7 National Competition Policy and the marketing of rural products

While many statutory marketing arrangements had been reviewed and dismantled prior to National Competition Policy (NCP), they are still a major feature of the institutional environment for certain rural products. As part of NCP, Australian governments have agreed to review systematically all of their remaining statutory marketing arrangements. Significant assistance is often provided to some rural activities through these arrangements. Consequently, review findings that they should be disbanded or modified to enhance community welfare more generally, can adversely affect some producers and some country regions.

7.1 Introduction

Statutory marketing arrangements have their origins in voluntary cooperatives formed at the turn of the century. Through these cooperatives, groups of producers sought to increase their returns by controlling the processing and marketing of produce. In the 1920s, some cooperatives sought, and gained, statutory backing for 'compulsory cooperatives'. Wartime regulation expanded the use of compulsion and it became an integral component of the pricing and marketing framework for many agricultural industries.

Since the early 1970s, statutory marketing arrangements have been subject to increased scrutiny, with all States initiating reviews of them in the 1980s and early 1990s (IC 1991). In part, this reflects the availability of newer and more efficient means of achieving their historical objectives. For example, better and cheaper communications, the development of new financial tools to manage risk, and the adoption of a flexible exchange rate, have substantially reduced the need for statutory arrangements to smooth out the effects of fluctuations in world prices or large exchange rate shifts.

In addition, the recognition that price regulation and the equalisation of export returns often served to mask price signals and inhibit product innovation led some agricultural industries themselves — such as the Australian Dried Fruits

Association — to ask for such arrangements to be dismantled (Minister for Customs and Consumer Affairs 1998).

Reductions in assistance to manufacturing industry, coupled with Australian initiatives in international forums to reduce government intervention in agriculture, have added to the impetus for the review of statutory marketing arrangements. Consequently, well before the introduction of NCP, government reviews of statutory marketing arrangements were leading to the dismantling of arrangements for many commodities — such as canned fruit, bread, processed tomatoes, oilseeds, navy beans, peas, processed apples and peanuts.

Despite this, the remaining statutory marketing arrangements now constitute the major form of assistance to agriculture. For example, in 1996-97, they contributed more than $500 million in assistance to a range of agricultural industries. This represented more than half of the total assistance afforded to agriculture as a whole (PC 1998f). Potential reform of statutory marketing arrangements thus has significant implications for many rural producers and, where activities are concentrated in particular locations, for regional communities.

There are presently Commonwealth statutory marketing authorities (SMAs) for dairying, horticulture, red meat products, wine and brandy, wool and pork. At the State level, statutory marketing arrangements still exist for a variety of primary industries, including bananas, citrus, red meat, grains, poultry, rice, tobacco, wine grapes, tomatoes, dairying, dried fruits, strawberries, eggs, sugar, honey and potatoes, although the deregulation of many of these arrangements has been announced. A list of Commonwealth, State and Territory SMAs as of the National Competition Council's (NCC's) Second Tranche Assessment, which covered each jurisdiction's review and reform progress to 31 December 1998, is provided in table 7.1. The Australian Wheat Board has since been privatised and no longer operates as a SMA.

In some areas of rural activity, agricultural cooperatives — voluntary producer organisations — operate successfully without any statutory backing. Common activities include building and operating storage and packing facilities, negotiating with buyers, the export of products and the operation and funding of processing facilities such as canneries. Cooperatives may potentially engage in anti-competitive practices such as price fixing, enforcing exit barriers and determining how much produce members can sell. Without statutory support, however, voluntary cooperatives face potential competition from producers selling outside the cooperative, and are subject to remedies under the Trade Practices Act (TPA). They are less likely to engage in anti-competitive behaviour than has been the case with SMAs.

The reform of SMAs, which has been under way since the 1970s, was given renewed impetus in April 1995 when Commonwealth, State and Territory governments agreed to implement NCP. Two aspects of NCP are particularly relevant to statutory marketing arrangements, namely:

- the extension of the competitive conduct rules of the TPA to all businesses, including SMAs and cooperatives; and
- NCP legislation reviews — Commonwealth, State and Territory governments have agreed to review and, where appropriate, reform legislation, which restricts competition by the end of the year 2000.

Table 7.1 **Statutory marketing authorities in Australia[a]**

Commonwealth	*New South Wales*	*Victoria*	*Western Australia*
Australian Dairy Corporation	Banana Industry Committee	Australian Barley Board	Chicken Meat Industry Committee
Australian Horticultural Corporation	Central Coast Citrus Marketing Board	Melbourne Market Authority	Cooperative Bulk Handling Limited
Australian Pork Corporation	Meat Industry Authority	Murray Valley Citrus Marketing Board	Dairy Industry Authority of WA
AWB Limited	Murray Valley Citrus Marketing Board	Northern Victorian Fresh Tomato Industry Development Comm.	Dried Fruits Board of WA
Australian Wine and Brandy Corporation	NSW Dairy Corporation	Tomato Industry Negotiating Committee	Grain Pool of WA
Wool International	NSW Grains Board	Victorian Broiler Industry Negotiating Committee	Honey Pool of WA
Meat and Livestock Australia	Poultry Meat Industry Committee	Victorian Dairy Industry Authority	Potato Marketing Corporation of WA
	NSW Rice Marketing Board	Victorian Meat Authority	WA Egg Marketing Board
	Wine Grapes Marketing Board	Victorian Strawberry Industry Committee	WA Meat Industry Authority
	Wine Grape Processing Industry Negotiating Committee	Wine Grape Industry Negotiating Committee	WA Meat Marketing Corporation

Queensland	*South Australia*	*Tasmania*	*ACT*
Queensland Dairy Industry Authority	Australian Barley Board	Egg Marketing Board of Tasmania	Milk Authority of the ACT
Queensland Sugar Corporation	Dairy Authority of SA	Tasmanian Dairy Industry Authority	
	Poultry Meat Industry Committee		
	SA Dried Fruits Board		
	SA Citrus Board		

Sources: IC (1995a); sub. 283; sub. D298 ; sub. D302.

7.2 Application of the Trade Practices Act

The TPA prohibits a number of anti-competitive practices. For some practices, such as the misuse of market power, the prohibition is absolute. Other practices, such as exclusive dealings contracts, can be authorised (ie allowed) by the Australian Competition and Consumer Commission (ACCC) subject to a 'public benefit' test (see chapter 4). Thus, anti-competitive arrangements can be allowed even though they might:

- substantially lessen competition;
- prevent competitors acquiring goods from, or supplying goods to, a particular person;
- allow one person trading with another to impose restrictions on the other's ability to choose with whom, or in what, they deal (exclusive dealing);
- allow one person supplying goods or services to others to require that the other person acquires goods or services from a particular third party (tied sales); and
- allow suppliers, manufacturers or wholesalers to specify a minimum price below which goods or services may not be sold (resale price maintenance).

The 'authorisation' and 'notification' provisions of the TPA give the ACCC the power to grant immunity from legal proceedings for most arrangements which otherwise might breach restrictive trade practices (ACCC 1998, p. 34).

The TPA (section 51(2)(g)) also 'provides an exemption for contracts that relate exclusively to the export of goods from Australia or to the supply of services outside Australia' (NCC 1998g, p. 18). In other words, anti-competitive practices are permitted if returns to Australian producers can be increased at the expense of overseas consumers. In the above-mentioned report to the Commonwealth Treasurer on 5 March 1999, the NCC recommended that this exemption be retained, noting that its use may increase as reforms to statutory marketing arrangements proceed.

The arrangements for the Australian Wool Exchange Limited illustrate an ACCC authorisation decision (box 7.1). The Australian Chicken Growers' Council (sub. 166) also noted that, when South Australia abolished its poultry meat legislation, authorisations were put into place for two processor groups (see appendix C). Authorisation processes can be put in place also for cooperatives — the ACCC authorised arrangements for the Victorian Egg Industry Co-operative (ACCC 1998).

Thus, although the extension of the TPA to SMAs is designed to promote competitive pricing and marketing of agricultural commodities, a wide range of anti-competitive arrangements may be allowed by the ACCC if they can be shown to be in the public interest. In particular, these can be used to provide agricultural producers with a transitional mechanism where marketing legislation has been revoked.

Box 7.1 **Authorisation and the Australian Wool Exchange Limited**

'The Australian Wool Exchange Limited (AWEX) was established by major groups in the wool industry to fill the vacuum left by the Government's withdrawal from the marketing of wool. AWEX sought authorisation for … rules and codes of conduct for buying and selling wool in Australia. The [ACCC's] general concern with a public company gaining such a large share of the market was that it would be in a position to stifle innovation and competition. It was also concerned that participants in the industry felt that they must join AWEX if they were not to be disadvantaged… . A number of small brokers indicated … that they felt they had been 'railroaded' into joining AWEX.

However, the [ACCC] recognised that the wool industry needed a period of stability to adapt to the dramatic changes it had recently undergone while AWEX reviewed its selling regulations and business rules to reflect the move to a deregulated market. … It also accepted that there were public benefits in AWEX maintaining many of the current industry standards after deregulation to provide for continuing quality control while it developed a comprehensive quality assurance program. … A program, which enhanced the willingness of processors to buy Australian wool and to pay premium prices for it in the face of competition from other countries, was seen as delivering benefits to the public.

The [ACCC] accepted that there was a public benefit in AWEX maintaining the existing wool selling rules, industry standards and codes of conduct to provide for the efficient functioning of the market during the transition phase. It granted authorisation for a period of three years… .'

Source: ACCC (1998), p. 35.

7.3 Review of SMA legislation

The legislation review program aims to ensure that legislation does not restrict competition unless it can be shown that the benefits to the community as a whole outweigh the costs, and that the objectives of the legislation can only be achieved by restricting competition.

Legislation underpinning SMAs is required to be reviewed because it is potentially anti-competitive. This section summarises progress in each jurisdiction's legislation reviews relating to SMAs, including consideration of some completed reviews. Further details of legislation reviews affecting primary industries can be found in appendix C.

Progress with the review schedule

Despite the recent confirmation of the commitment by Commonwealth, State and Territory governments to review statutory marketing arrangements under the NCP by the end of the year 2000, significant reviews in some jurisdictions are not scheduled until late in the review period (see box 7.2).

Box 7.2 **Progress with reviews of agricultural marketing legislation**[a]

Commonwealth: Two reviews are under way, but neither has been completed. Some legislation is not slated for review under the initial (to December 2000) timetable.

New South Wales: Reviews have been completed for rice, dairy, bananas, cooperatives, meat, farm produce, poultry processing, wine grapes, and tobacco. The reviews of grain and citrus marketing are still under way.

Victoria: Reviews have been completed for barley, dried fruits, and wine grapes. A review of marketing orders relating to tomatoes in Northern Victoria, and strawberries and emus, is under way. Reviews of citrus, dairy and broiler chickens are also under way. The review of meat marketing is to commence this year. The review of wheat marketing is awaiting the Commonwealth review.

Queensland: Reviews have been completed for the Brisbane Market Authority, cooperatives, dairy, sugar, primary producer marketing, fruit marketing, chicken meat, and grains. The Egg Industry Act 'sunsetted' in December 1998.

Western Australia: Reviews have been completed for bananas, chicken meat, cooperative societies, dairy, dried fruits and the meat industry authority. Reviews are in progress for eggs and potatoes. Reviews of meat, wheat marketing and the *Perth Market Act 1926* are to commence this year.

South Australia: Reviews of barley (in conjunction with Victoria), and poultry meat have been completed. Reviews of wine grapes, citrus, dairy, dried fruits are under way. A review of wheat marketing is to commence in 1999.

Other jurisdictions: Reviews of the Tasmanian dairy and egg industries have been completed. The ACT has one piece of statutory marketing legislation, the *Milk Authority Act 1971*, for which a review has been completed. The Northern Territory has no statutory marketing legislation since the repeal of the *Grain Marketing Act*.

[a] Progress as of 31 December 1998, reported for the NCC's Second Tranche Assessment, 30 June 1999. Some reviews shown as under way may have been completed since December 1998.

Source: Appendix C.

The NCC has previously expressed concerns about the timing of reviews:

> … the Council also questions the priorities being placed on important reviews by some governments … one example of a government failing to schedule important reviews early is the Commonwealth's planned examination of the *Wheat Marketing Act 1989* in 1999-2000. (NCC 1996a, p. 19)

At the Commonwealth level, there is little in the way of SMA reform outcomes that can be attributed directly to NCP. Reforms to wool, wheat, red meat and dried vine fruit arrangements reflect largely independent reform processes. Of the three pieces of legislation scheduled for review by June 1998, one (the *Wool International Act 1993*) was removed from the review schedule, while reviews of the others (the *Pig Industry Act 1986* and associated legislation and the Primary Industries Levies Acts and related Collection Acts), have not yet been completed (NCC 1999b, vol. 3).

Progress at the State and Territory level varies. Despite significant progress in the overall program of legislative review, reviews of several major agricultural commodities — barley, chicken meat, dairy, rice and wheat —are still under way. Among the reviews of statutory marketing legislation which have been completed, governments have announced in many cases that existing restrictions on competition will continue during transitional phases.

Consequently, it is difficult at this stage to assess the impacts of SMA reforms:

> … many of the statutory marketing arrangements are still in place and yet to be reviewed. Therefore, it is too soon to assess how large the benefits and costs will be and who may gain or lose from any changes to these arrangements. (Commonwealth Treasury 1998b, p. 48)

FINDING 7.1

The process of reviewing statutory marketing arrangements is well under way, but, to date, relatively few of these reviews have been completed or reforms implemented. Consequently, it is too soon to assess the effects of these reforms.

Legislation review issues

More than four years have passed since the NCP was agreed to by the Commonwealth, State and Territory governments. It is more than three years since each jurisdiction's legislation review schedule was published. Questions have arisen about NCP review processes and the legislation review outcomes.

Review processes

Questions have been raised about the composition of groups conducting (or overseeing the conduct of) the reviews. Some submissions argued that the use of non-industry representatives has produced poor outcomes. According to the Queensland Farmers' Federation, this can include:

> … an overt and at times aggressive attitude by Government representatives in relation to the primacy of efficiency gains … it appears to be ideologically driven and somewhat divorced from a genuine search for balanced economic reform. (sub. 90, p. 7)

Pritchard (sub. 184) used the New South Wales legislation review of the Wine Grapes Marketing Board as a 'case study' to demonstrate such concerns. He considered that the report was couched in market theory and presented the competing claims of the Board in a 'tokenistic and disinterested manner'.

> At the level of NCP implementation, as shown through the example of the NSW Legislative Review of *the Marketing of Primary Products [Wine Grapes Marketing Board] Act*, an enthusiasm for pro-competition outcomes can preclude wider debate into issues of agricultural supply chain efficiency. (sub. 184, p. 27)

In contrast, some participants were concerned about over-representation by industry groups. The Queensland Produce, Seed & Grain Merchants' Association noted:

> … in the case of some reviews of Australian grain marketing, the reviewers have been representatives of the actual statutory organisations being reviewed. This was the case in the most recent review of the grain regulations in Queensland where Grainco was represented on the review committee (and had a vote) and was the main beneficiary of re-regulation. (sub. 106, pp. 1–2)

Translating principle into operational outcomes from each review requires detailed industry knowledge. Industry involvement also may help the industry to 'sign on' to the reform process. This may be significant in ensuring that reform proposals are implemented effectively.

On the other hand, efficient outcomes require reform groups to make well-balanced assessments about the effect of changes from the perspective of the broader community. This could be difficult if some members of the group have a close association with either the industry or major users. Rather than have direct representation on review groups, it may be preferable for the involvement of industry and user representatives to occur via submissions or evidence at hearings with the review group. The NCC has said:

> The Council has various concerns about the reviews conducted to date. For example, the split along industry and government lines of recommendations from the New South Wales [dairy] Review Group highlight the Council's concerns about the need for review panels, particularly in sensitive areas such as dairy, to be independent from industry. Industry should participate in reviews via submissions … rather than direct representation on review panels. (1999b, vol 1, p. 104)

The appropriate roles of producers, users and others were raised in an earlier inquiry into aspects of NCP (Hawker 1997a). Its recommendations and the Commonwealth Government's response are outlined in box 7.3. The Commission endorses these

recommendations and the Government's response, but recognises that constituting a review panel with appropriate industry knowledge and independence may be difficult in practice.

Box 7.3 **Recommendations of the Hawker Committee**

The Hawker Committee inquiry into aspects of the National Competition Policy reform package (Hawker 1997a) recommended, in relation to legislation reviews, as follows:

Recommendation: '*The level of consultation may vary with the significance, diversity and sensitivity of the review. Consultation should involve key stakeholder groups'*. In endorsing this recommendation, the Government indicated that, for minor reviews of essentially in-house matters, consultation may be unnecessary, but that in the majority of cases considerable consultation will be warranted.

Recommendation: '*Where possible reviewers should be independent of the existing arrangements with more significant, more major and more sensitive reviews demanding greater independence'*. The Government agreed and added that:

- minor reviews may be best performed by an inter-departmental committee comprised perhaps of individuals involved in administering the matter under review;
- more significant and sensitive matters will require greater independence; and
- a judgment must be made on the necessity for independence versus specialist expertise — while members of the review body should not be directly involved in decision making, they need to have an understanding of existing arrangements.

Source: Hawker (1997a); HRSCFIPA (1998).

Another administrative problem identified in submissions relating to NCP processes is the expense for industry associations in arguing their case to review panels. For instance, the Western Australian Farmers' Federation claimed that it had:

> … spent upwards of $50 000 in preparing its submission … for the legislative review process of the dairy sector. If this is to be a recurrent cost to every other commodity sector represented … then such a situation would be untenable. (sub. 138, p. 14)

while Queensland's CANEGROWERS told the Commission:

> CANEGROWERS estimates that direct costs for its review [the Sugar Industry Review] were in the order [of] $2 million, with an additional $2 million at least in meeting costs borne by the participants. Implementation since then could cost up to an additional $1 million. (sub. D285, p. 4)

It is unlikely that all reviews would require such costly input. It is anticipated that, unlike major reviews such as that of the dairy industry, many other reviews will be relatively minor in nature. Nonetheless, if more significant reviews are to be conducted as recommended, this will require the involvement of interested parties.

Review outcomes

Aspects of the outcome of some reviews have been criticised by participants, as well as being raised as a matter of concern by the NCC. These concerns focus on the extent to which the implementation of reform is consistent with review recommendations, and the extent to which outcomes of some reviews are consistent with the intent of NCP. In the case of the New South Wales rice review, the implementation of some of the recommendations of reviews has been slow, despite findings that public benefits would flow from reform (box 7.4). Other reviews — sugar, and several State reviews of the dairy industry — have recommended the maintenance of anti-competitive arrangements (see boxes 7.5 and 7.6 below).

Box 7.4 **New South Wales rice review**

A 1995 review of the Rice Marketing Board recommended the retention of a single desk approach to rice exports and the deregulation of the domestic market by discontinuing vesting on 31 January 1999. In November 1997, the NSW Government decided to continue the Board's vesting powers until 2004, based on its assessment that the benefits of the regulations exceeded the costs to consumers. In June 1997, the NCC raised concerns about whether the outcome of the New South Wales assessment was consistent with the CPA, and recommended that the Commonwealth deduct $10 million from the NCP payments due to NSW. In August 1998, the Commonwealth Treasurer announced that a working group comprising representatives of the NSW Government, rice growers and the NCC had been established to develop a solution to this matter. The Commonwealth then offered to facilitate the establishment of a single desk selling arrangement for export rice contingent on deregulation of the domestic sector. New South Wales has given in-principle agreement to this outcome, and it appears that the $10 million competition payment will be made by the Commonwealth. Nevertheless, the NCC will monitor progress and make a supplementary second tranche assessment if progress is unduly delayed.

Sources: Appendix C; NCC (1999b, vol. 1).

Concerns have been raised also about the quality of analysis that has underpinned the recommendations of some reviews. For example, in relation to reviews of dairy, chicken meat and sugar in Queensland, the Queensland Farmers' Federation stated:

> … only parts of the industry have come under close scrutiny with other parts not analysed at all. Short-cuts [in the use of data] have been taken in work done in reviewing at least one industry in this State which certainly throw into question the reliability of the results. (sub. 90, p. 4)

The outcomes of the dairy reviews raise some questions about the use of cost–benefit analysis and the public interest test. For example, in some reviews, benefits may be included which are not really attributable to the existing regulations. The NCC has commented that:

> The Council is concerned about the robustness of the cost–benefit analysis undertaken in reviews … some of the identified 'benefits' presented in support of retaining marketing arrangements are doubtful … (NCC 1999b, vol. 1, p. 104)

Box 7.5 The Queensland sugar review

The Sugar Industry Review Working Party (SIRWP) reported in November 1996. The Queensland and Commonwealth Governments accepted all 74 recommendations. The review recommended the removal of the tariff on sugar imports, which it estimated cost consumers up to $27 million per annum. The tariff was subsequently removed. It also recommended the continuation of compulsory acquisition for all raw sugar produced in Queensland, the retention of the Queensland Sugar Corporation (QSC) as the single desk seller for the export and domestic markets, that the pooling of revenues and costs and coordinated management of quality be retained, and that a system of producer pricing be introduced. The Commonwealth Government introduced amendments to the TPA to retain the compulsory acquisition powers of the QSC.

The NCC was not convinced about the basis of the SIRWP recommendations, but did not challenge the outcome of the review. Its concerns centred on the review's conclusion that 'the benefits of full domestic deregulation could be achieved by mandating the provision of export parity priced raw sugar to the domestic market while, at the same time, avoiding the adverse impact of domestic deregulation on the competitiveness of export arrangements'. In response, the Queensland Government undertook to reconsider marketing arrangements for sugar within ten years if changes in market conditions suggest that the arrangements no longer provide a public benefit.

Sources: Appendix C; NCC (1999b, vol. 1).

Another concern is that the costs and benefits may be inappropriately weighted. The 'public interest' test is designed to ensure that social, environmental or other 'non-economic' costs and benefits are taken into account in the assessment. In the Queensland and New South Wales dairy reviews, however, the 'public interest' test has been used to give special emphasis to the social costs of deregulation on the grounds that they are geographically concentrated. In this context, the NCC has argued that:

> A common difficulty encountered when considering legislative reform is balancing the concentrated nature of the benefits arising from restrictions with diffuse benefits, often spread across the economy, from reform. … the Queensland Dairy Review Group …believed that the highly concentrated benefits to a few from the existing arrangements should be protected at the expense of the more diffuse costs to the majority. This approach is inconsistent with the principle underpinning the NCP …, that such arrangements should be reformed unless it can be shown that they deliver a net benefit to the community as a whole. (1999b, vol.1, p. 104, emphasis in original)

There is also the potential for the costs of deregulation to be over-estimated. For example, if dairy farmers are able to maintain their dairy herds by becoming more efficient, or could switch into other commodities, or if their local regions could

attract other industries, then the social costs can be overstated and the assumption that the cost–benefit assessments do not capture all the costs of deregulation may be incorrect. In such circumstances, where reform is not recommended on the grounds that adjustment will be costly, a State would forgo reforms for which the benefits exceed the costs. The NCC has argued:

> The approach proposed by New South Wales and Queensland for their dairy industries, leaving existing arrangements in place for a further five years without a progressive introduction of transitional arrangements to open competition, has the potential to exacerbate any industry dislocation. Such an approach provides no impetus or incentive for the dairy industry to prepare for, and respond to, expected change. (1999b, vol. 1, p. 106)

Box 7.6 **State dairy reviews**

In July 1998 the Queensland Legislation Review Committee (QDLRC) recommended that farm gate milk prices should continue to be regulated, and supply management arrangements should continue until 31 December 2003. The justification for these recommendations was that deregulation of prices and supply restrictions would lead to significant adverse economic impacts for some rural communities in Queensland, but that the benefits of deregulation to Queensland consumers were much more dispersed.

In New South Wales, the review of the *Dairy Industry Act 1979* recommended that milk production quotas, farm gate price regulations, and the vesting powers of the NSW Dairy Corporation should all be retained on the grounds that they provide dairy farmers with countervailing power against processors, and that their removal would lead to adverse economic impacts for dairy regions. The NSW Government accepted these recommendations and extended farm gate regulation until 2003.

In Western Australia, the review of the *Dairy Industry Act 1973* estimated that farm gate regulations provide an annual subsidy to dairy farmers of around $26 million, and that the discounted value of production quotas was around $88 million. Despite this, the review recommended that: farm gate price regulation be retained to provide countervailing power against processors; the Dairy Industry Authority retain its vesting powers; and the quota system be retained. These recommendations were endorsed by the Western Australian Cabinet.

Sources: Appendix C; NCC (1999b, vol. 1).

The NCC's concerns about the way in which the 'public interest' test has been used in the case of the dairy industry and other reviews have led it to raise the possibility of recommending that the second half of the second tranche payments be withheld in the year 2000 for all jurisdictions (NCC 1999b, Overview).

A further issue relates to the 'sustainability' of some review outcomes. For example, the review of the Queensland dairy legislation acknowledges that the

ability of its key recommendations to be put in place will depend on the outcome of the Victorian dairy legislation review. While the Queensland Government announced that it would maintain the farm gate price for milk, the dairy review committee noted:

> The proposed regulated farm-gate price … and associated supply management arrangements … would be difficult to maintain if deregulation occurs in Victoria before 31 December 2003. It may be necessary to review these recommendations when the outcome of the Victorian NCP review is known. (QDLRC 1998, pp. 14–15)

This would also be the case for New South Wales. For this reason, the NCC did not recommend the withholding of competition payments in the second tranche assessments:

> … recognising the significance of the outcome of the Victorian review in determining the direction of reform Australia wide, the Council [will] consider the New South Wales, Queensland, Western Australia and ACT reviews through a supplementary assessment before July 2000. (NCC 1999b, vol. 1, p. 104)

Sustainability of review outcomes was also an issue in the 1997 Queensland grain review. It recommended the retention of vesting for export barley subject to review should circumstances change in other States.

The Australian Chicken Growers' Council drew attention to a lack of consistency with legislation reviews in different States:

> Because the NCC has not set any precedent as to what is acceptable public benefits testing through outcomes analysis, each state has modified its approach to different acts over time as well as their previous reviews have (mainly) been rejected out of hand or substantially modified by the NCC. (sub. 166, p. 10)

This view of the NCC is commonly held. However, it is not the role of the NCC to reject or modify reviews. Moreover, the NCC released a document in November 1996 entitled 'Considering the Public Interest under National Competition Policy' which provides some guidance for review panels. Nevertheless, the Commission sees merit in State governments providing guidance to review groups on their interpretation of the broad-ranging public interest criteria, and has made a recommendation to this effect in chapter 11.

7.4 The impacts of SMA reform under NCP

Although the operations of SMAs vary considerably — both between products and between SMAs for the same product in different jurisdictions — SMA objectives are typically pursued through a range of powers which can encompass:

- vesting — the compulsory transfer of ownership of a commodity to an SMA;

- setting or negotiating prices — for example, setting different prices for different markets and end users (eg farm gate and retail prices);
- compulsory levies on producers to fund marketing activities or other services;
- licensing producers and exporters; and
- pooling and equalisation arrangements.

The instruments used by SMAs, such as acquisition of produce and price and production controls, affect the manner in which commodities are produced, processed or otherwise used and consumed. By influencing production, industry structure and prices — sometimes through the entire chain from the farm gate to wholesalers and retailers — statutory marketing arrangements can give rise to significant efficiency and distributional gains or losses.

SMAs can enhance efficiency if they improve market outcomes. Characteristics sometimes associated with rural products, such as the abuse of market power by buyers due to their concentration or the perishability of a commodity, the scope for premiums to be obtained in export markets, the existence of economies of scale and scope, and the public good nature of generic promotion, suggest that there is the potential for marketing arrangements to improve on market outcomes.

On the other hand, SMAs can detract from efficiency by restricting the entry and exit of firms or individuals into markets and by controlling prices and/or production levels. SMAs can also impose a range of restrictions on quality, advertising and promotional activities and, perhaps more importantly, reduce incentives for innovation.

The benefits and costs associated with SMAs depend on the nature of the arrangements in place and typically change over time. Whether the costs of a particular statutory intervention are outweighed by the benefits can be determined only on a case-by-case basis. This underlines the need to scrutinise statutory marketing legislation (and similar legislation which confers power upon producer cooperatives) under NCP.

Many SMAs have successfully used their powers outlined above to increase the returns which accrue to growers at the expense of processors and/or consumers. Consequently, producers' concerns about NCP reforms are focussed around the potentially adverse effect on grower returns of dismantling the present arrangements. While the Commission recognises that changes in statutory marketing arrangements do have the potential to lead to large losses for industry participants and some country regions, reform can still be justified on the basis that these adverse effects are outweighed by the benefits which accrue to other

Australian producers and final consumers, and — perhaps most importantly — the improved incentives for innovation.

Many of the instruments used by SMAs have been defended in terms of the need to:

- provide growers with a countervailing power against the perceived market power of processors and other end users;
- maximise returns from exports;
- iron out fluctuations in prices and production due to market instability and natural variability such as weather;
- capture economies of scale and scope in marketing and production;
- provide information and market development, research and promotion; and
- establish quality controls and standards.

These objectives often can be achieved without the statutory backing afforded to many of the anti-competitive restrictions associated with SMAs. Consequently, the outcomes of deregulation may not be as severe as many farmers expect. In relation to the dairy industry and the reasons advanced for the maintenance of farm gate regulations — ensuring year-round milk supplies, countervailing the power of processors and retailers, protecting dairy farmers from corrupt world markets, and supporting regional economies — the NCC has argued:

> - It is not clear why milk is significantly different from other basic foods, the price[s] of which fluctuate throughout the year… . …year round supply would be achieved in the absence of supply management arrangements, with higher prices paid to producers in lower production periods to ensure supply.
> - It is not clear that there is undue concentration and/or abuse of market power by retailers. Any risk of this is reduced by large farmer co-operatives that are a significant feature of the milk processing sector … . Further, … there are remedies available under the TPA.
> - It is true that world prices for dairy products are distorted … this has been the case for years … matching overseas assistance would impose significant costs on the Australia [sic], not only through any direct payments to producers, but through domestic market distortions and a reduced incentive for the industry to innovate.
> - While regional development is a legitimate … objective … a tax on milk consumers to subsidise producers is a particularly blunt policy tool to achieve this objective … (1999b, vol. 1, p. 105)

The market structures which emerge as a result of SMA reform will determine the distribution of any gains from reform between the growers, the processors, and final consumers (both domestic and overseas). In other words, whether grower returns will fall after the removal of anti-competitive restrictions will depend in large part

on the existence and nature of market power in different sections of the domestic market — processors, exporters, growers etc — and on the ability of growers to price discriminate between domestic and export markets.

The changes in market structures and the relationships between growers, processors and retailers as a result of SMA reforms will also determine the distribution of gains from the removal of other forms of assistance to agricultural industries. For example, lower tariffs should lead to lower domestic prices. If processors have market power, these lower prices will not necessarily be passed on to retailers and consumers unless the domestic market is also deregulated, such that increased competition can prevent the processors simply increasing their margins.

Where SMA reforms have been implemented, the ex-post assessments of the removal of anti-competitive regulation need to be sophisticated enough to account for other influences which can confound simple 'before and after' comparisons. These other factors encompass changes in weather, technology, prices for labour and other inputs, access to markets, consumer tastes, exchange rates, the price/availability of substitute products, and the price/availability of products supplied by overseas competitors. If account is not taken of these factors, the declining fortunes of growers in a particular industry could be incorrectly attributed to SMA reform rather than drought, declining world prices for commodities, etc.

The Commission received very little concrete evidence of the effects of past reforms of statutory marketing arrangements, even though it held discussions in several regions which have experienced the loss of statutory marketing and other arrangements, such as the Atherton region of Queensland (removal of statutory marketing and tariffs for tobacco), Mildura (deregulation of the dried fruits industry), Shepparton (statutory marketing arrangements for deciduous canning fruits), and Mount Gambier (abolition of milk price equalisation).

Apart from the experience of the tobacco growing regions in Queensland, participants considered that their regions had not been subject to lingering negative effects from deregulation.

In the case of Shepparton, when the deciduous canning fruits industry was reviewed in 1987, the Australian Canned Fruits Corporation said at the time that deregulation would lead to only one canner remaining in Australia, the loss of 3300 jobs (full-time equivalents of seasonal jobs), 1000 growers going out of business and the cessation of exports (IAC 1987). After the review, the Corporation was wound up and the industry deregulated. This was not considered to have been a major issue during the Commission's visit to Shepparton, and the Commission notes that both canneries, Ardmona and SPC, remain in the region.

In the case of grain deregulation, the Pastoralists' and Graziers' Association of WA argued:

> Since the deregulation of the domestic grain market in the Eastern States of Australia, there has followed huge investment in value adding infrastructure. This has created employment in regional areas and pricing options for grain growers. (sub. 72. p. 3)

Participants' views on SMAs

The overwhelming weight of submissions from agricultural producer groups (eg chicken meat, eggs, dairy, various grains and sugar) supported continuation of their respective statutory marketing arrangements. Indeed, many considered that even 'testing the benefits' of long-standing arrangements was inappropriate. Several arguments were advanced in support of statutory marketing arrangements:

> … single desk selling is a vital pillar to [the] structure of the sugar industry … acquisition and single desk selling for the Queensland raw sugar industry clearly provides net benefits to the community … (CANEGROWERS, sub. 46, p. 10)

> There is general agreement that the single desk [for barley] is able to price discriminate. However, other reasons the Board may be able to increase revenues are that the supply guarantee allows them to spread risk. If the Board did not exist, there would be higher variability in quantity, quality and price and lower confidence levels existing among producers to produce new and existing crops. (NSW Grains Board, sub. 61, p. 9)

> A decentralised Tasmanian egg industry would be unlikely to adopt a cooperative structure as all producers grade, sell and distribute direct to market. There is a public benefit in having a central body to administer food safety, producer education and improved farm practices. (Tasmanian Egg Producers Association, sub. 63, p. 9)

> … statutory bodies have played a central role in the provision of stability and certainty to the agricultural industry while keeping prices to consumers low. (Western Australian Farmers' Federation, sub. 138, p. 6)

> SMAs can play important roles in areas such as standards and quality control, fostering appropriate research and development and international sales. (National Farmers' Federation, sub. 144, p. 9)

Such claims were not uncontested. For example, the Pastoralists' and Graziers' Association of Western Australia (PGA) said that:

> Many of the groups and individuals objecting to national competition policy proceeding are a vocal minority simply protesting against the fact that their legislated privilege is to be reviewed. A compounding measure is the fact that statutory authorities that have been reviewed have been found wanting … (sub. 72, p. 1)

The Chamber of Commerce and Industry of Western Australia cited disadvantages of SMAs to producers as: a limited capacity to determine what to grow; lack of control over prices; loss of earnings if a product does not meet SMA standards or

timetable; limited capacity to achieve a competitive edge through quality, innovation, downstream processing or product differentiation; vulnerability to incompetence by a SMA; reduced returns owing to a SMA's administration costs and/or licence fees; reduced contact with consumers and processors; and potential exposure to penalties 'for activities which are not immoral and which in other very similar industries and activities would be legal and acceptable (for example, Western Australia has a black market in illegally traded potatoes, but not carrots)' (sub. 183, p 16). The Chamber and the PGA gave examples to support their claims (box 7.7).

Other participants — generally producers (who wanted more autonomy), processors and those using regulated inputs as feedstock into their own production processes (such as pig farmers) — also expressed dissatisfaction with aspects of statutory marketing arrangements. For instance, the Australian Grain Exporters Association advocated abandoning statutory marketing arrangements in favour of:

> … a competitive and complete marketing system that dramatically increases the linkage between growers and the market … fully commercial grower owned marketing companies capable of competing on equal terms with other members of the grain trade … the unrestricted ability, in terms of Federal and State legislation, for grain to be exported by all private entities/parties … (sub. 112, p. 4)

The National Farmers' Federation — which supported many facets of statutory marketing arrangements — summarised the arguments for reform of SMAs as:

- greater freedom to choose how, when, at what price and to whom products are sold;
- a possible reduction of the share of farmers' returns spent on administration costs;
- greater individual control over production, marketing and risk-management;
- greater incentives and opportunities for farmers, producers and rural communities to undertake innovative marketing and invest in higher-value, post-farm products; and
- removal of inappropriate (assumes incorrect now) prices signals as a result of the appearance of financial viability (sub. 144, p. 8).

Clearly, there are strongly held arguments for and against statutory marketing arrangements, even among producers who are commonly identified as beneficiaries of such arrangements.

Box 7.7 The potato police and other tales from Western Australia

The Chamber of Commerce and Industry of Western Australia noted that:

> During 1997 and into 1998, Galati Nominees, a WA potato grower and CCI member, came into dispute with Western Potatoes [a SMA]. The dispute arose initially when the growers failed to supply their crop within the deadline specified by the authority and were subsequently prohibited from selling their product for domestic retailing at premium rates. Rather than sell into the cheaper export or processing markets, the growers decided to give away their produce to WA consumers in an effort to draw attention to what they considered inappropriate anti-competitive legislation …
>
> Western Potatoes responded by engaging a private security firm to undertake surveillance of the growers' property, at a cost of $268 616, in order to 'ensure compliance with the Marketing of Potatoes Act'. In response to a question on notice, the representing Minister indicated that this had gained '… potential savings of around $2 million to the industry by preventing Galati's export and processing potatoes from entering the domestic ware market'. At the same time, potatoes grown in South Australia were freely entering the WA market.
>
> This seemingly trivial and at times farcical example of the impact of anti-competitive legislation on an agricultural family business illustrates both the difficulties and the importance of addressing competition policy issues. Apart from the costs to WA consumers of potato market regulation (around $12 million a year, probably along with a reduced quality and range of product), the impact of such policing tactics seems intrusive … and expensive.

The Pastoralists' and Graziers' Association of Western Australia reported that:

> The Grain Marketing Act of 1975 is the legislated privilege under which the Grain Pool of WA operates. In 1997, it was amended to allow free export of value added prescribed grains. The Australian Wheat Board embarked upon a project, which involved the value adding to lupins. The AWB were paying a premium to the projected pool returns of the GPWA. The GPWA, however, threatened legal action against the AWB over this issue, which was viewed as a threat to GPWA's single desk privilege. The AWB subsequently backed down due to its reluctance to inflame a public squabble with another statutory marketing authority. The result is that lupin growers in WA have lost an alternative market option which was paying a premium price. Lupin growers and the grains industry are poorer as a result.

Sources: Sub. 72; sub. 183.

FINDING 7.2

The range of conflicting views on the validity and effectiveness of statutory marketing arrangements reinforces the importance of NCP in requiring the review of such arrangements in order to assess whether they benefit the community as a whole.

Assessing the effects of future SMA reforms

Single desk selling

Centralised selling of agricultural commodities has been a longstanding feature of some major commodities (eg grains and sugar). Single desk selling typically has been underpinned by compulsory acquisition powers granted to SMAs. The extent to which single desk selling has increased industry returns through higher export prices has been the subject of debate for many years (IC 1991).

Initiatives to increase the returns to Australian producers in overseas markets are compatible with the interests of producers and the community as a whole. Broadly speaking, price premiums can arise in two ways: Australian exporters can raise world prices through restricting supply; or they can take advantage of price differentials in different markets.

In practice there is little scope for Australian agricultural producers to increase their returns by restricting supply and raising world commodity prices. Even though Australia is a major agricultural exporter, it is a 'price taker' in international markets (chapter 3). Removal of single desk seller arrangements would have little effect on the prices realised in overseas markets.

For many commodities, however, the 'world' market is in fact a series of regional markets, with different prices and market conditions able to persist because of transport cost differentials. Thus for some products or in certain niche markets, by controlling supplies Australia could be in a position to influence prices received in particular export markets, even if only for part of a year (eg because of seasonal factors). In this situation, the removal of a single desk selling arrangement could lower export returns and be contrary to the interest of producers, rural areas and the community as a whole. CANEGROWERS have argued:

> The Queensland raw sugar industry is able to extract a premium for export markets, however by no means does the Queensland industry influence world prices. …For the Queensland raw sugar industry, there is the ability to influence supplies and therefore price of raw sugar in [the] Far East (Asia) region. (sub. D285, p. 4)

Despite the possibility of lower returns to growers if single desk selling arrangements were dismantled, this could nevertheless be in the overall interests of the wider community. For example, there have been claims that single desk selling and associated arrangements inflate producer costs. In some industries it is alleged that transport, storage and/or administrative costs put in place by statutory marketing authorities are more costly than those that would exist in a competitive market. For some products — such as grains — international commodity traders

commonly argue that they are in a position to better realise the value of Australian products and pay higher prices to local producers than is a statutory body. This is because of their capacity to 'package' different grains from different sources and their established international trading practices and links.

Another community-wide benefit may be the greater capacity (and incentive) which producers have in a competitive market to develop new products and search out new markets which yield higher than average returns — a capacity which is generally denied them under centralised marketing arrangements. For instance, Joe White Maltings Limited (JWM) stated, in relation to restrictions on barley marketing:

> Deregulation will provide growers with more choices in the marketing of their malting barley. As an end user, JWM will be able to assist growers with clear market signals relating to both pricing and quality requirements. With deregulation, JWM anticipates efficiency improvements and better prices for growers. (sub. 19, p. 5)

Similarly, the Pastoralists' and Graziers' Association of Western Australia has argued that one of the costs of regulation is a reduction in the quality and range of products offered, as well as lower prices to growers:

> … even though they [SMAs] cause a higher price to the buying public, they generally bring about a lower average to the supplying grower. … In a free and open market the effective and efficient producer will produce a better product that can attract a premium in the market place. (trans., p. 67)

and the Tasmanian Government has said in relation to legislation reviews in general:

> Many existing legislative restrictions on competition impose substantial costs on consumers and society, through either cross subsidies, barriers to market entry by new businesses, unnecessary business costs or reduced incentives for firms to innovate and improve their efficiency. (sub. 198, p. 14)

In practice, it is difficult to demonstrate that single desk selling arrangements have (or have not) increased export returns. Even if data show that Australian commodity export prices are consistently higher than international prices, it can be difficult to ascertain the extent to which these higher prices may be attributable to other factors — such as higher quality, delivery arrangements, the availability of credit and other financial arrangements, the provision of technical assistance and the timing of sales.

In some cases, price premiums on export markets have been attributable to the import restrictions imposed by the importing country, as for meat imports into the United States in the 1970s and 80s, and barley imported into Japan (IC 1991). More recently, the Centre for International Economics (CIE) found that export price premiums for barley were due to quality and transport cost differentials rather than

any export pricing powers of the Australian Barley Board (CIE 1997). The Industry Commission has argued previously that:

> Price premiums attributable to market power should not be confused with price premiums per se which are affected by quality, sales volumes, services provided, delivery arrangements, goodwill, timing of sales and finance arrangements. (IC 1991, p. 45)

On the domestic market, single desk arrangements can be used (in the absence of close substitute products) to hold prices higher than they would be under competitive conditions. For tradeable goods, this margin can be considerable, especially if local producers are afforded protection against imports. If, following an NCP review, this capacity to extract domestic premiums is lost, producers — and possibly the regions in which they are located — may be worse off. However, this does not imply that Australia as a whole is worse off. Indeed, as domestic premiums from single desk selling are attained at the expense of higher prices paid by other Australians (ie users and consumers), their removal would usually be consistent with the national interest.

Countervailing market power

Many producers claim that the dismantling of SMAs will leave them at the mercy of large corporations which dominate some segments of the domestic food distribution chain. They claim that the statutory marketing regime provides them with the capacity to offset ('countervail') the market power of those businesses. For example, the Queensland Farmers' Federation noted:

> Existing arrangements for collective bargaining provide producers with some countervailing power in the market place. If these arrangements were unravelled there would be a shift in market power with already large processors and retailers gaining greater dominance and primary producers suffering a loss of influence. (sub. 90, p. 50)

It is certainly true that, for some products — either nationally or in some regions — one or a small number of buyers account for a large proportion of domestic sales by growers. This does not necessarily mean that these large buyers do not compete against each other or that they will be able to force prices below levels which would exist in a market where there were more buyers.

There are several stages in the chain between grower and consumer where there may be a potential for market power. Although the retail sector is characterised by considerable concentration, there is little evidence that this concentration enables retailers to exercise market power by 'gouging' either their suppliers or consumers (chapter 9).

Whether the concentration in the food processing sector can be used to drive prices to growers below competitive levels depends, in part, on the ability of processors to find alternative supplies of foodstuffs, and the ability of growers to find alternative purchasers. For instance, 50 to 90 per cent of most horticultural crops are sold to processors. Horticultural commodities are highly perishable, and the horticultural sector is characterised by small-scale family farms. It is possible that the processors can exert downward pressure on prices paid to growers because of the risk that growers will be unable to sell their produce in a timely manner if they do not accept the price offered.

Reflecting these characteristics, SMAs have been most prevalent for horticultural commodities sold to processors. The sale of fresh produce directly to retailers as has been predominantly through contracts between growers and retailers, which specify quality and time of delivery etc. The Commission has noted previously that, where SMAs raise prices to growers, they can lead to excess production of horticultural commodities for processing, and under–production of fresh produce. They can also provide a measure of assistance to inefficient growers, thus reducing the market share of efficient producers and thereby reducing innovation. Finally, they may provide an incentive for processors to grow their own produce (IC 1993a).

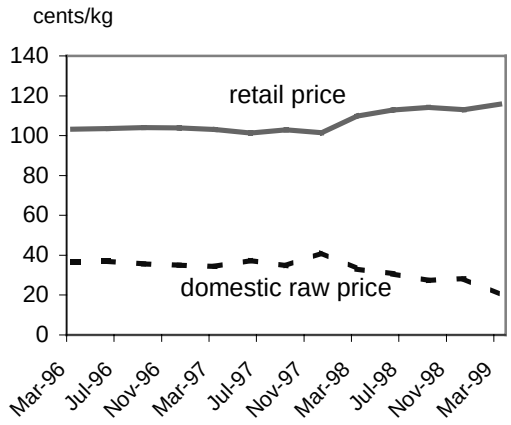
Meat producers are less likely to be vulnerable to such price pressure from processors given the greater flexibility with which animals can be sent to slaughter, and the availability of export markets for both meat and live animals. This gives growers some control over the sale of their product. Moreover, processors have some protection from growers' ability to raise prices artificially because of the high degree of substitutability in consumption between different types of meat (beef, pork etc). If one group of producers raises their prices, consumers can switch to another meat product (IC 1995c). Thus, past increases in meat processors' margins have been attributed to factors such as low labour productivity and inefficient (costly) meat inspection practices (IC 1994a) rather than market power on the part of processors.

The competitive nature of the retail sector makes it more likely that, if prices to retailers fall, then those price reductions will be passed on to consumers. Whether prices to retailers will fall as a result of SMA reform depends on the nature of the bargaining power between growers and processors, and between processors and retailers. This leaves four possible outcomes from SMA reform:

1. reduced prices to growers, with processors able to capture the efficiency gains via higher profit margins;

2. reduced prices to growers, which are then passed on to retailers (and consumers), with processors simply maintaining their margins;

Figure 7.1 **Sugar prices, March 1996 to March 1999**



Source: CANEGROWERS (sub. 46, p. 8).

3. higher prices to growers, with processors absorbing the cost increase. Prices to consumers would remain unchanged; or

4. higher prices to growers which the processors pass on to the retailers (and hence consumers).

Hence, the actual outcome of SMA reform, in terms of grower returns, processors' margins and prices paid by consumers will differ from commodity to commodity. For instance, where processing, distribution and retail margins in the dairy industry have been regulated by price controls at the farm gate and beyond, it would be surprising if some realignment of margins between dairy producers, processors, wholesalers and retailers did not occur after deregulation. Another example is provided by the removal of the sugar tariff from 1 July 1997. After the tariff was removed, the domestic price of raw sugar fell. As shown in figure 7.1, this does appear to have been followed by a realignment of margins in which the returns to sugar processors have increased.

Many concerns have been raised in this inquiry about 'middlemen' supposedly taking advantage of deregulation at the expense of producers (and, to a lesser extent, consumers). Two detailed examples are presented below, for the dairy industry and chicken meat.

Example 1: Dairy industry deregulation

Many submissions from dairy farmers claimed that fixed farm gate prices for milk were required to prevent 'middlemen' from capturing the benefits of deregulation.

> The only winner in the deregulation of the dairy industry will be the processors and supermarkets … (Wagga Wagga Dairy Farmers, sub. 96, p. 6)
>
> It is unfair that the producers have had to take a cut in their milk price when the retailer and the processors have increased their profits by millions. Deregulation is not suited to every industry and the Dairy Industry is one of those. (Winzer and Winzer, sub. 118, p. 1)
>
> I fail to understand why I eventually will go out of business and the processors and retailers continue to increase already record profits. (King, sub. 119, p. 1)

> In our case NCP means giving these powerful vested interested groups, eg big companies, a free ticket to take the small business out of production and then maintain the wealth for the company and shareholders. (Queensland Dairyfarmers Organisation — Eungella Branch, sub. 11, p. 2)

In October 1998, the New South Wales Minister for Agriculture said that, three months after the deregulation of *retail* milk prices in New South Wales, the price of milk had increased 3 cents per litre.

> This just goes to show that the National Competition Policy and deregulation is not always a good thing. … As a direct result of that decision to deregulate, the farm gate price for farmers has been collectively forced down from 53.35 cents a litre to 50.038 cents a litre, vendors have had their margins cut from 11.5 a litre to 6 cents a litre, and processors have also faced some reductions in their margins.
>
> The results are perfectly clear. The dairy farmers have lost out, the vendors have lost out and the consumers have lost out. The only winners are the supermarkets. (Minister for Agriculture and Minister for Land and Water Conservation 1998b)

The Minister appended the results of a survey by the New South Wales Dairy Corporation (table 7.2).

In Victoria, the 1992 deregulation of the milk market beyond the farm gate was accompanied by an increase in consumer milk prices. This has been linked to the actions of supermarkets, which in an unregulated environment have increased retail margins for milk (Sheen 1998).

Thus, retail price deregulation does appear to have led to an increase in the price of milk to consumers. Since retail price regulations were designed to increase the producer's 'cut' and to suppress processing and retailing margins, it is not surprising that these margins have risen in States which have deregulated their post farm gate controls. Of itself, this is not evidence of abuse of market power — it simply indicates that processing and retailing margins have risen to more normal competitive market levels. Given the competitive nature of retailing (see chapter 9) it is unlikely that this rise in the price of milk does represent profiteering by supermarkets.

The NCC also points out that, as long as farm gate prices continue to be regulated, thereby preventing the cost of raw milk to processors from being reduced, this adjustment of retail

Table 7.2 **Results of survey into retail prices of milk in New South Wales**

Pack size	*Pre-deregulation*	*Post-deregulation*
300ml	0.50	0.51
600ml	0.76	0.78
1 litre	1.16	1.19
2 litre	2.32	2.34
3 litre	3.48	3.45

Source: Minister for Agriculture and Minister for Land and Water Conservation (1998b).

margins can only occur through higher retail prices (NCC 1999b, vol. 1). The lack of price sensitivity of demand for milk products also lends itself to this outcome, since retailers would expect to lose few sales as a result. A similar argument was made by the Commonwealth Department of Agriculture, Fisheries and Forestry - Australia (AFFA) in its submission to this inquiry. AFFA (sub. 200) argued that retail prices will not begin to fall until farm gate regulations are relaxed.

The extent to which full deregulation, that is including farm gate prices, will actually lead to lower retail prices will depend on whether lower farm gate milk prices are passed along the system to the retailers. If processors have a degree of market power and can appropriate lower input costs resulting from farm gate deregulation by increasing their margins, then lower farm gate prices need not be fully passed on to retailers and consumers.

The Commission notes that deregulation of the *retail* price of milk in New South Wales also led to reductions in farm gate prices. This in part reflects competitive pressure from Victoria suppliers, but it could also suggest that processors do have some capacity to maintain their margins. Hence, it is possible that price reductions as a result of *farm gate* deregulation might not be fully passed on to consumers.

Regardless of the extent to which farm gate deregulation will lead to lower retail prices for milk, there is little question that it will reduce the prices received by dairy farmers.

In some States, sustaining the regulated farm gate price has required the use of restrictive market milk quota allocations to stop farmers saturating the market at that price. These quotas have become valuable assets in their own right. Indeed, the Commission has been made aware of cases in which farmers have negotiated loans on the basis of their quota allocation. The subsequent collapse of the inherent value of the quota in a deregulated environment could have serious consequences for debt servicing and farm viability for some dairy farmers who are dependent on them.

In turn, this could have implications for some dairy regions in country Australia. Despite the fact that farm gate deregulation will involve lower prices for farmers, with the associated adjustment difficulties as some have to leave the industry, it is also the case that over the long run, a deregulated market will also lead to a much more innovative and efficient dairy industry. This will not only benefit Australian consumers of milk products, but will also strengthen the economies of dairy regions, placing them on a more sustainable economic footing. Thus, while *prices* to farmers may fall as a result of deregulation, it does not always follow that all farm *returns* will fall.

Example 2: Chicken meat authorisation

The chicken meat industry illustrates the argument about countervailing power. The ACCC recently authorised a five year arrangement, which allows Inghams Enterprises Pty Ltd to negotiate a collective growing agreement with its contract chicken growers (ACCC 1997a). This authorisation for chicken growers was in recognition of the need for some (transitional) countervailing power in their dealings with processors.

While this collective agreement is consistent with the countervailing power argument, there are significant differences in the nature of the chicken meat and other industries. In contrast to, say, dairy farmers, who own their cows and control production up to the farm gate, contract chicken growers have a more limited role — growers produce the chickens, but processors specify the breeding of chicks (and the choice of breeding stock) and provide feed, medication and technical advice. That is, the 'growing' function is essentially contracted out.

The ACCC authorised the chicken meat arrangement to ease adjustment towards industry deregulation. It noted that the arrangement could lead to anti-competitive outcomes, such as: limiting the ability of chicken growers to switch processors; reducing entry into the growing and processing markets; and increasing the possibility of collusive anti-competitive behaviour. However, it saw a public benefit in sanctioning an interim arrangement on the grounds that deregulation was unlikely to occur unless there was a mechanism in place to protect growers in the transition stage. It also noted that its concerns about the potentially anti-competitive effects of the arrangement were partly alleviated by the existence of termination clauses, a company code of practice and by the ability of growers to negotiate individually with Inghams if they did not wish to be part of the collective process. This is in stark contrast to the compulsory nature of many statutory marketing arrangements.

Other issues

There are other ways in which reform of statutory marketing arrangements could reduce producer returns. These include:

- a reduced capacity to market products effectively;
- a reduced capacity to ensure and monitor quality standards; and
- loss of economies of scale and scope in marketing and distribution.

By and large, effective marketing, distribution and quality control do not require statutory backing. For example, several important agricultural industries have prospered without the need for statutory marketing authorities to act as monopoly

sellers. Australian raw cotton, for example, is marketed successfully under a competitive market system. Cotton growers have achieved economies of scale and applied sophisticated marketing strategies without the need for compulsion.

Implications for country Australia

While reform of SMAs has the potential to benefit consumers and users in both metropolitan and country Australia, parts of country Australia are vulnerable to reduced grower returns in agricultural industries which are regionally concentrated. The following are indicative of submissions received by the Commission:

> To the extent that primary production takes place mainly in regional or rural communities while the consumption of primary products is spread across the whole community, reductions in the monopoly power of marketing authorities could be seen to be disadvantaging regional and rural Australia relative to metropolitan Australia. (Chamber of Commerce and Industry of Western Australia, sub. 183, p. 15)

> In effect the outcome of these state legislation reviews is to move capital from the producer ('small business') to big business and from rural areas to the city. (Australian Chicken Growers' Council, sub. 166, p. 10)

> Deregulating the industry and removing special producer marketing advantages is seen as a means of reducing prices for Australian consumers whether they be wholesalers, retailers or the end consumers. The inference is that the cost of deregulation will be shouldered by the producer. (National Farmers' Federation, sub. 144, p. 12)

> … the removal of legislative support to the industry will result in the loss of about 20 per cent of dairy farmers. This will have a detrimental flow-on effect on regions centred around Harvey and Vasse [in WA] where there is a heavy investment in the dairy industry. (Western Australian Farmers' Federation, sub. 138, p. 21)

The view of the Western Australian Farmers' Federation about the potential impacts of dairy deregulation was echoed in discussions with dairy industry participants in regions of New South Wales, Tasmania and Queensland.

In Queensland, the regional impacts of deregulation of farm gate market milk were assessed by modelling six scenarios to reflect varying assumptions (QDLRC 1998). The State-wide effects of deregulation were estimated to range from a loss of $28 million to a gain of $54 million (net present value over a ten year period, in 1996-97 dollars). The results showed that the Darling Downs, Wide Bay Burnett and the Far North were most likely to contract if the farm gate price of milk was deregulated. Other regions would expand, with the main beneficiary being the Brisbane–Morton region.

In the worst affected region — Darling Downs — the projected job losses were in the order of 76 persons. To put the employment loss into perspective, the total

labour force in the region in 1996 was around 86 800. The employment in Brisbane-Moreton was projected to increase by 134 persons.

The QDLRC considered that the efficiency gains, being widely dispersed, were less important than the costs of deregulation which would be regionally concentrated:

> Whether a region expands or contracts after deregulation will depend on the 'concentration' of dairy production relative to consumers as a whole. If price reductions are passed on, consumers will gain an effective increase in real income from farm-gate deregulation while farmers will lose. Thus regions with a high concentration of consumers relative to farmers will tend to benefit from multiplier effects. In contrast, regions with an emphasis on production and relatively few consumers can be expected to contract as a result of multiplier effects. (QDLRC 1998, s. 11.4)
>
> … the overall impact on the economy is of less concern than the potentially important regional impacts. (QDLRC 1998, s. 14.6)

The QDLRC review quite properly assessed the costs of reform on particular dairy regions, but appears to have placed relatively little emphasis on the costs of restrictions on competition created by the regulations. The review recommended, and the Queensland Government agreed, that the regulated farm gate price of milk should continue until the end of December 2003.

7.5 Managing reform at the regional level

Given the diversity of agricultural commodities, it is difficult to draw general conclusions about the effects of reform. Indeed, it may not even be appropriate to infer the effects of future reform by drawing on the past experience of rural industries which have been subject to reform of their statutory marketing arrangements. The significant differences in the nature and extent of reforms implemented and the very disparate circumstances of agricultural industries and regions make such inferences problematic. These differences, coupled with the fact that there are invariably 'winners' and 'losers' associated with every reform process, help to explain the different perspectives expressed by participants about the outcomes of the reviews.

Nevertheless, the removal of some statutory marketing arrangements undoubtedly would expose some agricultural producers to significant adjustment pressures. Furthermore, because production of agricultural commodities is a significant contributor to many rural communities throughout Australia, it is not surprising that some participants suggested that support for regional economies should be a prime rationale for retaining practices such as farm gate price controls.

The Commission concurs that ending anti-competitive arrangements which presently transfer income to agricultural producers could have adverse effects for some regional communities. The severity of these effects are likely to vary across regions depending on:

- the magnitude of the transfer;
- the extent to which the value of anti-competitive regulation has directly been capitalised into asset values;
- the significance of commodities covered by anti-competitive arrangements in particular regional economies;
- the scope for farmers to diversify into other agricultural pursuits; and
- alternative employment opportunities outside agriculture.

Other considerations, which also can bear on the regional effects of reform, include: farmers' capacity to offset lower prices through productivity improvements and farm amalgamations (particularly notable in the broadacre and dairy sectors), or by switching into new, higher-value crops; and farmers' ability to institute alternative arrangements for capturing economies of scale and scope in, say, marketing without recourse to anti-competitive legislation.

Reforming SMAs can pose difficulties for policy makers because the costs of reform to individual producers can be substantial, whereas the benefits to dispersed consumers may run to a few cents per purchase. Transfers delivered in this way are conducive to the formation of interest groups with the capacity to mount pressure on politicians to maintain the status quo. This sets up an environment where arrangements which impose substantial costs on the community overall are likely to continue. The inertia inherent in such an environment does not mean that reform should not take place. Rather, it reinforces the need for governments to ensure that appropriate use is made of public interest criteria during NCP reviews and that the adjustment capacity of individuals and regions affected by reform is taken into consideration during the implementation of reform.

These issues and some direct mechanisms to meet regional development and adjustment assistance objectives are canvassed in part C of this report.