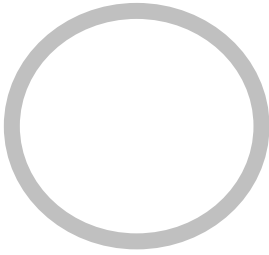


# Australian Chicken Growers' Council Limited

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SUBMISSION TO THE PRODUCTIVITY COMMISSION  
REVIEW OF NATIONAL COMPETITION POLICY ARRANGEMENTS

AIUSTRALIAN CHICKEN GROWERS COUNCIL  
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## **1.0 ABOUT THE AUSTRALIAN CHICKEN GROWERS COUNCIL**

The Australian Chicken Growers Council is the peak body representing poultry meat *farmers* in Australia (chicken and turkey). Between them, poultry meat farmers represent about 40% of the total industry investment and about 400m birds production annually, but represent only about 8% of the average retail price of chicken meat – about 22 cents per kg, largely unchanged in the last 20 years.

## **2.0 ABOUT THE POULTRY MEAT INDUSTRY**

The poultry industries in Australia have a strong similarity to that in the US, that is, they are highly vertically integrated, very capital intensive in relation to equipment that has no other use, and operate in a mature market. Around the world there other poultry meat industries are similarly structured, highly efficient economically with a multi-domestic structure as the cost of freight generally makes the traded product uneconomic.

The majority of worldwide trade is from three countries: Brazil, the US and Thailand. In each case there is assistance to allow world competitiveness – government subsidy on plant, export or effective subsidy on labour as a result of minimal government costs of labour. World market dumping of product is not uncommon. All three of these countries are subject to pests and diseases not found in Australia, and these critical biosecurity issues are the reason why only cooked chicken is allowed import into Australia.

In Australia, the industry operates not only in an unsubsidised market, but one for whom international competitiveness is worsened by the application of the single desk trading system for grains (70% of poultry feed is grain), and a market with relatively high government infrastructure costs.

## **3.0 PARTICULAR COMPETITION PROBLEMS FOR POULTRY FARMERS.**

There are three main processors in Australia –Inghams, Baiada and Bartter, who together share more than 80% of the Australian poultry production, with less than 10 other processors representing the remaining 20%. In addition these companies have the exclusive licenses for all commercial genetic stock from their overseas developers, making entry for new processors extremely difficult and making those smaller processors very dependent on the “big three” for policy decisions. This interdependence between processors is very close indeed – there is frequently interdependence in feed supply, as well as genetics, sharing of disease information and vaccination regimes, and they will purchase wholesale birds from each other to fill short term orders when supplies are low. After the ND outbreak processors also “banded together” to assist the affected processor by providing grandparent stock. Two of the major processors have a known prosecution for price fixing under the Trade Practices Act.

There may well be too many processors for the small Australian market, despite poultry meat this year becoming the most consumed meat per capita, and this, plus Australia’s world leading retail market power concentration tends to produce destructive business behaviours :behaviours well beyond “healthy competition”. Processors quoting below the cost of production results in processors seeking a net economic transfer from their supply chain. Because farmers are the least regulated of the major production costs (noting unionised plant and single desk grain), and the fact that growers have little ability to transfer cost increases, it has meant that frequently the farmers are especially targeted by processors to reduce their cost margins.

Farmers are contracted solely to a single processor, usually for 5 year contracts. Processors usually only allow farms to be built in the geographic zone serviced by their processing plants, which means farmers generally cannot trade their services to other processors for biosecurity and

geographic reasons. In addition, even in those areas where it might be possible for farmers to trade their services, the level of interdependence between the processors means that a farmer must have *permission* from his current processor to enter into discussions with another: this permission is frequently denied.

Farmers generally invest upward of \$1.5m each into poultry facilities of particular specifications that have no alternative uses, and increasingly this investment is tailored to the individual specifications of a processor – these are increasingly processor specific and not identical to alternative processors. Farmers may only sell their property as a going concern as a contract farm only if the processor approves the purchaser. Farmers must continue to reinvest at the behest of the processor.

Farmers are in an invidious negotiating position, as the single customer is also the major supplier. Because farmer profits are entirely as a result of throughput, (payment is price per bird) (maximising the number of birds grown each year at miniscule rates of profit), processors can “make a farmer comply” by reducing the number of birds placed on that farm, by delaying harvest in favour of other farmers (which not only reduces throughput but also increases farm costs dramatically) or by “placing out of turn” (putting other farmers ahead in the placement queue) – none of which are easy to prove in an unconscionable conduct investigation! Smaller issues like short placements and handwritten dockets from electronic weighbridges are common.

Farmers may be subject to monetary “performance penalties” if the birds become ill, even if the illness was not the fault of the farmer (eg by failed processor vaccination programme or poor feed) and are also penalised with “low productivity” monetary penalties when they are *only 2% below* the mean production performance levels. Individual farmers have been verbally threatened, contracts terminated without notice and those farmers elected to represent the rest of the group have frequently had their contracts terminated regardless of performance. These behaviours are well documented also in the US industry on which the Australian industry is modelled.

Farmers are thus economically *captive* to a processor, particularly on renewal of contract. Contracts are always much shorter than the pay back time on investment, therefore making the farmer *captive* when attempting to negotiate a further contract.

In each mainland state and as a result of this poor business behaviour being so well documented, legislation was enacted to provide farmers with a degree of market power in the late 1970's and regularly reviewed in all states.

Essentially, legislation provided farmers with the ability to collectively negotiate (noting that as employers, farmers cannot form a union); to have an independent body oversee the application of reasonably fair fees for farming services, the right to have and assistance to achieve an independent negotiation/arbitration in the event of a dispute with their processor and a number of other smaller countervailing power measures. .

Legislation has not arguably decreased the efficiency of this industry. Anecdotally it appears to be the opposite: those states with the stronger legislation now have the largest and most efficient farms (WA in particular) and those providing the weakest countervailing power the smallest and least efficient farms. It appears that the “security” of the countervailing power provisions have encouraged farmers to reinvest in their farms and the banks to lend for that purpose.

Equally, countervailing power legislation has clearly not made Australian poultry farming inefficient in world competition terms. After about 20 years of the operation of countervailing power legislation, the World bank's analysis of poultry farming efficiency in 1999 rated Australian poultry farmers 2<sup>nd</sup> in the world (after Denmark).

It is this legislation that has “fallen foul” of the National Competition Policy review process

#### **4.0 OUTCOMES OF THE NATIONAL COMPETITION POLICY REVIEWS FOR THE POULTRY FARMING INDUSTRY.**

The application of National Competition Policy to the countervailing power legislation has been close to a disaster for the industry. The reasons for this are highlighted in the points below.

##### **4.1 Terms Of Reference Refer Mainly To Government And Statutory Bodies**

All major considerations of the application of NCP have always been on the “monopoly” legislation held by state and federal governments. This lack of focus by NCC and federal policy makers on the issues faced by the “added industries legislation”, particularly in the poultry industry, has resulted in “effective removal” of legislation that was enacted with good reason, often with shallow “textbook” analysis, without assessment of whether outcomes are reasonable and with neither monitoring nor restructuring assistance.

The real problem has been the actual assessment process of state legislation review and the NCC assessment of these reviews. This is referred to only briefly in the terms of reference, yet ACGC believes that it is the single biggest area of failure of the National Competition Policy.

In agricultural legislation reviews and particularly in poultry, the state assessments of legitimate countervailing power legislation and the assessment of the NCC in the context of the state: federal funding power struggle has left these farmers as the innocent human flotsam in a grossly failed process.

##### **4.2 The Outcome Of The Competition Policy Process In Ancillary Legislation Is That There Has Been An Unwinding Of Countervailing Power Legislation In Critical Areas Of Significant Market Failure.**

**The Outcome Of Competition Policy Has Been The De-Harmonisation Of State Legislative And Other Instruments In A Situation Where The Market Forces Are Essentially The Same, Or The Outcomes The Opposite Of That Which Is Rational**

That is, in Qld where there is effectively a comfortable processor duopoly with a moderate degree of market power abuse, there is weak legislation that has been approved by the NCC. In WA where there is an absolute processor duopoly with relatively appropriate business behaviours and little market power abuse, there is extremely powerful legislation that has been approved by the NCC. In NSW, where there is an oligopoly and very significant market abuse, very weak countervailing power legislation has been rejected by the NCC.

##### **4.3 NCC guidelines have been poorly understood (deliberately or accidentally) by the state instrumentalities that have carried out the ancillary legislation reviews. NCC has failed to provide adequate guidelines and training for reviews and in it's own reviews has failed to assess the public benefit tests against its own guidelines.**

This means that there has been no consistency of review between states, even when the market situation for a particular industry has been essentially identical. For those industries operating nationally, this has actually created barriers to national trade rather than enhancing it, and is biasing investment decisions. Thus the net result is increased state silo systems, working against national harmonisation.

##### **4.4 There Appears To Have Been No Quality Assurance Carried Out By NCC In It's Assessment Of State Reviews.**

This has resulted in unpredictable decision making, confusion and an *ad hoc* approach to assessment which has confused the state reviewers, and the industry which has been admitted by

the NCC. For example, the amended WA legislation was approved with effective arbitration allowance for disputes, whereas the amended SA legislation was refused and the SA government “fined” for achieving less in similar legislation.

#### **4.6 NCC May Have Exceeded It's Own Terms Of Reference**

This is adequately illustrated in the NCC assessment of the SA Poultry Meat Legislation review. The NCC essentially announced that it chose not to believe the state review, and this in spite of failed quality assessment on all other such reviews. The cynical might conclude that the NCC was finding any excuse not to approve reviews in order that the tranche payments might not be paid.

There appears to be a similar, albeit more confusing result in the NCC's assessment of the NSW review of the Poultry Meat Industry Act

#### **4.7 The Outcome Of NCC Decisions Has Essentially Been To Encourage Market Power Abuse By Powerful Oligopolies Against Suppliers And Small Business, Without Any Meaningful Recourse For Such Businesses , Even In The Face Of Clearly Identified And Significant Market Failure.**

The outcome of the National Competition Policy in many areas seems to have been to entrench the market power of the large corporations and increase barriers to entry to that industry by “deregulating” any countervailing power afforded to smaller players such as farmers through countervailing power legislation. In the poultry industry it appears to be resulting in a net transfer of economic resources directly from the small farmers to the processor, which should result in further concentration of already concentrated industries.

#### **4.8 State Bureaucrats And Consultants Who Have Undertaken Reviews Of Ancillary Legislation Appear To Have Almost Universally Ignored The Qualitative Issues Such As Access, Equity, And Barriers To Entry.**

In at least one case, the bureaucrat that undertook the first review and oversaw the second review clearly identified a second agenda in the first public meeting of the first review, and was allowed to continue. Again this highlights the failure of any probity checks with small business becoming the innocent victims of the outcomes.

Further in agricultural industries, there is a significant international market benefit from Australia's much vaunted “clean green” image, and this is also reflected in the interdependency of the primary industries in world trade terms.

For example, during the Newcastle Disease crisis in NSW ( a “local” outbreak rather than a true exotic disease) egg exports were effectively stopped from all states and beef exports were questioned by a number of Australia's trading partners. On this basis “bio-security” is a real issue for Australia and loss of biosecurity precautions in one industry may have adverse effects for the entire Australian trade, yet not one reviewer of countervailing power legislation had even seriously attempted to define the net public benefit from this critical attribute.

In a similar manner, social concerns such as the demise of the efficient family farming structures, and the equity issues of countervailing power have also been largely ignored by state reviewers, and apparently not subject to probity analysis by NCC.

#### **4.9 There appears to be No Evidence That The NCC Has Undertaken Any accurate Review Of The Poultry Meat Industry Prior To Determining That A State Review Has Or Has Not Followed The Guidelines**

By its own admission at a meeting with ACGC in March 2004, NCC staff and Chairperson admitted that they had managed to review 5 states assessments of poultry meat countervailing power legislation without being aware that the farmers at no stage own the livestock that they farm – surely a critical issue in the assessment of negotiating strength by a market player and a critical issue behind the original introduction of the state countervailing power legislature.

Similarly, the NCC appeared to be unaware that their state reviews lacked any quality control, admitting that they had been assessing this national issue on an *ad hoc* basis. Likewise NCC appeared to be unaware of the concentration of market power held by the three major processing companies. They admitted to having met with the processors, but had not either notified the growers (who after all are the topic of the assessment) nor had met with growers prior to completing 5 state reviews of countervailing power legislation.

NCC was also apparently unaware of the extent to which farmers are engaged in active competition within the countervailing power structure – by competing for a share of a pool payment or being part of a Performance Incentive System (PIF) within the context of an industry assisted or statutory price structure

Anecdotally at least, NCC appeared to have chosen to hold beliefs given to them by the processors rather than even beginning to have applied due process to investigation.

#### **4.10 The Oft Stated Remedies At Law For Failure Of Market Power Are At Best Useless And At Worst Counterproductive For The Poultry Meat Industry.**

This is the reason that most agricultural state legislation was enacted in the first instance, and in the case of the poultry farming industry state based legislation has (in NSW in particular) only held barely held coercive business behaviour in check. This is not simply anecdotal, ACCC investigated the industry in 2001 and concluded that while there was insufficient documentation to proceed with prosecution, that there was significant evidence of market failure in the farming sector. (*Comm. J Martin, pers comm.*)

The ACCC has admitted to the ACGC that authorisation can not provide appropriate protection in this industry, that there is evidence of very significant market failure, that unconscionable conduct legislation is not practical or useful in implementation. While the Dawson review will go some way to improving this situation, it is unlikely that ACCC will have sufficient resources to investigate this industry, and it is impossible for farmers (for cost and coercion reasons) to take their own action under the TPA.

In addition, any actions that a farmer might take under contract law (a prospect frequently put by processors as adequate legal recompense when there is a contractual dispute) generally results in forced exit from the industry, or “fire sale” under imminent threat of bankruptcy. Practically, it is unlikely that farmers would have the finances to take action against a billion dollar processor, and class action is virtually impossible.

Any contract that is in dispute can be deemed void pending resolution, which has minimal impact on the processor’s cashflow or product, but conversely has a devastating impact on the individual grower and leaves them with no resources to mount a reasonable defence. It is a denial of natural justice in its crudest form.

#### **4.11 One Critical Outcome Of The NCC Process In The Poultry Farming Industry Has Been To Encourage Open Abuse Of Market Power**

In SA, under threat of introduction of new countervailing power legislation, farmer delegates were individually threatened in at least one case termination of contract not as a result of performance was affected.

In NSW under threat on continuance of countervailing power legislation farmer delegates were individually threatened and a number of delegates were also not renewed without consideration of productivity performance.

The process of contract renewal in NSW and SA even under legislation has been difficult, with processors deliberately commissioning new farms to be built and refusing to renew contracts for many farmers, even those farmers with adequate facilities and high performance. Farmers are being punished for supporting the continuing application of countervailing power legislation in those states “brave enough to take on the NCC”

In each of Vic, SA and NSW during the NCC state reviews, processors approached politicians and threatened to remove all their investment from that state if they did not agree to withdraw countervailing power legislation.

This has resulted in insecurity, farming fees are rapidly falling below the cost of production with no net change in consumer prices; random contract terminations bear no relationship with performance or efficiency; random application of financial penalties to farmers which are not related to negligence and bank investigations into the new risk status of the industry mean that farmers are already reporting increased “risk ratings” There has been no net improvement in economic efficiency, in fact the net effect is probably backwards as economic resources are sunk into adequate farm operations that are no longer used by the processor and have no alternative use.

In WA which has strong balanced legislation re-enacted, there has been active poaching by Banks that have no poultry farms in their Agri-business portfolio. This phenomenon occurred following the proclamation of the WA Chicken Meat Act,

#### **4.12 There May Be Inadequate Understanding Of Issues Of Market Power In This Industry By Reviewers, Legislators, NCC And Government In The Context Of Vertical Vs Horizontal Arrangements.**

Market power is generally viewed in the context of horizontal arrangements – that is unequal competition between companies at the same level of the market, Market power analysis in NCC review processes is rarely applied to the vertical arrangements that exist in the poultry meat and increasingly in other industries.

In the case of the poultry meat industries the majority of abuse of market power is vertical, and the countervailing power legislation provided which has been so badly reviewed, does not appear on international measures to have reduced the competitiveness of farmers.

The measurement of effectiveness of the NCC process is that the price to consumers has fallen or will fall. This is clearly not the case with the reviews of the poultry meat legislation as consumer prices have remained static: there has been capture of any economic gain by processors or retailers, further entrenching their market power at the loss of the small business. The NCC process has therefore failed in this case.

#### **4.13 There Has Been Inadequate Understanding (Deliberate Or Accidental) Of Pricing Arrangements In This Industry, Resulting In Aberrant Allegations Of Anticompetitive Behaviour, Aberrant Beliefs About Competition At Retail Level And Aberrant Understanding Of State Legislation**

NCC has continually alleged (including in the media) that the poultry meat farmers are anticompetitive and has implied that poultry farmers are somehow cosseted, overpaid and uncompetitive on the world stage. There is considerable data to suggest otherwise that has been presented to both state reviewers and the NCC directly, and yet the NCC both continues to make such allegations and has not seen fit to re-examine its own assessments. This is even in the face of considerable additional data provided by one state reviewer and expert agricultural economist.

It could be noted that one major processor which had a significant farming sector, has, or is actively attempting to divest themselves of those farms.

This follows a critical examination of that processors "return on capital" by the Banks and showed that the farming sector was its most poorly performing division. There has never been any move by any Processor to acquire these so called over-paid farms when they are listed for sale.

#### **4.14 There Has Been No Structural Adjustment Available From Any Government In This Process For This Industry, Farmers Have Simply Become Pawns In The Federal:State Funding Power Struggle.**

The general understanding of farmers from the NCC process has been that where farmers have made very significant investment in property and equipment for farming meat poultry under a particular legislative system made available by government. When a government process changes the rules; there should be made available structural adjustment funding from the tranche payments that are made available to the state governments.

In the case of the dairy industry this appears to have been the case, with a national structural adjustment scheme administered by the federal government when the government "deregulated" the industry (albeit predating NCC process). While the result of the dairy deregulation does not appear to have benefited consumers, the outcome to farmers has at least been a reasonably dignified exit from the industry and the ability to turn farms to other uses without excessive waste of sunk costs.

The meat poultry industry, partly because of the lateness of the state reviews in most cases, partly because of the *ad hoc* nature of the NCC reviews and partly because the political will may be lacking, poultry meat farmers have had to survive this government induced process without any form of assistance. That so many farmers are now facing loss of contract and effective forced exit from the industry is testament to the lack of fairness and equity being applied during the NCP implementation.