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ECONOMIC AND POLICY CONSULTING

The nature of competition in the beef processing industry

REPORT

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Executive Summary

The nature of competition in the Australian beef industry has been subject to a high level of scrutiny by government in recent years. Currently there is a Parliamentary inquiry and a 'market study' by the competition regulator following close on the heels of an inquiry into allegations of collusive behaviour at sale yards. No action was taken in relation to anti-competitive conduct, and since 2002, the competition regulator has closely investigated and approved eight red meat processing transactions.

Most recent concerns on the part of some livestock producers and organisations about competition in the industry make a link between levels of concentration in the industry and abnormally high margins. This in turn is linked to concerns about the extent to which prices paid for livestock are not transparent. In effect, the allegation is that processors use their superior information and market power to depress prices for livestock below market levels. No evidence has been found of this to convince the competition regulator to date.

The conclusion of this report, which has been commissioned by the Australian Meat Processor Corporation to inform discussion of the relevant issues, is that the above concerns are based on a view of the nature of competition in the industry which does not reflect the reality of what processors do and how they compete. The information available to processors in determining what prices they are able to offer for livestock is far from perfect. Processing entails considerable risks (factors which can be quantified) and uncertainties (which cannot). Concentration in a market does not equate to anti-competitive conduct.

Food product manufacturing is now Australia's largest manufacturing industry and meat processing is Australia's largest food product manufacturing industry. Indeed, beef processing should more appropriately be referred to as beef manufacturing.

What processors actually do is: buy animals, make (process/manufacture) them and sell beef. This report describes key features of each activity and how processors compete. **In the buying stage, livestock producers have a range of options of what to do with their cattle through the life cycle of production, and in the methods they use to sell their animals.** The livestock production sector involves many beef producers with different size, capacity and profitability. **But differences in producer profitability reflect the costs rather than prices received for cattle.**

Processors accordingly have a range of options in buying, and in determining the prices that they are able to affordably offer for cattle, processors generally undertake a procedure that involves a great deal of risk and uncertainty. Processors have different scale and cost structures and on the sell side they are all price takers in a highly competitive international market. The international market drives the prices that processors can afford to pay for cattle since exports account for around three quarters of output.

The dynamics of the industry and the supply chain are driven by supply (available cattle) and demand (internationally). **There is significant competition for livestock from processors/buyers. There is no evidence of market power on the buy side.** The market is the market. Beef processing is a manufacturing sector using a diverse range of inputs that vary by factors such as size, breed and condition. Not all beef cattle are the same (not homogeneous); not all processor are the same; and not all sellers of finished product are the same. Not all markets are the same in terms of access and the costs of servicing these markets.

Processors' estimates of how much they can afford to pay for cattle rests on all sorts of assumptions – what they might sell the beef products for, what their processing throughput will be, what the supply of cattle will be – and if these prove to be incorrectly calculated, processors will find themselves suddenly losing money. These losses may continue because processors need to maintain throughput otherwise unit costs will rise. If they are eventually forced to shut down plants, major financial costs are incurred and resources lost (notably skilled labour) which may not be easily regained, if at all.

When assertions about concentration and excessive margins mentioned above were made in 2013-14, figures were cited showing a sharp rise in the gap between prices received by processors for some beef exports and the prices paid to livestock producers for some cattle. However, this reflected an exceptional set of circumstances, with record sales of cattle during a serious drought in Australia and high prices for beef in the US market. **Up-to–date figures indicate the spread between the price of livestock and beef has reversed to become sharply negative and well below the long-term trend.**

Processors cannot remain in business indefinitely losing money whatever the short-term imperatives to maintain throughput. **A continuation of current conditions will see the less cost-efficient processors go out of business.** Even more cost-efficient processors will consider taking labour-intensive processing operations offshore.

The abovementioned concerns about concentration and the level of transparency in pricing have led to pressure for action to enhance competition. At its extreme, this has included calls for mandatory price reporting as is done in the USA. However, as noted above, concentration does not mean a lack of competition and the level of concentration in the USA is far higher than here. **There are potentially unintended adverse impacts of mandatory reporting (e.g. it can facilitate anti-competitive practices such as price signalling in concentrated markets, and equally signal to meat buyers prompting a race to the bottom in pricing) which would adversely affect livestock producers as well as processors.**

Concerns about some features of price reporting stem from industry-agreed practices and standards. **If technological solutions can be found which enable more accurate information to be disseminated in a manner that is cost-efficient (and there are very structured R&D programs underway to do this), then there is no reason why they should not be adopted.**

The Australian beef processing industry is both labour and capital intensive. It has a high cost to processing a beef animal compared to the major international competitors of US, Brazil and New Zealand. The currency is the currency for all and processors cannot control it. **The seller of the end product competes and bears the risks to sell into highly competitive domestic and international markets.** Importantly, once the ownership of the animal passes to the processor, the commercial and operational risks are borne fully by that processor and seller who aims to maximise the return based off the price paid for each animal.

Given that processors are price takers, having the lowest cost for processing is a key means by which processors compete. Interventions that increase risks and costs therefore undermine competitiveness and reduce the capacity to afford paying prices for livestock. **Unfortunately, the cost structure of the local industry is relatively high internationally, and has been made worse by government-influenced taxes and charges.**

The beef processing industry is an important one not only for those directly involved but also more broadly for regional, state and the national economy. Analysis undertaken for this report indicates that, for 2014-15, the **beef** processing industry accounted for $18.2 billion in value added, $6.7 billion in household income and approximately 105,000 FTE jobs when flow-on effects are taken into account. Accordingly, cessation of meat processing activities would have a significant impact on regional communities and the national economy, which in turn would be expected to generate significant negative social consequences.

The reason for pointing out the economic and social impact and significance of the industry is this: **makers of policy in relation to competition in this industry need to take into account that their decisions can have profound impacts on a very significant industry** and, through that industry on the local, regional and national economic value and household income generated, as well as the employment and social wellbeing of hundreds of thousands of people.

The unintended consequences of policies applied to one part of the industry will flow on to others. In particular, the economic fate of processors is intimately tied to that of livestock producers, and vice versa.

There are major challenges posed for policymakers by smaller producers who have difficulty in fully participating in the development of the beef industry (and indeed other agricultural industries), where economic forces generate competitive advantages for those able to realise the benefits of scale. Policy can accommodate this process or hinder it. **Where competition in the industry concerned is strong, there is no justification for using competition policy to hinder economic forces and limit the potential gains in efficiency and competitiveness of the industry as a whole.**

1 Introduction

The **Australian Meat Processor Corporation has commissioned this research report to inform discussion of the relevant issues being examined by the** ACCC as part of the market study it is conducting on the cattle and beef sector. The ACCC states in the Issues Paper for the study, issued on 7 April 2016, that it is in response to a number of issues raised by stakeholders in the industry in 2015. The study's purpose, according to the ACCC, is to examine competition and transparency in the supply chain and consider whether there are impediments to competition and efficiency at various stages of the supply chain in cattle and beef markets.

The nature of competition in the beef industry has been a focus of policy attention for the ACCC and other parts of government for a long time, but especially so over the past 15 years. There was an ACCC *Report to the Senate by the ACCC on Prices Paid to Suppliers by Retailers in the Australian Grocery Industry* in 2002; an *Examination of the prices paid to farmers for livestock and the prices paid by Australian consumers for red meat*, undertaken by the ACCC in 2007; and a Report of the ACCC *Inquiry into the competitiveness of retail prices for standard groceries* which analysed the meat industry in 2008.

This focus has sharpened over the past year, when both the ACCC and the Australian Senate Standing Committee on Rural and Regional Affairs and Transport have closely scrutinised the industry. The Australian Senate initiated an inquiry into the effect of market consolidation on the red meat processing sector and recently issued its interim report. Some livestock industry representative bodies have urged action to enhance aspects of industry competition and research has been conducted on mandatory price reporting.

In recent years, the ACCC has reviewed a number of significant acquisitions in the red meat processing sector as processors have sought to consolidate their operations. Since 2002, the ACCC has closely investigated and approved eight red meat processing transactions as follows:

2002	Merger between Consolidated Meat Group and Teys Bros.
2005	Elders Ltd acquisition of EG Green & Sons Pty Ltd
2008	JBS Southern Australia Pty Ltd acquisition of Tasman Group Services Pty Ltd
2009	Metcash Trading Limited acquisition of Fresh Market Meats.
2010	ZM Australia Pty Ltd acquisition of Tatiara Meat Company Pty Ltd
2010	Swift Australia Pty Ltd acquisition of Rockdale Beef Pty Ltd
2011	Merger of Teys Bros (Holdings) Pty Limited and Cargill Beef Australia
2015	JBS USA Holdings Inc acquisition of Australian Consolidated Food Investments Pty Ltd (Primo Smallgoods).

In 2015, the ACCC also investigated claims processors collectively boycotted the Barnawartha saleyard.

Individual processors will certainly have their own perspectives on what representations they might wish to make to the ACCC, government or other stakeholders, guided by their own specific interests in relation to the ACCC's market study.

However, the red meat processing industry, acting collectively through the AMPC, decided to commission research that provides empirical data and other relevant information to inform the research and analysis of the issues. The AMPC commissioned SG Heilbron Economic & Policy Consultants to prepare this report as part of that research.

- The claimed inflexibility of grid pricing e.g. that the prices drop 'off a cliff' at either end of the indicated ranges. The calculations required by processors to develop a grid are highly complex. If ranges were to be set based on sliding scales to reflect all the potential sales and offer prices stemming from those calculations, the information for livestock producers would be overwhelming. Different ranges would need to be calculated for each product.

- However, the number of products that are regularly sold by processors needs to be considered. Just for offal cuts, there might be 5 types of tongue alone that are regularly sold, 3 types of tendon, 5 types of tripe, and so on. There may be 30 types of muscle cuts typically sold. One must seriously question the value to producers of reporting such complexity. Finally, in relation to grading issues, it must be remembered that AUS-MEAT standard carcase trim standards apply at all accredited export facilities.

Mandatory Price Reporting

Concerns about transparency have led some to argue for schemes that require processors to divulge prices at which products have been sold, such as the Mandatory Price Reporting (MPR) system that operates in the USA. As the Department of Agriculture points out, "*Anecdotally, Australian producers refer to the farmers' share of farm gate returns in the United States as being markedly greater than in Australia. Margins in the US industry tend to be more transparent than those in Australia where lack of appropriate data—at both sector level and firm level—makes it difficult to analyse pricing through the value chain. In contrast, in the United States, several research companies and equities analysts perform packer margin assessments on a daily or weekly basis. Additionally, the US Department of Agriculture's Packers and Stockyards Program received powers from the Packers and Stockyard Act 1921 to collect information on industry-wide margins for the meat industry*".[34]

Relevant points about this are as follows:

- In economic terms, transparent prices play a key role in the efficient allocation of goods and services that avoid waste and hence match what suppliers make and what consumers want, which is how economists define efficiency. Financial economic researchers typically define markets as efficient when prices reflect all available information and when prices adjust swiftly as new information arrives. If buyers and sellers do not know what prices are, then some mutually agreeable trades will fail to occur, thus creating inefficiencies.

- Barriers to price transparency include both explicit restrictions on information (such as concealment by firms of prices or price-setting approaches), and costs of search by consumers or sellers. The simplest theories suggest that more information about prices should decrease prices (or increase them in the case of sellers) and also bring prices closer together.

- However, price monitoring comes at a cost. Public administrations need to collect, check, store, process and publish data and analysis. Businesses incur reporting costs. With this in mind, policy should try to strike a balance between the costs and the benefits of improved market transparency.

- In markets with many suppliers and customers, in which little is known about prices, greater transparency will lead to lower search costs and more transactions. The distribution of effects between chain parties however cannot be known in advance. In concentrated markets, the result may be an excess of transparency: if prices are published which are too up-to-date and

[34] Department of Agriculture, op. cit., p. 29

company-specific, actors will be able to start coordinating prices with each other. Price transparency therefore does not offer a solution for unequal power relationships in the chain.

- There are differing views on the success of Mandatory Price Reporting (MPR) in the USA in achieving its objectives. [35] Koontz and Ward, reflecting the concern about unintended consequences above, point out that an area of future research that is clearly in need has to do with the ability of MPR to improve noncompetitive behavior by the packing industry. This appears to be the largest concern found in the literature (*e.g., Wachenheim and DeVuyst 2001, Azzam 2003, and Njoroge 2003*), and even in the latest literature these concerns have not been definitely put to rest.[36]

- From a commercial perspective, government mandated price transparency can have significant adverse unintended consequences. It can lead to a 'race-to-the-bottom' in pricing, whereby customers use the indicated prices as a maximum they are prepared to pay. Should this eventuate, less will be available for the processor to pay for livestock or invest in productive efficiency or capacity.

- Finally, extreme caution must be exercised in comparing the competitive situation in vastly different industries like the beef industry of the USA and Australia, and then concluding that a policy such as mandatory price reporting adopted by government in one country will be appropriate to the other.

- There are several key differences between the structural characteristics of the livestock and beef market in the US and Australia:

    - Firstly, the level of concentration in beef processing in the US is well above that in Australia. In the US, the four largest steer and heifer slaughter firms increased their share of slaughter to 85 per cent in 2010, after remaining between 78 and 81 per cent between 1998 and 2009[37]. As noted above, estimates of the share accounted for by the top 5 beef processors in Australia range between 25-30 and 57 per cent.

    - Secondly, a far higher proportion of cattle are sold via open market auctions in Australia than in the US. As indicated above, auctions remain a major form of livestock sale method in Australia, accounting for around half of national cattle sales. Only around 20 per cent of cattle in the US are sold via negotiated cash prices which includes (but is not totally comprised of) auctions – auctions would be a be a smaller percentage of total sales.

    - Thirdly, MPR in the USA was implemented in a market where cattle were predominantly sold on a 'live on the average' basis, which provided little incentive for producers to sell and processors to buy on the basis of the value of the animal. MPR facilitated a shift towards grid-based pricing, with premiums and discounts based on the characteristics of the animal.

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[35] See for example, Ted C. Schroeder, Sarah Grunewald, and Clement E. Ward, *Mandatory Price Reporting in Fed Cattle Markets: Motivations and Implications,* Council on Food, Agricultural, and Resource Economics (C-FARE) Annual Symposium, November 6 2002; Economic Research Service of USDA, *Did the Mandatory Requirement Aid the Market? Impact of the Livestock Mandatory Reporting Act*, Janet Perry, James MacDonald, Ken Nelson, William Hahn, Carlos Arnade, and Gerald Plato, September 2005, and Stephen R. Koontz and Clement E. Ward, *Livestock Mandatory Price Reporting: A Literature Review and Synthesis of Related Market Information,* Research Journal of Agricultural & Food Industrial Organization: Vol. 9: Iss. 1, Article 9, 2011

[36] Kenneth H. Mathews, Jr., Wade Brorsen, William F. Hahn, Carlos Arnade, and Erik Dohlman *Mandatory Price Reporting, Market Efficiency, and Price Discovery in Livestock Markets*, Economic Research Service of USDA, September 2015

[37] See http://www.ers.usda.gov/topics/food-markets-prices/processing-marketing/manufacturing.aspx

However as is noted above grid based pricing is a feature of the Australian livestock selling system already, which reflects the fact that all animals are not the same when it comes to processing[38].

- Finally, not only can MPR facilitate price signaling by processors it can equally signal prices to meat buyers prompting a race to the bottom in pricing especially for Australian beef exports. This is less of an issue in the US because it relies on exports for only around 15 per cent of its production.

How are prices transmitted?

What may be considered more significant than price transparency, in respect of concerns about competition, is the means by which prices are transmitted along the chain. Past studies in Europe, for example, have indicated the main issues within the European food value chain are related to asymmetric price transmission (or price levelling). Prices downstream rose quickly with input prices, but took much longer to fall when price pressures were relieved. In a perfect world, price changes would be instantly and evenly transmitted from one node to another.

Economic research has found that the Australian beef processing industry tends to "price level" at the wholesale stage i.e. when livestock prices increase this tends to be absorbed for a while at least by processors who do not pass all of the increase on to consumers.

Equally, when livestock prices fall, not all of the fall is passed on by processors. This conduct is not consistent with the economic concept of perfect competition, but as long as this price leveling is temporary, there is no real problem in trade practices terms. However, if it is sustained, then processors may be said to have market power.[39]
Critically, the research cited, which evaluated real price spreads, analysed the competitive behaviour of both selling and purchasing along the Australian meat marketing chain from the farm-gate to the retail level, given empirical evidence of increasing real marketing margins in the years examined and a continuing interest in the topic by the ACCC.

It concluded that the existence of perfect competition in both the input and output markets for each meat industry, at the retail level, could not be rejected, using the models, techniques and data.

In other words, as with previous studies, no evidence was found that the marketing chains for the Australian fresh meat industries are non-competitive[40]. Moreover, as has been seen in the discussion of price spreads above, the increase in the real price spreads in 2013-14 proved to be temporary.

5 The 'sell' activity

Selling beef on the world's markets adds another set of complexities, risks and uncertainties for Australian beef processors. On the sell side, processors have different capacities to maximise the value of finished beef product. Some sell direct to end customer, sell to agents or use third parties to sell on their behalf. But Australian sellers are price takers in an international market.

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[38] see: http://www.beefcentral.com/news/kays-cuts-mla-should-re-evaluate-mandatory-price-reportings-value/?utm_medium=email&utm_campaign=Beef%20Central%20news%20headlines%20June%2014%202016&utm_content=Beef%20Central%20news%20headlines%20June%2014%202016+CID_d10552f8cc60a562c3fbaf78b4d85767&utm_source=eGenerator&utm_term=Kays%20Cuts%20MLA%20should%20re-evaluate%20Mandatory%20Price%20Reportings%20value

[39] Kit C. Chung and Garry R. Griffith, *"Another Look at Market Power in the Australian Fresh Meat Industries"*, Australasian Agribusiness Review,Vol.17, 2009

[40] Ibid, p. 230

In export markets, which account for around 75 per cent of sales:

- demand is from principal purchasers: US, Japan, South Korea and EU
- competition is from other suppliers: US, South America, New Zealand, India
- domestic returns are then determined by exchange rates

Market access

One of the key risks on the sell side relates to market access. To illustrate this, consider the four stages of exporting beef to China.[41]

1. Permission to export

- *Export licences*: Exporters must obtain certification from Australian Quarantine & Inspection Service and accreditation from AUS-MEAT Limited (AUS-MEAT). They must also satisfy Chinese import requirements and demonstrate that certain on-farm and meat processing requirements are met.

- *Export permits*: May be granted to exporters after Customs assesses the preparation, handling and storage of beef products in accordance with statutory standards. Apply within 28 days of shipment.

2. Permission to import

- *AQSIQ filing*: Both importers and exporters must apply for filing at the Chinese General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). Process takes about 1 week, records must be kept for 2 years.

- *MOFCOM filing*: Importers must file records with the Chinese Ministry of Commerce or its local offices (MOFCOM) and obtain a licence to import. Licences to import beef products (which falls into the 'free' category in China's Catalogue System) are normally granted provided all procedural requirements are met, but this is subject to quota and tariff requirements. Process takes about 1 week.

3. Inspection, quarantine and quality control

- *CNCA approval*: Foreign meat producers must register their facility with AQSIQ through the Chinese Certification and Accreditation Administration (CNCA), which requires compliance with certain health, sanitation and quality criteria. Accreditation may be granted for cold store, slaughter and/or boning activities. Application process takes at least 1 year.

- *Entry-exit inspection and quarantine (CIQ) bureaus*: For each batch of imported products, documents need to be submitted to the relevant CIQ bureau for inspection and quarantine. Process usually takes several days, but may be extended if there are quality or labelling issues. For first time imports, AQSIQ conducts a document review, label verification and sample inspection to ensure compliance with Chinese regulations.

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[41] Business Council of Australia, *Building Australia's Comparative Advantages: A 21st Century Agrifood Sector*, December 2015, p. 29

4. Customs clearance

- *Customs filing*: Importers must file records at the local Customs. Process takes about 1 week.

- *Customs inspection*: Customs inspects all imported meat to ensure it complies with mandatory standards and to confirm the value of the goods. For first time imports, Customs will also review the clearance sheet issued by CIQ.

Market access rules are a major risk for beef processors selling beef onto world markets. These rules can change overnight and sales may be reduced or stopped completely for reasons that have nothing to do with the individual exporter. The nature of competition in export markets, which account for around three quarters of Australia's beef production, is heavily influenced by these market access rules.

In order to sell into a market, a processor's facilities have to be recognised ('listed') by the authorities of Australia and the importing country. This requires investment to ensure recognition and ingoing compliance. Processors have to make critical decisions as to what investment they will undertake to supply a particular market, and this entails significant capital and hence risk.

Other sell-side risks

It has been pointed out above that formal forward contracts are a rarity in selling beef internationally. Products are essentially sold on a spot price basis. Seasonality in production can render estimates used in calculating breakeven prices for buying cattle incorrect. Processors aim to try and guess what sales prices will be into literally dozens of markets, each of which have their own particular import requirements (see above the example of China). A major processor can sell literally hundreds of different products to as many as five dozen different countries.

Processors will use whatever public information is available in these markets to forecast the prices they might receive for their products and to use this information in negotiations with buyers, but essentially these forecasts remain highly uncertain.
Even after the product has been sold, risks remain.

- The exchange rate can move against the processor. A processor can find that a change in the currency can mean the breakeven price for livestock used to purchase the animals for processing has been over-estimated.

- Orders can be subject to revision, especially if the exchange rate has moved against the buyer of the beef products overseas. Slowdowns or deferrals of shipments or reduced volumes required will result in costs to processors exporting.

- Payment risks arise in relation to customers who may be new to the processor or who may be importing into countries with under-developed banking systems.

Regulatory costs and processing competitiveness

The significant impact of market access on the competitiveness of beef exporters was noted above. Apart from the investment costs associated with registration, there is another aspect of market access which is worth noting.

The Australian Government charges exporters for meat inspection and certification which is required for market access purposes.

In the year 2000, these costs amounted to approximately $50 million[42]. Research funded by the industry concluded that these charges should be reduced by 40 per cent to reflect economic marginal cost pricing principles, rather than uneconomic average cost pricing (which results in a tax on the industry), and after representations by meat exporters, the Federal Government agreed to reduce these costs by 40 per cent.

This meant the costs paid by the industry fell to approximately $30 million. But in 2011, processors entered into an agreement with the Federal Government for the delivery of the new Australian Export Meat Inspection Service (AEMIS).

According to AMIC[43], however, implementation of AEMIS is not meeting expectations – and it was always intended as just the start of a drive for new efficiencies. In 2013, the Federal Department of Agriculture (DA) enacted 100 per cent cost recovery for AQIS export certification charges (from 60 per cent). This has impacted significantly on the sector and is affecting viability of export processing in some meat plants. AMIC points out "*every processor in Australia is paying more than ever before for Export Certification while trying to compete in world marketplaces against countries such as the US and Brazil where exporters are not charged for government certification*".

At the Federal level, Department of Agriculture (AQIS) charges to red meat processors for export meat inspection and certification now exceed $80-$85 million a year. In addition, some inspection functions have been transferred slowly back to processor management and these cost processors another $35-$40m a year to run. The costs paid by industry have therefore quadrupled.

In an environment where buying, making and selling beef is complex and risky, where profitability is highly variable, and competition in selling internationally is heavily influenced by access to markets, uneconomic cost imposts of the kind described above undermine the competitiveness of the industry.

6 The appropriate policy settings

Based on the analysis above of the nature of competition in the red meat processing industry, what are the appropriate competition policy settings to enhance the development of the industry? There are a number of aspects of competition policy settings which should be considered. These aspects have been brought into focus by the concerns raised in relation to consolidation in the industry.

It was noted at the start of this report that the processing industry has been subject to a high level of scrutiny on competition grounds. There have been numerous investigations, research studies and inquiries. Since 2002, the ACCC has closely investigated and approved eight red meat processing transactions.

Despite this level of scrutiny, nothing untoward has been found, and applications which have resulted in market consolation have been approved by the authorities with minimal conditions. Nevertheless, the competition regulation appears to be heading towards tightening of controls over meat processing activities. This is evident in a number of areas.

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[42] SG Heilbron Economic & Policy Consulting, *Study on the impact of government on industry competitiveness*, Report for MLA, February 2001

[43] Australian Meat Industry Council, Submission to the Senate Standing Committee on Rural and Regional Affairs and Transport Inquiry, The effect of market consolidation on the red meat processing sector, July 2015, p. 37

Anti-competitive conduct

The recent claims of collusive practices at the Barnawatha sale yards, as previously noted, were investigated by the ACCC and no further action was taken. Nevertheless, the competition regulator supports changes to competition law relating to collusive practices through the establishment of an offence of 'concerted action' as recommended by the Harper Review on competition[44].

The ACCC considers there is a gap in Australia's competition law, as it fails to address a type of cartel-like behaviour known as a 'facilitating' or 'concerted' practice. This conduct usually involves some form of 'tacit collusion'; that is, communication between competitors falling short of an agreement or understanding, but which significantly alters the uncertainty or strategic risk that would otherwise deliver price competition and innovation. The ACCC argues that *"In most advanced country competition law systems overseas, concerted practices are prohibited. In Europe for example, anti-competitive information disclosures are prohibited by Article 101 of the Treaty on the Functioning of the European Union. It prohibits 'concerted practices' that have "the purpose or effect of distorting competition".*

"One recent example is the LIBOR and EURIBOR case taken by the European Commission against a large number of international banks in which it determined that those banks had engaged in concerted practices when sharing information on pricing and other transaction details between competitors through 'chat rooms'. A 'concerted practice' case against such conduct would not be possible in Australia," was noted by the Chairman of the ACCC. *"This gap in our laws can damage competition and so the proper functioning of our market economy".*

One can trace a process whereby the boundaries of offences relating to collusion have been continuously widened in Australia. The starting point was the offence of price fixing. Then since 2009 Australia has had a specific prohibition of 'cartel conduct' whereby parties engaged in cartel conduct may be guilty of a criminal offence or subject to a civil penalty or both. There have been very few cases of this.

Then in 2012 'price signalling' legislation came into operation, prohibiting certain forms of price information exchange. It applied only to the banking industry and it is subject to numerous exceptions. The provisions have not yet been the subject of litigation and remain controversial[45]. Now the proposal is to further expand the ambit of offences again with 'concerted practices'. The risks associated with this ever-expanding process is that legitimate economically efficient commercial activity, will be made unlawful, and hence will not be undertaken because of the fear of being judged an offence.

The implications of this are profound for an industry which depends for its ongoing survival and growth on buying, processing and selling beef and for generating the associated trading, investment and employment activities.

A similar process of expanding the ambit of anti-competitive offences relates to the proposal for an 'effects test' in the misuse of market power. This too risks making legitimate commercial activity unlawful, creating uncertainty and undermining legitimate trading and investment activity.

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[44] See ACCC, The Harper Review and privatisation, 23 April 2015, https://www.accc.gov.au/media-release/the-harper-review-and-privatisation

[45] Australian Competition Law, Cartels and anti-competitive agreements, see http //www.australiancompetitionlaw org/law/cartels.html

Market definition

The way in which a market is defined is critical to competition regulation concerning mergers and acquisitions and also in relation to market power. It was noted above that the geographic area from which cattle are purchased by meat processors has increased over recent years. This is the result of the consolidation of plants and increase in scale of facilities and transport efficiencies.

The geographic dimension of markets has increased, but the direction of competition policy seems to have moved in the opposite direction i.e. markets are being defined on a regional basis. This began with the separation of Queensland into three separate regional markets for acquisition of cattle in the AMH decision in 1989. Given that, as described above, major processors in that state purchase the vast majority of their cattle from as far away as 1,600 kms from their facilities, it is highly unlikely that such a narrow definition of the market would be considered economically justifiable today. Yet despite this, the ACCC continues to emphasise smaller regional dimensions to a market.

For example, in the Primo decision, in considering the geographic dimension of the relevant market, the ACCC took account of market feedback suggesting cattle normally travel distances of up to around 600 kilometres from farm to abattoir. The ACCC also noted information that fat cattle buyers in the relevant market would sometimes acquire cattle from other geographic areas (such as northern or central Queensland). However, these purchases were a small proportion of their total purchases.[46]

'Freezing' the level of consolidation

Furthermore, the ACCC in the Primo decision appears to be effectively 'freezing' the level of consolidation in the industry. It states that "*while the ACCC determined that, in this instance, the proposed acquisition would be unlikely to raise significant competition concerns, the ACCC is wary of the potential impact of further consolidation of abattoirs*" and that "*the ACCC will continue to monitor this industry and any future acquisitions will face additional scrutiny*". It has been outlined in this report how important scale economies are to the competitiveness of the industry and hence its ability to pay the best possible prices for livestock. Effectively, freezing the level of consolidation in the industry will undermine the future prospects of processing and livestock producers[47].

Price reporting

Proposals to increase price transparency in beef processing have been discussed above, notably in relation to the idea of introducing of a US-style mandatory price reporting system in Australia[48].

The US has had mandatory price reporting in place for many years. This has caused considerable costs to processors and there are divergent views amongst economic analysts on the benefits generated for cattle producers. Economic analysis has pointed to unintended consequences, because the effect of greater transparency on prices is dependent on the market context. The US has a different market structure to Australia's with a far higher level of concentration and less market transparency through a significant auction market.

[46] ACCC, JBS USA Holdings Inc - proposed acquisition of Australian Consolidated Food Investments Pty Ltd (Primo Smallgoods), 2015, see
http://registers.accc.gov.au/content/index.phtml/itemId/1184586/fromItemId/751046
[47] ACCC, ACCC will not oppose JBS's proposed acquisition of Primo, 2015 see https://www.accc.gov.au/media-release/accc-will-not-oppose-jbss-proposed-acquisition-of-primo
[48] Brian Todd, aginfo Pty Ltd and Peter Barnard, Oliver and Doan Pty Ltd, *Beef rice transparency*, Milestone 5, MLA 2015

It is also worthwhile noting that in Europe, whilst a number of countries monitor prices of agricultural products at various stages of the supply chain, only in Spain and France is there full monitoring of costs and prices. In 2013, the Dutch Government reviewed the costs and benefits of such an extreme option and decided against it[49].

Other areas of policy intervention

Similarly, considerable caution should be exercised in considering other ideas for regulatory intervention to promote completion in the processing industry, such as the development of Codes of Conduct. The costs and benefits of any such proposals need to be carefully analysed or they will simply result in additional cost imposts on the industry which will hinder its competitiveness.

7 Conclusions and recommendations

Recent concerns on the part of some livestock producers and organisations about competition in the industry make a link between levels of concentration in the industry and abnormally high margins. This, in turn, is linked to concerns about the extent to which prices paid for livestock are not transparent. In effect, the allegation is that processors use their superior information and market power to depress prices for livestock below market levels. No evidence has been found of this to convince the competition regulator to date.

The conclusion of this report, which has been commissioned by the Australian Meat Processor Corporation to inform discussion of the relevant issues, is that the above concerns are based on a view of the nature of competition in the industry which does not reflect the reality of what processors do and how they compete.

The information available to processors in determining what prices they are able to offer for livestock is far from perfect. Processing entails considerable risks (factors which can be quantified) and uncertainties (which cannot). And concentration in a market does not equate to anti-competitive conduct.

The beef processing industry buys, makes and sells beef. This entails a high degree of risk and uncertainty. Processors compete with each other for cattle on the basis of calculating what they can afford to pay relying on highly imperfect information on what they might be able to sell the beef for, and the breakeven point for processing a certain level of throughput, which itself might not be realised.

Accordingly, there would appear to be no economic justification for changes to competition laws that tighten provisions relating to anti-competitive conduct, market definitions and price reporting.

Policy action is, however, economically warranted in relation to costs, given that both livestock producers and processors are price takers and operate with highly variable and weak long term profitability. It is in their mutual interest to ensure any unnecessary cost imposts are addressed.

There are major challenges posed for policymakers by smaller producers who have difficulty in fully participating in the development of the beef industry (and indeed other agricultural industries), where economic forces generate competitive advantages for those able to realise the benefits of scale.

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[49] Elsje Oosterkamp et al, "Food price monitoring and observatories: an exploration of costs and effects", LEI Memorandum 13-058, June 2013

Policy can accommodate this process or hinder it. Where competition in the industry concerned is strong, there is no justification for using competition policy to hinder economic forces and limit the potential gains in efficiency and competitiveness of the industry as a whole.

Accordingly, the recommendations of this report are as follows:

1. Current competition policy settings are appropriate for the industry, and there is no justification for 'freezing' the structure of the industry, widening the basis of offences to 'concerted action', introducing an 'effects test', or narrowing the definition of markets to make consolidation more difficult.

2. Mandatory price reporting should not be introduced based on a market structures in foreign countries that are different in Australia and, because of unintended consequences, will adversely affect the industry as a whole.

3. Where there are potential improvements to be made in reporting and grading systems, technological solutions should be sought through research and development and, where cost-effective, introduced in the industry.

4. Policy to advance the development of the industry should focus on minimising uneconomic regulatory cost imposts that adversely affect investment and competitiveness.

5. More broadly, policy should focus on addressing the underlying cost efficiency challenges faced by small producers in agriculture.

The Consultants

SG Heilbron has considerable experience in providing independent economic and policy analysis for commercial, industry and government clients since 1991, including the red meat industry.

Dr Selwyn Heilbron – Director, SG Heilbron Pty Ltd

Dr Selwyn Heilbron has particular experience in the red meat industry, having undertaken numerous economic and policy-oriented research projects over the past two and a half decades. Clients have included major processing companies and industry organisations have included the Australian Meat Processor Corporation, Australian Meat Industry Council, and Meat and Livestock Australia.

Dr Heilbron is a senior business economist and corporate consultant with special expertise in Australian and international agribusiness, food and beverages industries. Dr Heilbron has undertaken economic and policy analysis for clients in relation to major mergers and acquisitions, authorisation of anti-competitive conduct, export joint-venture guidelines, rural guidelines, and collective bargaining.

He has served as Research Consultant with the World Bank, Washington DC., Senior Economist with the Department of Trade, Canberra, and as Manager (Finance and Planning) and Chief Economist of Elders Agribusiness, Melbourne. Dr Heilbron holds degrees of Bachelor of Arts from Kent University, Master of Science in Agricultural Economics from the University of London, and Doctor of Philosophy (Land Economy) from Cambridge University, UK.

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