legislation or regulations that do not restrict competition, then it is considered to be a non-regulatory state for the purpose of this Review.

Following receipt of submissions and discussion by the Review Committee, it was agreed that Option 6.3a should be assessed in accordance with the first criterion. The Review Committee sought assistance from the Department of Primary Industries to undertake a Public Benefit Test (PBT) of this option and the outcome of this study is presented below.

7.2 Valuation of Grower impacts

For the purposes of this Review three main impacts on growers from moving from *the selected option* to a deregulated state will be assessed. A number of less concrete but nonetheless significant impacts are also likely, resulting in changes in investment levels, technology adoption and industry harmony. However, the extent and direction of these impacts are difficult to predict or quantify. The main quantifiable impacts include:

- (i) *lower growing fees as a result of the increased competition for chicken growing contracts.* This includes the loss of any economic rents which would accrue to growers due to the nature of the fee determination process;
- (ii) *lower growing fees reflecting a reduction in growing costs due to improved productivity following the relaxation of restrictions on contract availability and transferability;* and
- (iii) *increased transaction costs.*

The first impact represents, in the short term, a transfer of income from growers to processors while the second constitutes an efficiency gain as a result of resource savings in the production of a given quantity of chickens. The extent to which these reductions in growing fees are retained by processors or passed on in the form of lower consumer prices will be discussed in the sections dealing with processor and consumer impacts.

If all growers are currently operating at their least cost level of output and are not receiving any economic rents (returns above normal profits) as a result of the fee determination process, then any exercise of market power by processors would be matched by some reduction in industry output in response to the lower prices paid for the services provided by contract growers. The magnitude of such an impact on output would depend on such factors as the supply response of growers to a fall in grower fees (elasticity of supply of grower services) and the nature of the processor's demand for grower services (elasticity of demand for grower services).

If economic rents exist in the provision of growing services as a result of the fee determination process and other constraints on entry and industry adjustment, then these would be competed away in the deregulated state through competition among existing and potential growers for access to processor contracts. *In both cases the growing fee would fall.*

However, in the first case industry output unambiguously falls as growers respond to a lower fee for their services and this reduction in output represents a net welfare loss for society as a whole. In addition grower incomes also fall.

In the second case, output may remain unchanged, increase or decrease slightly *in comparison with the present regulated state.* However the total resources (ie. those supplied by both growers and processors) required to produce the existing level of output could fall as high cost growers are replaced by lower cost existing growers expanding their enterprises or by new entrants altogether. In addition, the increased

competition among growers may result in increased efficiency (ie. lower live bird costs per kilogram¹) across existing growers.

In both cases, processors gain through lower live bird costs but under competitive wholesale and retail markets for chicken meat most of these gains would be passed on to consumers in the form of lower retail chicken prices.

Transaction costs are costs of the drawing up of contracts, legal costs, search and information, bargaining and decision and policing and enforcement. Details of these are given in Section 3.4. The deregulated state is likely to result in an increase in bargaining and decision costs, and processors will experience an increase in search and information costs. The requirement for *individual* grower contracts in the deregulated state will therefore result in extra grower and processor costs which must be covered like all other costs involved in chicken production.

Loss of grower rents

One measure of the extent of rents in an industry is the difference between the walk-in-walk-out value of an existing chicken growing farm and the replacement value of a comparable farm, depreciated for the age of the existing farm². In the case of contract chicken growing a reliable estimate of the new replacement value of an average farm is provided in the farm model used for growing fee determination (see Attachment B). Using the farm model applied in the most recent review of growing fees (1.7.97) the new replacement cost of the 'average' chicken farm is as detailed in table 7.1.

TABLE 7.1 REPLACEMENT COST OF 'AVERAGE' CHICKEN FARM

Capital Item	Value(\$)
Shedding	524,017
Plant & Equipment	476,760
Roads	61,000
Owners Residence	60,000
Land	150,000
Total	\$1,271,777

¹ It should be noted that for the purposes of this PBT, efficiency improvements relate to reductions in live bird costs per kilogram of chicken meat produced and not cost per bird. Growers have submitted that lower costs per bird may be achieved at the expense of performance in terms of lower average live bird weights, feed conversion or quality of carcass. Hence, a weight based measure of productivity gains is necessary to overcome the limitations of using changes in costs per bird.

² The chicken growers' submission stated that the market value of an average 10 year old 4-shed farm in Australia is currently around \$800,000 while the cost of an equivalent "greenfield" development would be \$1,000,000.

Depreciating the model farm over say 6 years using the depreciation rates used in the fee determination model gives the depreciated farm value shown in Table 7.2.

TABLE 7.2 DEPRECIATED VALUE OF 6 YEAR OLD 'AVERAGE' CHICKEN FARM

Capital Item	Value(\$)
Shedding	398,253
Plant & Equipment	255,298
Roads	61,000
Owners Residence	49,200 ³
Land	300,000 ⁴
Total	\$1,063,751

In Queensland, the walk-in-walk-out (WIWO) market value of an existing farm which would be comparable to the farm used in the fee determining model shown in Table 7.1, would be in the order of \$1.2m (based on an accepted industry standard of \$15/bird).

An estimate of the rents earned by contract chicken growers can be obtained by contrasting the depreciated value of the model farm (ie. \$1,063,751) and the current market value of the comparable farm (ie. \$1.2m). The difference between these figures represents the capitalised value of future super-normal profits or rents. In other words, a purchaser would be able to pay the market price of \$1.2m for assets with a 'real' value closer to \$1,063,751 but would, under the present legislative framework, be able to earn super-normal profits to recoup the extra investment. A term often used to describe this component of farm assets is 'goodwill'.

Another indication of the presence of rents in the contract growing sector is the frequent occurrence of enquires to processors from persons wishing to invest in "greenfield" growing facilities. Such investors would avoid having to pay for the goodwill component in existing growing facilities.

Annualising the capitalised rents over, say, 20 years at an interest rate of 8% and expressing the annual figure on a per bird basis gives a rent per bird of around 5 cents. Table 7.3 below illustrates the sensitivity of this per bird rent to changes in interest rates and time periods.

³ It was necessary to adjust the farm model to include an owners residence as the market values of existing farms would, in most cases, include the owners house.

⁴ While the value of land in the current fee determination model is \$150,000 it was determined that a more realistic value of \$300,000 should be used for this purpose as it is more comparable to the land values found in the WIWO market valuation.

TABLE 7.3 RESULTS OF SENSITIVITY ANALYSIS ON PER BIRD RENTS. (CENTS/BIRD)

Period (years)	Interest Rate		
	4%	6%	8%
10	5.63	6.20	6.80
15	4.11	4.70	5.33
20	3.36	3.98	4.65

The rental value ranges from 3.36 cents per bird to 6.80 cents. Applying these two estimates of the rental value to the model farm shows that moving from the selected restrictive state to the non-restrictive state would result in a loss of farm income of between \$15,200 and \$30,737 or between 6.6% and 13.4% of gross farm income. The total impact on the contract growing sector would be a reduction in total sector income of between \$1.7m and \$3.4m per annum.

An important feature of Table 7.3, at least from a policy perspective, is the length of the period used to convert the 'goodwill' value to an annualised 'rental' value - ie. the implied payback period used by growers to calculate the worth of a walk-in-walk-out chicken farm. There is little evidence available to confirm or refute the values used in Table 7.3. As illustrated, the shorter the implied payback period, the higher the imputed rent per bird. A payback period significantly shorter than those used in Table 7.3, say 5 years, would mean that, in the case of deregulation, existing growers would suffer a much smaller capital loss if the transition period is in line with the length of the payback period.

As mentioned previously, the estimate of the likely impact of a move from the Review Committee's selected option to a deregulated state will depend on such matters as the process used for the determination of growing fees and other contractual details and the criteria under which the arbitrator is to operate, and on which his/her decisions are based. This analysis presumes that a process similar to that presently employed will continue under the Committee's selected option

Reduction in growing costs

Estimation of the possible reduction in the actual cost of growing chickens following deregulation is somewhat more difficult than measuring the loss of rents incurred by growers as shown above. If the total cost of producing a given quantity of chicken meat falls following deregulation then the costs saved constitute an efficiency gain and not a transfer between industry groups. Information on the level and distribution of growing costs per kilogram for existing growers and the growing costs of potential new entrants is required to make an assessment of any possible change in costs following the relaxation of entry restrictions.

As stated previously, growers maintain that the distribution of growers according to per bird growing costs is, at best, an inadequate indication of relative productivity across the growing sector. What is required is comparable data on both grower and processor live bird costs on a per kilogram basis. Unfortunately, data on the actual level and distribution of the unit (per kg) grower costs of chicken meat production are not available. In the following analysis per bird costs are used as a proxy for per kilogram costs with the results expressed on a per kg basis for further analysis in later sections.

The existing average 'rent-free' growing cost ranges from 40 to 44c/bird (ie. 47.65c/bird less 3.66 to 7.42c/bird). How much further this average cost could be reduced by the relaxation of entry restrictions and restrictions on contract transferability is not expected to be significant. A conservative estimate of likely productivity gains would be a reduction in rent free growing costs of between 3% to 5%. This equates to a cost saving of between 1.3 and 2.2c/bird or between 0.6 and 1.0c/kg of chicken meat delivered to processing plants. A less conservative estimate of the productivity gain of 1.5c/kg will be used later in the report to test the sensitivity of the overall results to changes in these assumptions.

7.3 Processor Impacts

Deregulation of the industry as previously identified could impact on processors in a number of ways. These impacts include:

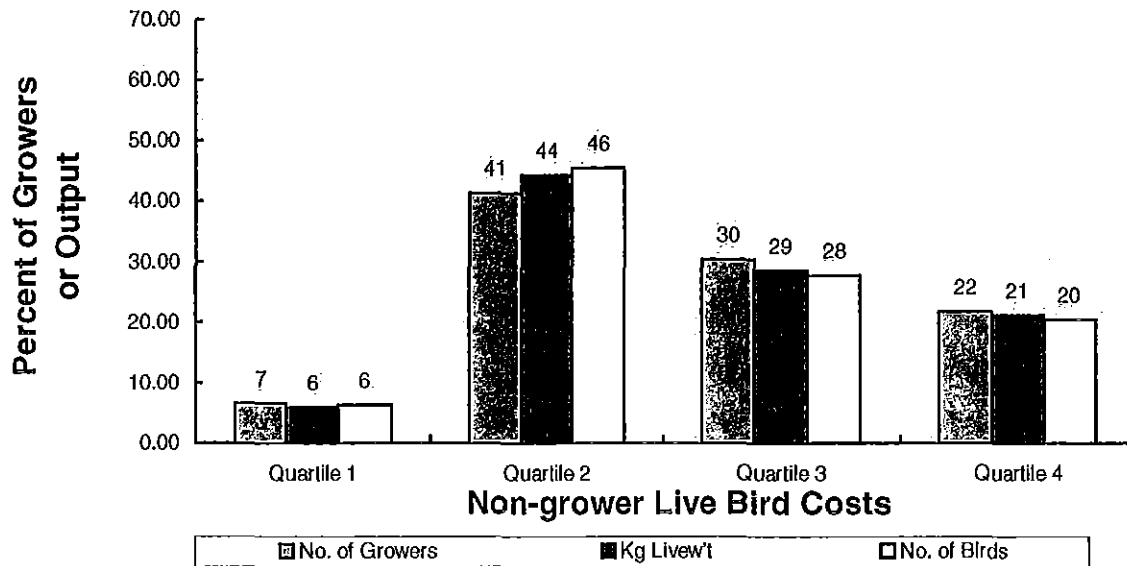
- reduced processor incurred live bird costs;
- increased transaction costs; and
- possible increase in the costs of maintaining food safety and chicken meat quality standards.

Reduction in processor live bird costs

In the deregulated state, the capacity of the processor to achieve the least cost production of chickens through individual contract negotiation and increased flexibility with regard to the supply of market growth is likely to be improved. The impact on processors resulting from this improvement is a reduction in the average live bird costs currently met by them including feed costs, bird health services, field services, etc.

Valuation of the reduction in the non-grower live bird costs incurred by processors has been undertaken using individual grower data provided by Steggles and Inghams. These data included the cost per kilogram of liveweight chickens for feed, bird health and medicines, field services, administration and day-old-chickens (DOC) over a 10 batch period. The distribution of growers and output by total non-grower live bird costs is shown in Figure 7.1 with the first quartile containing the least cost growers through to the highest cost growers in the fourth quartile. The weighted average cost for all growers was 87.26c/kg liveweight. As shown in Figure 7.1 the distribution of growers and output by non-grower or processor live bird costs is reasonably 'tight' with over 70% of all growers located in the two middle quartiles.

FIGURE 7.1: DISTRIBUTION OF GROWERS AND OUTPUT BY NON-GROWER LIVE BIRDS COSTS



Processors suggest that growing costs would fall following deregulation as a result of some improvement in efficiency following the replacement of less efficient growers by existing or new growers. While such improvements are possible under existing arrangements it is considered that they could be more easily achieved under the selected regulatory arrangements. However any gains in this area would be mollified by continued constraints on entry and on contract transferability under the selected regulatory arrangements.

Redistribution of around 50% of the output of the highest cost growers, ie. those in the top quartile, proportionately among the remaining growers, would result in total industry resource savings of \$395,000 per annum or \$3.60/tonne (liveweight) of chicken. If the output of these higher cost growers was redistributed to the next most efficient group the annual saving in processor live bird costs would be \$150,000 or \$1.36/tonne. Alternatively, if that output is taken up by the lowest cost group, average processor live bird costs would fall by \$6.45/tonne. These resource savings equate to productivity gains of less than 1%. While these gains may appear to be extremely conservative compared with the expected improvement in grower productivity, ie. between 3 and 5%, previous research suggests a much tighter distribution for processor live bird costs and hence considerable less scope for productivity gains in that cost component.

Increased transaction costs

As discussed earlier in a deregulated state, processors will be faced with an increase in search, bargaining and information costs. Again, all or some of these costs will be reflected in the price paid by consumers of chicken meat and chicken meat products.

Possible increase in the costs of maintaining food safety and chicken meat quality standards

The Review Committee identified the possibility of increased costs associated with food safety and quality primarily due to the absence of a degree of regulation in the non-restrictive state (ie. Option 6.6). However, in more restrictive cases the degree of risk was negligible due to involvement of an industry body in areas such as the setting of guidelines for agreements and the involvement of individual processor negotiating groups in contract negotiation.

7.4 Consumer Impacts

The impact of changes in growing costs (and grower returns) and transaction costs, on retail prices and consumer benefits following a move from a regulated to a deregulated state will depend, as mentioned earlier, on the degree of competition among wholesalers and retailers of chicken meat and chicken meat products.

While it is difficult to precisely predict the final impact of changes in costs at the grower and processor level on prices to consumers, it appears that the chicken meat and chicken meat products industry is characterised by a high level of price competition at the wholesale and retail level. Consequently any changes in costs brought about by a move from a regulated to a deregulated environment are likely to be reflected in a corresponding change in the wholesale and retail prices for chicken meat and chicken meat products.

As shown in Chapter 6 the real retail price for frozen chicken (\$/kg) has fallen, on average, by over 4 percent annually over the past 15 years (ABARE, 1996). While such a fall is largely the result of improvements in bird genetics and efficiencies in other aspects of bird production, these efficiency gains have been translated into falls in the retail price of frozen chickens and other chicken meat products (the price differential between frozen chicken meat and fresh chicken meat has remained relatively constant over the period with the exception of the past 18 months where the margin has narrowed significantly due to falling supplies of whole frozen chickens). The real growing fee, in contrast, fell by less than 3 percent per annum over the same period suggesting that at the wholesale and retail levels, competition among the sectors for market share has resulted in significant consumer benefits. It is difficult to argue that competitive behaviour at these levels would not persist in a deregulated environment.

The Review Committee concluded that a minimum of 50% of any cost reductions in the growing sector would be passed on to consumers in the form of lower retail chicken prices. For example, it is estimated that a total cost saving of between 7 and 9c/kg (liveweight) in the growing sector would result in a fall of between 11 and 14c/kg dressed weight, assuming a dressing percentage of 67%. Retail prices would therefore be expected to fall by at least 6c/kg.

7.5 Valuation of Common Impacts (Transaction costs)

The Review Committee estimated that total transaction costs would increase substantially in a deregulated environment by \$110,000 per annum. This figure may under-estimate the possible increase in these costs. In addition to the costs of contract negotiation, information gathering and other search and measurement costs, there would be the cost of establishing and maintaining the dispute settlement/arbitration mechanism which is a crucial element of the unrestricted state as defined above. These costs which equate to approximately \$1/tonne of chicken meat (liveweight) at existing output levels are shared equally between growers and processors in the calculation of group impacts.

If no dispute resolution mechanism is included in the unrestricted state, it is estimated that transaction costs could be in the order of two to three times greater than that referred to above - ie. \$2-3/tonne.

7.6 Valuation of Overall Net Impact on Economy

In assessing the most likely economy-wide impacts, it was necessary to first derive the impacts on each impacted group; the growers, the processors and finally the consumers. Second, if prices change there would be a second round effect on supply and demand and hence on the overall net impact on the economy. This second round component is termed an 'output' impact as it would be realised through induced changes in output.

The parameters outlined in earlier sections are now combined to use in the PBT and are summarised in Table 7.4.

Table 7.4 Key Parameters Used in the Public Benefit Test

Parameter	Units	Value
<i>Base quantities-</i>		
• Production level: - Selected Regulatory State	Birds	52 million
• Growing fee in Regulated State	c/bird	48c
• Average live bird weight	kg/bird	2.20kg
<i>Analysed changes-</i>		
• Production level in the Deregulated State	Birds	¹
• Increased transaction costs following deregulation	\$/tonne	1.00
• Loss of grower rents following deregulation	c/bird	5c
• Productivity gain leading to a fall in grower live bird costs following deregulation	c/kg	1c
• Productivity gain leading to a fall in processor live bird costs following deregulation	\$/tonne (live weight)	\$3.60
<i>Assumed response parameters-</i>		
• Elasticity of supply of chicken meat	-	5 ²
• Elasticity of demand for chicken meat	-	-0.8

¹ Output in the deregulated state is calculated using the model and will vary depending on price changes and supply and demand elasticities

² "For the long run, in an industry which uses non-specialised labour and easily replicated physical capital facilities, unitary supply elasticity seems much too low. The composite model assumes a supply elasticity of 10. Sensitivity testing shows that changes in the elasticity of supply have little effect on the social welfare loss....". Beck R, C Hoskins and G Murney (1994)

The impacts can be shown diagrammatically as in Figure 7.2. In this case the current industry situation is represented as 110,000,000 kg sold at a price of 109c/kg. Following deregulation productivity enables more to be produced at each price and a new market equilibrium is derived where 111,500,000 kg is supplied at a price of 107c/kg. The relative gains are shown as the respective shaded areas. The area labelled 'Consumer Gain(A)' is the positive impact on consumers at the existing output level (and incorporates the loss of rents to growers), 'Productivity Improvement(B)' is that portion of productivity gains retained by growers and processors while 'Consumer Gain(C)' and 'Producer Gain(D)' together represent the output effect following deregulation. The welfare changes are shown in Table 7.5.

FIGURE 7.2: WHOLESALE MARKET FOR CHICKENS

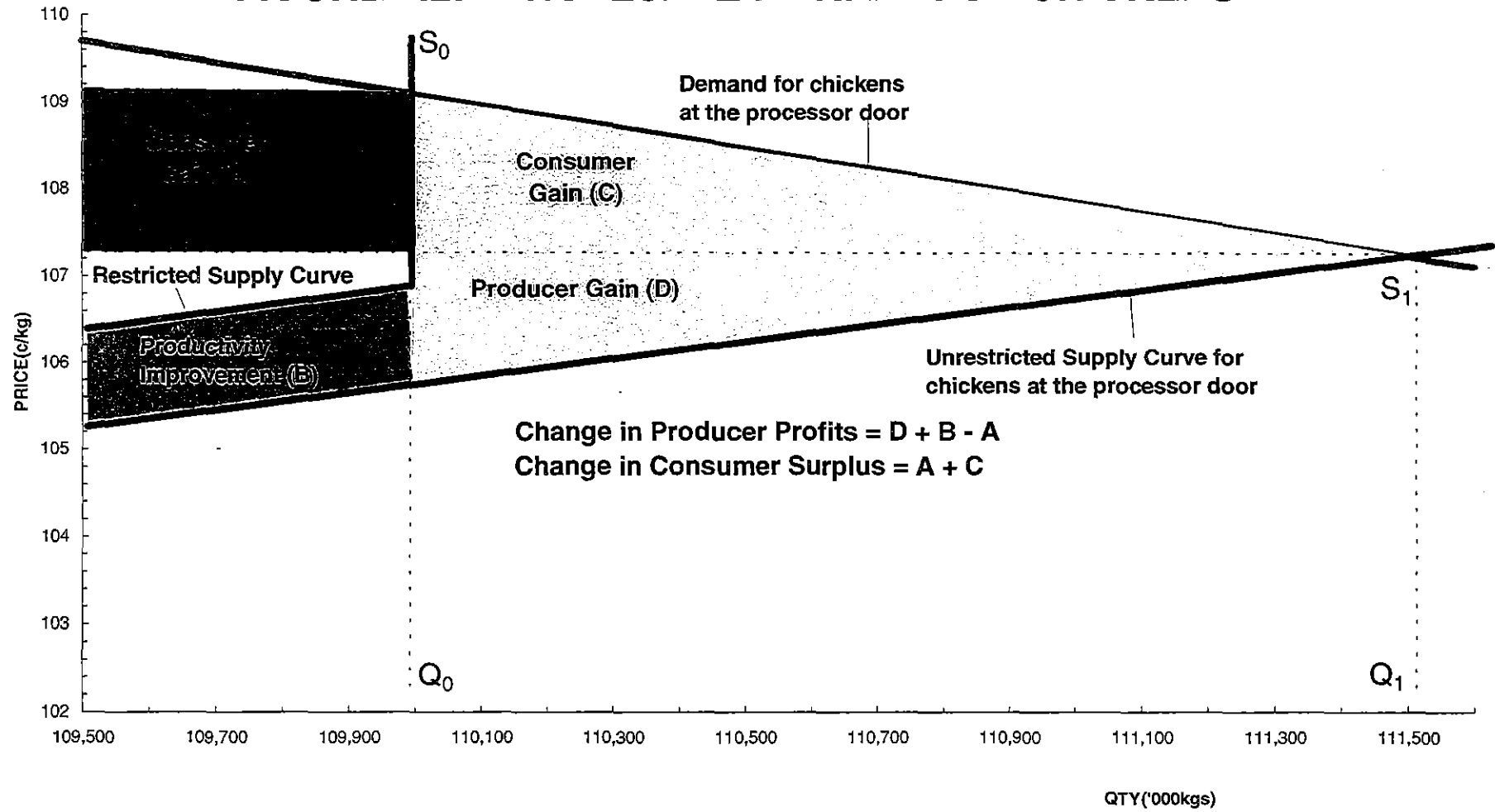


TABLE 7.5 : IMPACT OF DEREGULATION OF THE CHICKEN MEAT INDUSTRY ON AFFECTED GROUPS AND ON THE OVERALL ECONOMY OF QUEENSLAND.

Impacted Group	Calculation of benefit	Most Likely Outcome \$
Impact at existing output level		
<ul style="list-style-type: none"> • Consumers 	Total transfer of grower rents of 5c/bird plus a share of the productivity gains passed on by growers and processors. - Area A	3,263,793
<ul style="list-style-type: none"> • Growers 	The total loss of rents of 5c/bird plus a share of the productivity gains which growers retain. - Parts of Areas A and B.	(2,359,559)
<ul style="list-style-type: none"> • Processors 	A portion of the productivity gains which they retain. - Part of Area B	417,766
Output effect	The increase in welfare to consumers and producers following deregulation less the costs of producing that output increase. - Areas C and D	41,194
Net Welfare change	Summation of the above welfare changes	1,327,194

The tabled impact of removing restrictions by deregulating for the most likely outcome at the consumer level, means that consumers of chicken and chicken meat products would be potentially better off by an amount of \$3.26 million per annum. This is equivalent to around 3 c/kg on all chicken meat sold in Queensland. However the ultimate impact, as mentioned previously, will depend on the degree of competition among wholesalers and retailers of chicken and chicken meat products. If all efficiencies and reductions in rents are passed on to final consumers then the calculated figure(s) in Table 7.5 represent the benefits to consumers from a move from Option 6.3 to the deregulated state. To the extent some of these potential benefits are realised by wholesalers or retailers, then these benefits will be diminished.

It is estimated that, in aggregate, current growers of chicken will be worse off by an amount of \$2.36 million per annum. This represents a decline in annual farm incomes of approximately \$20,000. This follows from the predicted fall in the growing fee as a result of competition and removal of rents, and further falls in the growing fee subsequent to productivity improvements and industry restructuring. Processors of chicken meat are expected to be better off by approximately \$420,000 as a result of savings in non-grower live bird costs subsequent to restructuring of the industry.

The net welfare change (with all impacts equally weighted) is, not surprisingly, small given the demand elasticities used in the analysis. The overall net impact of a move from the selected option to a deregulated state is \$1.3m per annum.

The results contained in Table 7.5 do not include the non-quantifiable factors shown in Table 2.1. The impacts of these factors are considered to be small and their inclusion would not significantly alter the magnitude of the net welfare change or the individual group impacts shown above.

7.7 Sensitivity Analysis

The results of the analysis of most likely response is now subjected to a sensitivity test to better understand the relative responsiveness to issues identified in the earlier analysis. These alternate scenarios as shown in Table 7.6 are characterised by:

- no productivity gains achieved in the production of chickens following deregulation;
- higher and lower initial per bird rental values as shown in Table 7.3 ; and
- a lower elasticity of supply for wholesale chicken meat than that used in the most likely situation.

TABLE 7.6: SENSITIVITY ANALYSIS OF THE IMPACT OF DEREGULATION OF THE CHICKEN MEAT INDUSTRY(\$)

Impacted Group	Most Likely Outcome	No Productivity Gains	Higher Rental Value (6.8c)	Lower Rental Value (3.36c)	Supply Elasticity (2.0)
Impact at existing output level -					
• Consumers	3,263,793	2,060,345	4,039,655	2,556,897	2,704,286
• Growers	(2,359,559)	(2,082,345)	(3,270,731)	(1,598,179)	(2,283,657)
• Processors	417,766	(88,000)	517,076	327,283	865,371
Output effect	41,194	16,416	63,107	25,282	34,132
Net Welfare change	1,327,194	(93,584)	1,349,107	1,311,282	1,320,132

From this analysis it is clear that the variable which has by far the largest impact is the productivity levels. Alternate assumptions of the rental value or supply elasticities make little (less than 2%) difference.

Consequently, the Committee considered the issue of productivity in much greater detail. Further sensitivity analysis was conducted on the extent of any productivity improvements which could result from deregulation. High, low and most likely values, as presented in sections 7.2 and 7.3, are used for both sources of productivity improvement. The results are presented in Table 7.7.

TABLE 7.7 SENSITIVITY ANALYSIS OF PRODUCTIVITY GAINS FROM DE-REGULATION

(\$ Net Welfare Change)
Grower live bird cost savings (c/kg)

		0.6	1.0	1.5
Processor live bird cost savings (\$/t)	1.36	566,345	1,075,606	1,842,482
	3.60	817,032	1,327,194	2,095,131
	6.45	1,136,735	1,647,798	2,417,087

The table sets out the responsiveness of the ranges identified in the discussion around the most likely values. This analysis demonstrates that it is the changes in grower productivity which have the greater impact, around twice that of processor live bird costs. This reflects the much greater spread in the distribution of grower live bird costs relative to the more densely distributed processor live bird cost performance. This posed problems for the Committee since no recent survey of grower costs was available and, in particular, no ability existed to relate high and low cost growers respectively to those growers having high or low performance in delivered live bird processor costs. Nevertheless, even if high grower live bird costs were associated with lower processor live bird costs in all cases, it is still likely that some productivity response would result and average grower live bird costs, per kilogram liveweight, would fall.

7.8 Minority view of some Review Committee members

Review Committee members representing chicken growers and the CMIC disagree with the conclusions drawn from the PBT of Option 6.3a and submit that this Option is clearly in the public interest. Consequently, the consideration of less restrictive options, in their view, is unnecessary. In particular, these members maintain that:

- The estimated productivity gains achieved under total deregulation, and hence foregone under Option 6.3a, are totally unsubstantiated. They further argue that any productivity gains available have, in fact, been achieved by the industry as demonstrated by the significant fall in real chicken meat prices depicted in Figure 6.1.
- In addition, the current CMIC Act does not prevent processors from undertaking any redistribution of growing contracts to achieve an overall improvement in the economic performance of the growing sector.
- The estimated per bird rental values used in the PBT assessment to calculate changes in consumer and grower surpluses are substantially overstated. The methodology used to calculate these rental values, albeit theoretically sound, fails to take account of a number of practical considerations and the realities involved in chicken production. Specifically, estimation of the market value of the representative farm used in the analysis is based on a 'rule of thumb' which may or may not bear any relationship with actual current market values.
- Further, the role of the CMIC in the negotiation of growing fees has been overstated in this Review. Growing fees negotiated between processors as a group and growers as a group are simply acknowledged by the CMIC and form the base for price determination. However, this base price does not represent a 'standard growing fee' across the entire industry and does not constitute the price which must be paid by a processor for each chicken grown.



- Insufficient consideration was given to qualitative factors such as public health and safety, industry stability and investor confidence.
- In addition, the assessment failed to take account of the contribution which the current and proposed arrangements would make to harmony within the industry and the resulting productivity gains which have been achieved. Deregulation of the industry as defined by Option 6.6 will result in substantial disruption within the industry and an increase in growing costs and ultimately in retail prices.
- In the unlikely event that any reduction in live bird costs could be achieved through further deregulation, little, if any, of the potential consumer gains identified above would result in practice. It is the minority view of these members that any potential gains would most likely be captured by the major chicken retailers and to a lesser extent by chicken meat processors.

In summary, movement to a state less restrictive than that defined by Option 6.3a would not result in any productivity gains; would not benefit consumers to any degree; would result in costly disruption in the industry; and cause a reduction in investment in the industry, particularly in new technology. Therefore, a public benefit can be obtained from a movement from the unrestrictive state to Option 6.3(a).

7.9 Majority view of Review Committee members

The majority of the Review Committee, while acknowledging the views expressed by representatives of growers and the CMIC, were of the view that the results of the PBT of Option 6.3a, to the extent that it is possible, reflect the direction and magnitude of the economic impacts associated with the restrictions contained in that option. Consequently, as Option 6.3a does not pass the PBT (ie. does not show a clear public benefit) a less restrictive option needs to be considered.

With regard to the specific points raised in the minority report the Review Committee, by majority, states that:

- While estimates of productivity gains may be somewhat subjective, it is considered highly unlikely that the relaxation of restrictive practices in an industry which has been subjected to restrictions for a number of years would not result in some productivity improvement. The estimates of productivity gains used in the PBT of Option 6.3a are not, in the Review Committee's view, overly optimistic. It should be noted that, if other impacts are ignored, productivity *losses* would have to occur following deregulation for the proposed restrictions to pass the PBT. The Review Committee, by majority, considers this to be highly unlikely.
- With respect to the ability of processors to redistribute existing grower contracts to achieve productivity improvements, the Review Committee concludes that the combined effect of collective bargaining and compulsory arbitration on growing fees and other contract conditions for new contracts is to restrict the processors ability to redistribute contracts among existing growers and to encourage the entry of new growers.
- With respect to the calculation of above normal profits (rents) in chicken growing, the Review Committee has noted advice that the methodology used in the PBT is appropriate and was correctly applied. They concur with the general magnitude and direction of the results obtained. Further, the Review Committee believes that these above normal profits would continue to exist under Option 6.3a with the resultant adverse impact on consumers.

- The net impact of non-quantifiable factors is not expected to be large enough to offset the estimated gains associated with further deregulation. Also, the magnitude of the impacts of such factors as the continuation of industry harmony, investor confidence and stability are not only difficult to quantify in dollar terms but the direction of those impacts is not always clear. For example, deregulation may have a positive influence on investment levels as new and existing growers and processors respond to new opportunities as a result of the output effects of deregulation. Improved productivity may also assist the industry withstand the threat of imports and result in a more stable industry.
- With respect to public health and safety and environmental factors, the majority view of the Committee was that there are a range of other legislative and non-legislative mechanisms specifically designed to ensure public health and environmental safety and that deregulation would not significantly reduce the efficacy of those instruments.
- Finally, the majority of the Review Committee recognises the potential for capture of some of the farmgate price reduction by processors and/or retailers. As stated in section 7.4 above, the Committee concluded that approximately 50% of any cost savings in the growing sector would be passed on in the form of lower consumer prices. No conclusion was drawn as to who would appropriate the remaining 50%. Further, analysis conducted earlier suggests that in the past 15 years productivity gains in the growing sector appear to have been passed on in full to consumers, at least for frozen whole chickens.

To conclude, the majority of the Committee views Option 6.3a as imposing a net cost on the community in terms of a loss of potential productivity gains, continuation of a significant transfer from consumers to chicken growers and lower output of chickens than would occur under a deregulated market. ***Under the Competition Principles Agreement the application of the PBT must result in a clear net public benefit of retaining any legislation that restricts competition.***

Hence, for the minority view to be accepted, not only would the estimated gains from further deregulation need to be shown to be either totally non-existent or overwhelmed by other negative factors, but additional negative impacts would need to be clearly identified. The Review Committee, by majority, does not consider that such a case has been adequately demonstrated by the minority members of the Committee.

7.10 Who wins and who would lose from the less restrictive case.

The estimated economic rents earned by contract chicken growers represent the capitalised value of future super-normal profits or rents. In other words, a purchaser would be able to pay more for assets with a 'real' value less than that value. While a term often used by producers to describe this component of farm assets is 'goodwill', it represents a negative impact on consumers. This gain to growers is a transfer from consumers, via the processors, because consumers are asked to pay a higher price than would be asked in a perfectly competitive market.

On the other hand, the possible reduction in the actual cost of growing chickens following adoption of a less restrictive environment constitutes an efficiency gain and not a transfer between industry groups. How much average live bird costs could be reduced by the relaxation of entry restrictions and restrictions on contract transferability is not expected to be significant. Potentially, it is a partial redistribution amongst growers since the fall in average costs will result from the redistribution of some growing contracts from high cost growers to more efficient existing or potential ones.

Moreover, potential contract growers should find their ability to enter the industry may be enhanced as growing contracts are redistributed on the basis of total live bird cost performance.

As stated previously, processors of chicken meat are expected to be better off by approximately \$420,000 as a result of savings in non-grower live bird costs subsequent to restructuring of the industry. Further, depending on how much of the reduction in grower rents is passed on to consumers and how much is retained by processors, the potential exists for the gains to be greater. However, it has been shown historically that most of the reduction in costs have been translated into retail price reductions and hence, the likelihood of processors retaining this rent is low.

The Committee acknowledged that the adoption of the less restrictive legislative option (6.3a) would require it to satisfy the PBT by providing net benefits to the community.

However, the PBT identified that there was a net cost to the community of the less restrictive Option 6.3a. The costs incurred by the community as a whole, principally in the form of higher retail prices compared to the unrestrictive case, out-weigh the benefits of the restrictions. The higher retail prices are associated with the restrictions allowing above normal profits to be earned by the contract growers. The resulting reduction in consumer welfare exceeded the savings in transaction costs. These savings resulted from the ability to undertake collective negotiation which minimises bargaining and decision costs, and search, information, policing and enforcement costs.

Dissent was expressed by representatives from the CMIC and Growers regarding the methodology and the data used to ascertain benefits and costs. In acknowledging the need to move toward less regulation they view Option 6.3a as appropriate. Specifically, they contend that the inclusion of collective negotiation and compulsory arbitration on growing fees and other contract conditions for new contracts will not result in Option 6.3a failing the PBT.

However, in the view of the majority of the Review Committee the PBT has indicated that Option 6.3a leads to a net cost to the community by the maintenance of restrictive practices. Consequently, as Option 6.3a did not satisfy the PBT, the Committee, by majority, rejected this option and identified an alternative option, Option 6.3b, for review.

8. PUBLIC BENEFIT TEST ON MOVING TO A LEAST RESTRICTIVE LEGISLATIVE OPTION AND ISSUES OF TRANSITION.

8.1. Impact of removal of most restrictive elements of Option 6.3a.

Option 6.3b is a much less restrictive, but still regulated, environment where contracts between individual growers and processors exist. The CMIC Act which authorises the negotiation of growing fees by the CMIC and requires all contracts be approved by the CMIC would be amended, thereby eliminating the perceived anti-competitive effects of the legislation. A dispute settlement/arbitration system would be retained in legislation but only to address disputes relating to performance matters with respect to contractual obligations. It would not deal with disputes relating to the initial determination of growing fees and contract conditions. It could deal with disputes relating to the 6 monthly adjustments of growing fees under existing contracts.

This would involve the elimination of the role of the CMIC in growing fee determination but maintain the processor negotiating groups similar to those in Option 6.3a. Specifically, this option would be characterised by legislation which provided for:

- the creation of a number of individual processor based negotiating groups responsible for negotiating the detailed terms and conditions of growing contracts, including growing fees. Such groups would still be authorised to bargain collectively with their respective processors;
- the CMIC or other agreed body to mediate disputes referred to it by the processor negotiating groups over matters relating to existing contract conditions;
- original contract negotiation not subject to legislated dispute resolution procedure;
- all collectively negotiated contracts may provide for periodic reviews and adjustments of growing fees and other contract conditions;
- the negotiation of one or more payment options available to all qualifying growers; and
- the negotiation of special contractual arrangements between a processor and individual or groups of growers outside the collective negotiations.

This would constitute a regulated (ie.. legislated) yet less restrictive environment, and due to its similarities to Option 6.3a, it will be referred to as Option 6.3b.

8.2. Quantifying the PBT of Option 6.3b against deregulation

Loss of grower rents

The estimate of the rents earned by contract chicken growers in this case is close to zero because there is no significant market power exercised by growers and no price setting by any party. A purchaser would not pay a higher than 'real' value of existing properties because there are no super normal profits to be earned. The price would be determined by the market.

Reduction in growing costs

The existing average 'rent-free' growing cost ranges from 40 to 44c/bird. As stated previously, a reduction in average growing costs or productivity gain could result from a redistribution of growing contracts from high to low cost growers where costs are defined on a cent/kilogram liveweight basis. In this analysis it is assumed that any productivity gains which could be achieved under a completely deregulated state are largely achieved under Option 6.3b. Hence, little, if any, further reductions in average growing costs could be achieved by further deregulation or, alternatively, no potential gains will be foregone by implementing Option 6.3b.

Reduction in processor live bird costs

Redistribution of the output of high cost growers to low cost growers under complete deregulation would also be expected to result in a reduction in average processor live bird growing costs. Once again, it is assumed that the adoption of Option 6.3b would effectively achieve the same reduction in average processor live bird costs as would total deregulation. Therefore, no productivity gains are foregone by the adoption of Option 6.3b.

The impact of changes in growing costs (and grower returns) and transaction costs on consumers

The Review Committee estimated that total transaction costs would increase substantially in a deregulated environment by at least \$110,000 per annum. These costs include the costs of contract negotiation, information gathering and other search and measurement costs. Consequently, an increase in transaction costs following deregulation of around \$110,000 has been used in the following analysis. These costs equate to approximately \$1/tonne of chicken meat (liveweight) at existing output levels. In the calculation of group impacts these costs were shared proportionally between growers and processors on the basis of the relative shares of total growing costs.

In assessing the most likely economy-wide impacts on each impacted group and the overall net impact on the economy the following values of key variables were used:

TABLE 8.1 VALUES OF KEY VARIABLES USED IN THE PUBLIC BENEFIT TEST OF OPTION 6.3B

Parameter	Units	Value
Production level	Million birds	53
Growing fee	c/bird	43c
Loss of grower rents following deregulation	c/bird	0c
Fall in growing costs following deregulation	c/kg	0c
Fall in processor live bird costs following deregulation	\$/tonne (liveweight)	\$0
Elasticity of supply of chicken meat	-	5
Elasticity of demand for chicken meat	-	-0.8
Average live bird weight	kg/bird	2.20kg
Increased transaction costs	\$/tonne	1.00

TABLE 8.2: IMPACT OF A MOVE FROM OPTION 6.3B TO TOTAL DE-REGULATION OF THE CHICKEN MEAT INDUSTRY ON AFFECTED GROUPS AND ON THE OVERALL ECONOMY OF QUEENSLAND (\$)

Impacted Group	Impact
Impact at existing output level -	
• Consumers	(94,828)
• Growers	(3,034)
• Processors	(12,138)
Output effect	Small Negative
Net Welfare change	(\$110,000)

As shown in Table 8.2 Option 6.3b passes the PBT as further de-regulation would impose additional costs on consumers and producers of chicken meat. The net welfare change, given the characteristics of Option 6.3b, are effectively the increase in transaction costs which result from further de-regulation. The overall net impact of a move from the selected option to a deregulated state is \$110,000 per annum. Hence, the higher the transaction costs assumption used in the analysis the higher the net welfare loss of further de-regulation.

Given the elasticities used in the analysis, the majority of the welfare loss would be born by consumers even though the higher transaction costs will be initially incurred by growers and processors.

The least restrictive legislative option, namely Option 6.3b, was similar to Option 6.3a with the essential difference that no arbitration (or mechanism for setting the growing fee when it failed to be determined by negotiation) is provided for during initial contract negotiation. Option 6.3b was subsequently shown to provide a net public benefit and hence satisfies the PBT criterion. It was shown to have the benefits of reduced grower rents, potential productivity gains and lower transaction costs. These gains arise in part since it provides for a collective bargaining process of negotiation between processors and growers. It would also be the intention of this legislative option that an external dispute resolution mechanism be identified to address disputes relating to compliance with existing contract conditions and determination of disputes relating to the adjustment of growing fees during the period of existing contracts.

In contrast to Option 6.3a this option does not lead to costs on consumers. Transfers from consumers to growers in the form of super normal rents could not be said to result from such legislation. Further, the very substantial transaction costs which would arise in a totally deregulated state are avoided.

Recommendation 8.1.

Consequently, the Committee recommends that legislation consistent with Option 6.3b should be introduced. Specifically, the Review Committee recommends that the Chicken Meat Industry Committee Act 1976 be redrafted to provide for:

- *a process of collective negotiation between individual processors and their grower groups; and*
- *an external dispute resolution mechanism to address disputes relating to contracts, including growing fee adjustments during existing contracts but excluding the negotiation of initial contract conditions.*

8.3. Comparison of 'least restrictive legislative' with 'authorised' chicken industry state

The South Australian ACCC authorisation for Inghams, and pending for Steggles, has marked similarities with the Option 6.3b as proposed. Key areas of similarity and difference are noted in Table 8.1.

Key similarities exist on almost all key features. Collective bargaining for processor groups is allowed, no arbitration on fee determination on new contracts occurs, but there are similar dispute resolution arrangements for contract matters and fee adjustment. The additional benefits of the proposed Option 6.3b are the legislative certainty as opposed to the five year transition with authorisation, and a requirement for written contracts. In this regard the 'least restrictive legislative' state should have the support of most industry participants. In particular, both Inghams (see pages 23 & 40) and Steggles (see page 39) supported such structures in their submissions. The Queensland Chicken Growers Association assisted the South Australian ACCC authorisation application. However, the Growers believed that ACCC authorisation provided for independent arbitration on the initial contract and specifically the setting of the fee. This does not appear to be the case under authorisation.

In summary, Option 6.3b would appear to provide a framework for future industry development broadly acceptable to the majority of participants.

TABLE 8.3. CHARACTERISTICS OF REGULATORY AND ACCC AUTHORISED STATES CONSIDERED.

Attribute	Least restrictive legislation (option 6.3b)	ACCC authorised industry model (option 6.5)	Unrestrictive case (option 6.6)
1. Guidelines for agreements (minimum conditions)	CMIC and/or industry bodies recommend	Industry bodies/ACCC recommend	Industry bodies recommend
2. Examination of agreements to ensure guidelines followed and approval of agreements	None	None	No vetting or approval and there is the ability to have flexible fee arrangements
3. Requirement for a <u>written</u> contract	Legislative requirement	None	None
4. Collective bargaining negotiation process between processors and growers	Individual processor negotiating groups	Individual processor negotiating groups	None without ACCC authorisation
5. Ability to opt out of individual processor negotiating groups	Yes	Yes	Not applicable
6. Determination of the initial growing fee and other contract conditions for new contracts (for a negotiating group or individual, for a given period)	Market determined between processor and grower negotiating groups or individual grower	Market determined between processor and grower negotiating groups or individual growers	Market determined between processor and individual grower
7. Mediation of disputes relating to existing contract conditions, excluding growing fee adjustments	CMIC appointed mediator	Australian Commercial Disputes Centre (ACDC)	Courts
8. Arbitration of disputes arising from negotiation of new contracts, including disputes relating to the growing fees	None	None	None
9. Determination of disputes under existing contracts, including batch payments	CMIC appointed independent arbitrator under legislation	ACDC appointed independent expert	Courts
10. Determination of disputes relating to growing fee adjustments under exiting contracts	Formal mediation and arbitration under legislation (not CMIC)	ACDC appointed independent expert	By agreement

8.4. Timing, adjustment and the need for transition.

Contract growers who have been long term industry participants appear to have benefited from the existence of rents and this has been capitalised into their growing operations. On the other hand, producers who have recently purchased an established property and paid a higher price on the expectation that this will be offset over time may be financially disadvantaged if restrictions are removed immediately.

Growers who have purchased farms and who based the valuation of that farm on a short payback period will be less impacted than those who purchased with a longer payback period. Some growers may fall into this latter category because of the need to pay higher interest rates on borrowed capital.

Consequently, the issue of an implementation or transition period becomes relevant. Clearly, the longer the adjustment period allowed the fewer will be the number of growers disadvantaged. However, offsetting this, the longer the period allowed the slower will be the adjustment process and the longer it will take to achieve the efficiency gains identified with this option.

It can be argued that the adjustment costs would be minimal because most of the efficiency gains that could be gained would result from actions of the processors to restore a balance of incentives and penalties to the more and less efficient growers respectively. This would occur largely independent of any change in the level of regulation.

The legislation framework implemented will also determine the adjustment path and the need for explicit transition arrangements. For example, implementation of Option 6.3b would still provide a framework for processors and contract growers to minimise transaction costs (a public benefit) and to make most, if not all, of the efficiency gains potentially available from total deregulation. If such a path was implemented, then implementation could be immediate and no transition period or phased implementation would be required.

The Committee concluded that if Option 6.3b were adopted then the gains from the move to a less restricted environment would flow while adjustment costs will be minimised. Moreover, the collectively agreed actions of processors and growers would ensure that adjustments were not so severe as to cause industry displacement or instability. Therefore, the Committee considers that a transition arrangement would not be necessary.

9. TRADE PRACTICES ACT (1974) IMPLICATIONS

The provisions of the CMIC Act and particularly the powers granted to the CMIC relating to growing fees and the approval of agreements between growers and processors are anti-competitive. Further, in the absence of an exemption, conduct consistent with these provisions by the CMIC and growers and processors may contravene the Trade Practices Act 1974.

As section 51 of the Trade Practices Act presently exempts activities specifically authorised by a State Act, conduct or activities consistent with the provisions of the CMIC Act are authorised. However, on 21 July 1998 an amendment to section 51 will take effect which will make such legislation ineffective.

Recommendation 9.1.

Because the least restrictive legislative (Option 6.3b) case still has collective bargaining provisions it may be argued that this process and contracts resulting from this structure would be in potential breach of the TPA beyond 21 July 1998. Consequently, the Committee recommends that explicit TPA exemption authorising this conduct be included in the amended CMIC Act.

10. AUTHORISATION

The South Australian experience may provide a useful contemporary example of how an industry can negotiate contracts without the involvement of a formal industry body and government. There, the Australian Competition and Consumer Commission (ACCC) has been satisfied that anti-competitive effects of proposed arrangements between South Australian growers and Inghams are outweighed by the public benefits. In this instance the ACCC has provided an exemption.

The ACCC in South Australia has recently approved contracts between growers and the processor Inghams beyond the scope of the state legislation that was originally enacted to promote the 'stability' of the industry. The contracts are anti-competitive in nature, are 5 years in duration and are designed to assist the industry move to complete deregulation within that period. Steggle's South Australia has an application pending.

Mr Alan Ducret, Regional Director (Queensland), Australian Competition and Consumer Commission confirmed that industry members could still pursue authorisation regardless of the outcome of this Review.

During the course of deliberations the Committee ascertained that authorisation is to be initiated by participants of a particular industry, and hence falls outside the scope of the Review.

Recommendation 10.1.

The Review Committee acknowledges that the option continues to exist for industry bodies to seek authorisation from the ACCC. The Committee declined to recommend any action in this regard because it concluded that such action would be outside of its Terms of Reference.

ATTACHMENT A: TERMS OF REFERENCE

1. The Working Party reviewing the *Chicken Meat Industry Committee Act 1976* shall be required to conduct the review in accordance with the terms for legislation reviews set out in the National Competition Principles Agreement. The guiding principle of the review is that legislation should not restrict competition unless it can be demonstrated that:
 - the benefits of the restriction to the community as a whole outweigh the costs; and
 - the objectives of the legislation can only be achieved by restricting competition.

2. Without limiting the scope of the review of the *Chicken Meat Industry Committee Act 1976* the Working Party shall:
 - clarify the objectives of the *Chicken Meat Industry Committee Act 1976* and recommend any changes as necessary;
 - identify the nature of the restrictions of the *Act* on competition;
 - analyse the likely effect of any identified restriction on competition on the economy generally;
 - assess and balance the costs and benefits of the restriction; and
 - consider alternative means, including non-legislative approaches, for achieving the objectives.

3. In the course of the review the working party should:
 - coordinate its review with similar reviews of chicken meat legislation in other jurisdictions to the maximum extent possible; and
 - consider whether any of the activities of the Chicken Meat Industry Committee contravene the restrictive conduct rules in Part IV of the *Trade Practices Act 1974* and the *Competition Policy Reform Act 1995* (Commonwealth) and identify options available to the Government to achieve compliance therewith.

4. The Working Party shall invite submissions from consumers, producers, processors, distributors, retailers, and, as necessary, consult with any such parties.
5. The Working Party may engage consultants to assist it in carrying out its Terms of Reference.
6. During the course of the review, the Working Party will conduct public benefit assessments of those options which contain restrictions on competition, including existing legislation. The Working Party will determine for each 'change' option identified whether the public benefit resulting from the change (ie.. from the status quo) outweighs any detriment caused by the change. It will also provide an assessment for the 'without change' option - ie.. status quo.

Such assessments will be in accordance with approved Queensland Treasury methodology.

7. The Working Party is to submit the outcomes of its review process to the Minister by November 1997.

ATTACHMENT B: CMIC MODEL DATA AS AT JULY '97

Growing Costs Calculation

Key Parameters

Farm Area:	5373 m ²
Density:	15.4 birds/m ²
Batches:	5.46 /annum
Annual Production:	451783 birds
Average bird Weight:	2.2 kg
Depreciation Rates:	
- Sheds	4%
- Feeders, Drinkers etc	10%
- Insulation, bins etc	7%
- Bins	5%
- Fans	8%
- Ancillary Plant	7%
Return on Investment:	
- Non-land	7%
- Land	4%
Interest rate on working capital:	12.20%

Variable Costs

	c/bird	Total
Litter	1.37	10222
Pest control	0.23	450
Gas	0.77	6094
Electricity	1.29	7800
Fuel/oil	1.31	2440
Repairs & Maintenance	4.30	21912
Paid wages	2.60	12761
Sanitation	0.12	3755
Other	0.36	2255
Total Variable Costs		\$67,689

Fixed Cash Costs

Insurance	3000
Post & Telephone	1194
Accounting	1959
Other Administration	4638
Total Fixed Cash Costs	\$10,791

Imputed Costs

Owner-operator labour	43329
Working capital	1379
Depreciation	
- Sheds	20961
- Plant	36910
Return on Capital	
- Shedding	19624
- Plant and Equipment	17855
- Roads	4569
- Land	6000
Total Imputed Costs	\$150,627

Total Growing Costs	\$229,107
Cost per Bird	50.7 cents *
Cost per Kilogram	23.1 cents

* NOTE : The calculation of the growing fee establishes parameters for the negotiation of a final fee.

Calculation of Depreciation

Item	CMV	Rate	Deprn.
Sheds	524017	4%	20961
Plant & Equipment			
Feeders	45953	7%	3217
Drinkers	44252	10%	4425
Crossover	0	10%	0
Fans	40104	8%	3342
Heater	12741	10%	1274
Insulation	59708	7%	4180
Cool Pads	50527	10%	5053
Bins	49775	5%	2489
Controller	19927	10%	1993
Vent System	25542	7%	1788
Baffles, Fences and Curtain	16710	10%	1671
Tank stand and Winch	17620	7%	1233
Ancillary Plant & Equip	93900	7%	6246
Total	\$476,760		\$ 36,910

Calculation of Return on Investment

Capital Item	CMV	Half Life	Rate	ROI
Shedding	524017	262009	7.49%	19624
Plant & Equipment				
Feeders	45953	22976	7.49%	1721
Drinkers	44252	22126	7.49%	1657
Crossover	0	0	7.49%	0
Fans	40104	20052	7.49%	1502
Heater	12741	6371	7.49%	477
Insulation	59708	29854	7.49%	2236
Cool Pads	50527	25264	7.49%	1892
bins	49775	24888	7.49%	1864
Controller	19927	9963	7.49%	746
Vent System	25542	12771	7.49%	957
Baffles, Fences and Curtain	16710	8355	7.49%	626
Tank stand and Winch	17620	8810	7.49%	660
Ancillary Plant & Equip	93900	46950	7.49%	3517
Total Plant & Equipment	476760	238380		17855
Roads	61000	61000	7.49%	4569
Land	150000	150000	4.00%	6000
Total	\$1,211,777	\$711,388		\$48,048

Calculation of Economic Rents in the Growing Sector

Capital Item	CMV	Depn. Rate	Annual Depn	Dep'd Value (6 years)
Sheds	524017	4%	20961	398253
Plant & Equipment				
Feeders	45953	7.00%	3217	26653
Drinkers	44252	10.00%	4425	17701
Crossover	0	10.00%	0	0
Fans	40104	8.33%	3342	20053
Heater	12741	10.00%	1274	5097
Insulation	59708	7.00%	4180	34631
Cool Pads	50527	10.00%	5053	20211
bins	49775	5.00%	2489	34843
Controller	19927	10.00%	1993	7971
Vent System	25542	7.00%	1788	14815
Baffles, Fences and Curtain	16710	10.00%	1671	6684
Tank stand and Winch	17620	7.00%	1233	10219
Ancillary Plant & Equip	93900	6.65%	6246	56423
Total Plant & Equip	\$476,760		\$36,910	\$255,298
Roads	61000			61000
Cottage	60000	3%	1800	49200
Land	300000			300000
Total Roads, Land & Houses	\$1,421,777			\$1,063,751
Purchase price:	\$1,270,000			
Goodwill:	\$206,249			
Payback Period:	20			
Interest rate:	0.04			
Annualised Goodwill:	\$15,176			
Annualised goodwill per bird:	3.36		c/bird	

ATTACHMENT C: DESCRIPTION OF WHOLESAL MODEL

Derivation of the slope of supply and demand curves -

$$\eta_d \text{ (Elasticity of demand)} = \frac{\Delta Q / Q_0}{\Delta P / P_0}$$

Hence,

$$\frac{\Delta P}{\Delta Q} = \frac{1}{\eta_d * Q_0 / P_0} \text{ (Slope of the demand Curve at } Q_0) \quad (1)$$

and similarly,

$$\frac{\Delta P}{\Delta Q} = \frac{1}{\eta_s * Q_0 / P_0} \text{ (Slope of the Supply Curve at } Q_0) \quad (2)$$

where:

- η_d = Price elasticity of demand at the Wholesale level
- η_s = Price elasticity of demand at the Wholesale level
- Q_0 = Original Output level (110,000 tonnes liveweight)
- P_0 = Original price at output level Q_0

Derivation of the intercepts of supply and demand curves -

$$P_0 = \alpha_1 + \beta_1 Q_0 \quad (3)$$

Where α_1 = Intercept of the supply curve on the Y axis, and
 β_1 = Slope of the Supply curve

From Eqn. (2) and (3)

$$P_1 = \alpha_1 + \frac{1}{\eta_s * Q_0 / P_1} Q_0 \quad (4)$$

Where P_1 = the rent free, productivity improved cost of production at the original output Q_0

$$\therefore \alpha_1 = P_1 - \frac{1}{\eta_s * Q_0 / P_1} Q_0 \quad (5)$$

Similarly, using Eqn. 1

$$\alpha_2 = P_2 + \frac{1}{\eta_d * Q_0 / P_2} Q_0 \quad (6)$$

Where α_2 = Intercept of the demand curve on the Y axis
 P_2 = Regulated wholesale Price of chicken meat

Derivation of equilibrium price and output following deregulation

At equilibrium,

$$\alpha_1 + \beta_1 Q^* = \alpha_2 - \beta_2 Q^* = P^* \quad (7)$$

Where Q^* and P^* = Equilibrium output level and wholesale price without regulation

$$\therefore Q^* = (\alpha_2 - \alpha_1) / (\beta_2 + \beta_1) \quad (8)$$

$$\text{and } P^* = \alpha_1 + \beta_1 Q^* \quad (9)$$

Derivation of measures of surplus changes -

Change in consumer surplus at Q_0 -

$$(P_0 - P^*) * Q_0 \quad (10)$$

Change in Grower surplus at Q_0 -

$$\{(P_{1(\text{adj})} - P_2) * Q_0 * Wt_g\} - \{(P_0 - P^*) * Q\} \quad (11)$$

Change in Processor Surplus at Q_0 -

$$\{(P_{1(\text{adj})} - P_2) * Q_0 * Wt_p\} \quad (12)$$

Where:

- Wt_g and Wt_p are distributional weights applied to total productivity gains based on relative cost contributions of growers and processors at the wholesale level, and
- $P_{1(\text{adj})}$ is the cost of production at the original output level before taking into account any productivity improvements.

Output effect -

$$\{(P_0 - P_1)(Q^* - Q_0)\} / 2 \quad (13)$$

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