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**GOVERNMENT INTERVENTION IN AGRICULTURAL MARKETING:  
A CASE STUDY OF THE NSW POULTRY MEAT INDUSTRY<sup>1</sup>**

David Darvall and Zoë de Saram

Economists  
Economic Services Unit  
NSW Agriculture

*Abstract*

The economic and social environment shaping the major issues and options in Australian agricultural policy have changed significantly in the last two decades. Reflecting these developments, the rationale for government intervention in the marketing of agricultural commodities applied by agencies such as the Industry Commission has become more stringent. Nevertheless, there are many instances of institutional and regulatory arrangements governing agricultural industries which have little justification on efficiency criteria but remain unchanged.

The New South Wales poultry meat industry is one such example. Under the *Poultry Meat Industry Act 1986*, a negotiating committee is established to provide growers with a countervailing mechanism against the potential abuse of market power by the processing sector. This is attempted primarily through the committee's role in determining standard rearing fees paid to contract growers.

The purpose of this paper is to assess the appropriateness of stated objectives of legislation and the impact of existing marketing arrangements on the efficiency of resource use against the background of recent industry policy developments. This paper is based on a recent investigation of the New South Wales poultry meat industry (NSW Agriculture 1992).

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<sup>1</sup> The *NSW Poultry Meat Industry Act 1986* is currently being reviewed by NSW Agriculture and a report has been submitted to the Minister for Agriculture & Rural Affairs for consideration. The report has been released for public comment prior to Government making a decision on future marketing arrangements. The views expressed in this paper do not necessarily reflect those of the Minister for Agriculture & Rural Affairs or NSW Agriculture.

## 1. INTRODUCTION

The economic and social environment shaping the major issues and options in Australian agricultural policy have changed significantly in the last two decades. Reflecting these developments, the rationale for government intervention in the marketing of agricultural commodities applied by agencies such as the Industry Commission has become more stringent (Williams 1990).

Identification of market failure is now a necessary but not sufficient condition for government intervention. In a review of statutory marketing arrangements for primary products, the Industry Commission (1991) concluded that "even in cases of obvious market failure there are no guarantees that government intervention will efficiently overcome the problem. It is likely that, from an efficiency standpoint, there are cases where the community is better off with the existing problem".

This change in perspective stems largely from the recognition that, in reality, government intervention is not costless. Furthermore, the operation of government policies frequently fail to realise their objectives or do so only at large costs to the community because of the presence of factors such as 'non-market failure' (Wolfe 1979).

As a consequence, there is now greater reliance on market forces in a framework of general trade practices legislation (NSW Government 1991). There are, however, many instances of institutional and regulatory arrangements governing agricultural industries which have little justification on efficiency criteria but remain unchanged. The New South Wales poultry meat industry is one such example.

Under the *Poultry Meat Industry Act 1986*, a negotiating committee is established to provide growers with a countervailing mechanism against the potential abuse of market power by the processing sector. This is attempted primarily through the administrative determination of standard rearing fees paid to contract growers.

The purpose of this paper is to assess the appropriateness of the *Poultry Meat Industry Act's* objectives and the impact of existing marketing arrangements on the efficiency of resource use against the background of recent industry policy developments. This paper is based on an investigation of the New South Wales poultry meat industry conducted by NSW Agriculture (NSW Agriculture 1992).

The changing structure of the New South Wales poultry meat industry and current marketing arrangements are outlined in Sections 2 and 3 respectively. This information is then used to evaluate current marketing arrangements on efficiency criteria in Section 4. Conclusions on the scope for government intervention in the poultry meat industry are made in Section 5.

## 2. STRUCTURE OF THE NSW POULTRY MEAT INDUSTRY

The New South Wales poultry meat industry is composed of breeders, hatcheries, growers, processors, wholesalers and retailers. Although the industry is highly integrated, dependence on other industries including suppliers of feed, veterinary products, capital equipment, transport and labour is significant. The following sections outline the structure of the New South Wales poultry meat industry's growing and processing sectors, which are directly influenced by the *Poultry Meat Industry Act*.

### 2.1 The Growing Sector

There are currently 363 poultry meat growers in New South Wales, with a combined investment of approximately \$185 million or 90 per cent of total capital investment in the industry. The majority of poultry meat farms are capital intensive, highly mechanised units occupying relatively small areas of land primarily around the outskirts of the Sydney metropolitan area and Central Coast. A smaller number of farms are located near Tamworth and Griffith.

The location of farms around the Sydney metropolitan area and Newcastle effectively ensures relatively low transport costs to urban-based processing plants and easier access to supplies of feed, electricity, labour and water (NSW Agriculture 1992).

It is estimated that 80 per cent of chickens produced in New South Wales are currently grown under contract, with company farms accounting for the remaining 20 per cent (Australian Bureau of Agricultural & Resource Economics 1991). This pattern is illustrated in Table 2.1 for the period 1978 to 1991.

**Table 2.1: Proportion of Chickens Grown Under Contract in New South Wales (1978 to 1991)**

Year	No. Contract Growers	Contract Farm Production ('000 birds)	Total Production ('000 birds)
1978	341	n.a.	n.a.
1981	449	73 098	86 000
1983	406	71 137	83 700
1986	372	81 088	95 400
1988	364	88 491	104 100
1991	363	89 982	112 500

(Source: NSW Agriculture 1992)

Since the mid 1970s, there has been negligible change in company farm capacity of processors based in Sydney. Company farm capacity of these processors is currently estimated at around 186,000 square metres, representing 13 per cent of total capacity utilised (NSW Agriculture

1992). The only significant growth in company capacity has been by Bartter Pty Ltd<sup>2</sup>, who has been unable to attract potential contract growers to the Griffith area.

Processors claim that there will be an increase in the number of company-owned or leased farms utilised over the next five years because of a widening disparity in rearing fees on company and leased farms relative to contract farms. Rearing fees relating to the alternative means of production are currently estimated at:

(a)	contract farms	42.90 ¢/bird;
(b)	company farms	33.45 ¢/bird;
(c)	leased farms	33.56 ¢/bird.

Recent expenditure on company and leased shed capacity by independent processors confirms this assertion (NSW Agriculture 1992). Under current legislation, however, leasing is an illegal activity if the processor leases the growing facilities on the farm from a grower and the grower manages the farm.

## 2.2 The Processing Sector

Throughout the 1960s, hundreds of growers and many processors left the industry as a consequence of intense competition and price-cutting. Moreover, as poultry growing requires a high initial capital outlay, the industry attracted significant amounts of non-farm capital, including foreign investment.

Vertical and horizontal integration changed small operating units into major holdings, such that in 1985/86, the principal participants in the industry (other than in the growing sector) were firms affiliated with two corporate groups – Amatil Limited and Inghams Enterprises Pty Ltd.

According to the Prices Surveillance Authority, a series of acquisitions by Amatil and Inghams during the 1980s culminated in Amatil and Ingham affiliates producing some 78 per cent of Australia's processed chickens in 1985/86 and approximately 84 per cent of grown birds ready for slaughter (Prices Surveillance Authority 1986).

The remainder of the industry was comprised of a number of processors operating on a local basis. These included Manos Poultry Industries in South Australia, R. Cordina & Sons Pty Ltd, Baiada Pty Ltd and Red Lea Chickens Pty Ltd in New South Wales.

In 1990/91, the majority of poultry growers are still contracted to two principal processors – Inghams and Australian Poultry Ltd (APL). Inghams and APL presently control approximately 65 per cent of chicken production in Australia (NSW Agriculture 1992). As the two companies are represented by the Australian Poultry Industry Association (APIA), they will be referred to as "associated processors" hereafter.

The proportion of poultry production controlled by the associated processors in New South Wales is currently estimated at 58 per cent (NSW Agriculture 1992). Seventy "independent processors" account for the remaining 42 per cent of production.

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<sup>2</sup> Bartter Pty Ltd operates outside existing regulations as no contract growers are employed by the firm.

The largest independent processors include Bartter Enterprises Pty Ltd (14 per cent), Baiada Poultry Pty Ltd (9 per cent), R. Cordina and Son Pty Ltd (8 per cent), Red Lea Pty Ltd (6 per cent), Vella Poultry (2.5 per cent)<sup>3</sup> and Sunnybrand Chickens Pty Ltd (2.5 per cent). These major independent processors supply between 35 and 40 per cent of poultry meat within New South Wales.

In aggregate, the remaining sixty processors command less than 5 per cent of production. These processors typically purchase grown live birds for processing from one of the principal companies.

The market share controlled by independent processors in New South Wales is far higher than in all other States. The NSW Chicken Growers' Association attributes this to: (i) a large decline in processing volume by APL within New South Wales in recent years following a reduction in inter-state "exports"; and (ii) growth of the Bartter operation over the past three years.

This characteristic of the New South Wales poultry meat industry stems chiefly from the significant reduction in the barriers to entry to new processors and improved access to overseas supplies of genetic stock over the last five years. Prior to 1986, independent processors relied heavily on Inghams and Amatil – or affiliates of these companies – for their supplies of breeder stock and day old chicks. Reflecting growing concern regarding restrictive trade practices by the associated processors in 1985, a number of independent processors requested the Prices Surveillance Authority (PSA) to undertake a comprehensive review of the day old chicken market.

The PSA concluded in its final report that "...[Industry changes]...have resulted in a situation where the major companies in the market...are able to control the prices at which day old chicks are supplied to independent processors and at the same time are competing against those processors in the market for the finished product" (Prices Surveillance Authority 1986).

Within the last five years, however, the entry of Bartter and Imloson P/L – trading as HiChick – has significantly increased the level of competition in the supply of day old chicks to independent processors. HiChick which is owned by Baiada, Red Lea, and Cordina & Son was specifically established to counter the perceived market power of associated processors. Processors entering the New South Wales market are now also able to obtain supplies of day old chicks from interstate sources.

While the number of companies supplying day old chicks remains small, it appears that the only real barrier to the entry of new processors is the availability of capital. The growth of Bartter and Sunnybrand as major players in the industry in the last three years is viewed as confirmation of the lack of commercial barriers to aspiring entrants to the industry.

### 3. INSTITUTIONAL AND REGULATORY ARRANGEMENTS

The *Poultry Meat Industry Act 1986* provides for the establishment of a statutory body known as the Poultry Meat Industry Committee (PMIC) to regulate contract growers and processors of poultry meat within New South Wales. The primary functions of the Committee are as follows:

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<sup>3</sup> Vella Poultry P/L retired from the New South Wales poultry meat industry in early December 1991. Data contained in this study, however, has not been modified due to a lack of up-to-date market information.

- (a) with the approval of the Minister, to set guidelines for the drawing up of agreements between growers and processors;
- (b) to approve forms of agreement between growers and processors if they are in accordance with those guidelines;
- (c) to determine prices paid by processors to growers for poultry;
- (d) to settle by negotiation disputes between growers and processors.

### 3.1 Agreements Between Growers and Processors

The length of contracts between growers and processors is currently set at five years, extending from June 1989 to June 1994. The *Poultry Meat Industry Act 1986* requires the PMIC to approve agreements between growers and processors for poultry grown in a batch of 1,000 or more on contract farms.

As there is no legislative requirement for processors employing contract growers to use standard agreements, different types of agreements could be used – as long as the majority of growers concur with the variation and the agreement is approved by the Committee.

### 3.2 Determination of Standard Rearing Fee

The Committee is charged with the determination of prices to be paid by processors to contract growers for "designated poultry"<sup>4</sup>. As poultry meat growers are supplied with day old chicks and feed by the processor to whom they are contracted, the rearing fee represents a payment to growers for labour and management, the operating costs associated with poultry meat production, and a return on capital investment in shedding and equipment.

Section 10(2) of the Act instructs the Committee to ensure "a reasonable minimum return to growers while encouraging industry efficiency" by having regard to:

- (a) growing costs;
- (b) the species of poultry involved;
- (c) the duration of any relevant rearing period;
- (d) the annual throughput of poultry;
- (e) poultry housing density;
- (f) the needs of the industry;
- (g) market forces affecting the industry;
- (h) the public interest; and
- (i) such other matters as the Committee thinks relevant.

The Committee currently applies the "model farm" concept to establish an indicative rearing fee which is equivalent to the average total cost of production. Fundamental parameters of the model include shedding, equipment, labour, cash costs, investment, return on capital, depreciation and throughput. These parameters are varied every three years on the basis of survey data – subject to acceptance by all contract growers and processors.

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<sup>4</sup> "Designated poultry" refers to: (a) a chicken of the species *Gallus gallus* which is not more than eighteen weeks old; or (b) another bird of such species or description as the Governor may declare to be designated poultry for the purposes of the Act.

Every six months the model is updated manually according to changes in the Consumer Price Index to establish a "model fee" for the forthcoming six-monthly period. The gazetted rearing fee is then negotiated by the Committee with regard to existing market conditions and changes in non-cash costs.

The actual rearing fee received by individual growers is determined using the model fee as a point of reference. Several additional payment and deduction criteria are specified in the model such as deductions for changes in throughput (i.e., batch rate per year) sub-standard equipment, supplies of gas and supplies of floor litter. Additional payments are made for equipment improvements and excess litter requirements.

The standard batch rate is currently set at 5.6 batches per annum. If any processor's productivity exceeds the standard batch rate, the processors can lower the standard rearing fee paid to his growers. This alteration is referred to as a "throughput discount".

The throughput discount was initially intended to provide integrated processors with an incentive to fully utilise existing contract farms during times of increased demand rather than constructing additional company sheds. The construction of such sheds would typically replace individual contract growers or decrease throughput on existing contract farms, thereby reducing gross income per farm.

The throughput discount was originally complemented by a "throughput premium", whereby individual processors were required to pay growers a bonus on the standard rearing fee if the number of batches provided to growers was sub-standard. Processors, however, usually avoided paying such a premium by terminating contracts to ensure a standard throughput on remaining farms. For this reason, individual processors are not required to pay growers a bonus on the standard rearing fee under current arrangements "provided that the processor has made reasonable endeavours to meet optimal productivity" (NSW Agriculture 1992).

Grower returns are further influenced by a pooling system used to rank individual growers according to efficiency criteria (e.g., feed conversion ratio and mortality). An associated efficiency rating system, whereby individual growers are assigned an efficiency score per batch, also determines payments or penalties. Under the pooling system, growers who demonstrate sub-standard performance over a period of one year could have their contracts terminated. In this instance, "inefficiency" is defined as a level of performance that is more than 3 per cent below a specific group average.

Despite the inclusion of efficiency criteria, the "standard contract" specifies a fixed range for individual growing fees, thus limiting the scope for price fluctuation. The payment range is presently set at 17.5 per cent of the gazetted growing fee or 42.9 +/- 3.75 cents per bird.

### 3.3 Resolution of Disputes

The Committee is also charged with the responsibility of acting as a mediator between growers and processors when disagreements or disputes arise on matters such as the payment of standard fees, method of payment for unsatisfactory batches and sharing of growing opportunities between company and contract farms.



The role of the Committee in such disputes is largely one of conciliation rather than arbitration, as it has no statutory power to enforce decisions on either party. The *Poultry Meat Industry Act 1986* specifies penalties for the breach of individual regulations. Proceedings for any offence against this Act, however, are heard before a Local Court constituted by a Magistrate sitting alone.

#### 4. EVALUATION OF CURRENT MARKETING ARRANGEMENTS

##### 4.1 Appropriateness of Objectives

Poultry meat growers have expressed concern about being exploited by the processing sector in the absence of industry-specific legislation, particularly in terms of payment for their services and capital. This concern arises because growers are perceived to be in a weak bargaining position by virtue of their smaller size and larger number relative to the processing companies to whom they are contracted.

In such an environment, growers consider themselves to be highly vulnerable because they do not control the production and marketing of poultry meat as their position has changed from that of an independent farmer with a commodity to sell to a provider of a highly specialised service. Moreover, the facilities used for growing have no alternative use and, typically, growers have a limited number of processors to deal with in a specific geographic region.

Growers claim that this situation is exacerbated by the present levelling in consumer demand, surplus capacity of growing facilities and, thus, reduced processing margins. Under these conditions, processing companies would require growers to provide services at "below cost" in order to maintain profitability and market share. Therefore, growers conclude that continuation of the contract system would be dependent on growers being provided with some measure of countervailing power in their dealings with processors (NSW Agriculture 1992).

Concentration of ownership in the processing sector, coupled with limited resource mobility and inadequate market intelligence, has the potential to reduce market efficiency if processing companies depress the rearing fee below the level that would be received in a competitive market. Therefore, there may be scope for government intervention in the poultry meat industry on efficiency criteria. The fundamental question is, however, whether government intervention should be in the form of general or industry-specific legislation.

The first of these policy options entails improving competition in the processing sector by reducing artificial barriers to entry, more stringent application of the Trade Practices Act when abuse of market power is clearly demonstrated and greater industry scrutiny by government agencies such as the Prices Surveillance Authority and Industry Commission. Consistent with recent developments in industry policy, industry-specific legislation should be confined to cases where it is demonstrated that the Trade Practices Act affords inadequate protection to growers and the costs of market failure outweigh the economic and social costs of administering legislation.

General legislation is predicated upon the acceptance that a high degree of ownership concentration does not necessarily confer significant market power. That is, in a highly concentrated industry, individual buyers would be constrained in their use of market power to

depress producer margins by the threat of potential competition for producers' services and other inputs.

There is strong evidence to suggest that the New South Wales poultry meat industry's processing sector is of this nature (NSW Agriculture 1992). Over the last six years, there has been a significant increase in the level of competition on the buying-side due to a reduction in artificial barriers to entry and subsequent entry of independent processors. The majority of growers are now able to deal with more than one processor, with transport costs to an alternative processor establishing a limit on the extent to which rearing fees can be lowered. This is not to deny, however, that bargaining strength may be held unevenly in some transactions – just as it is in many daily market transactions for which there is no special form of assistance provided.

The mutual dependency between growers and processors can be viewed as an additional factor limiting the potential for abuse of market power under general legislation. Processors are heavily dependent on growers to provide a constant supply of poultry meat to ensure the efficient utilisation of plant and equipment. Individual processors would, therefore, be more inclined to foster goodwill with efficient contract growers rather than jeopardising their considerable capital investment and long term viability for the sake of securing a lower rearing fee in the short term.

This assertion is confirmed by the New South Wales processing sector's apparent reluctance to use company facilities over the last thirty years. Evidence from the New Zealand poultry meat industry, which currently operates successfully under competitive market forces, also confirms this view. While the industry is highly concentrated relative to New South Wales, the New Zealand Ministry of Agriculture advised that, "contracted growers are achieving reasonable returns and, in general, do not complain about any disparity of bargaining strength between themselves and processors. It is in the processors interests to have satisfied growers producing a quality product to the specifications they require" (Ministry of Agriculture & Fisheries, personal communication 1991).

In contrast, the *Poultry Meat Industry Act* is based on the public provision of countervailing market power to contract growers. This approach to overcome the potential abuse of market power appears to be inherently flawed as the equalisation of power may not be possible. There is no way to determine when power is equal. There can be no certainty that equality – and nothing more – will be attained.

Furthermore, maintaining industry-specific legislation to prevent the potential abuse of market power by individual processors at an unknown time is likely to unnecessarily impose significant regulatory costs on society. The National Poultry Association (1991, personal communication) estimates the cost of legislation would be more than \$2 million per annum – representing the difference between the contract and company rearing fees multiplied by the processing sector's annual turnover.

While this estimate has a number of limitations, it does attempt to quantify the financial cost of regulation. The true social cost of regulation is likely to exceed this estimate as it would also include administrative costs associated with the Poultry Meat Industry Committee and opportunity costs whereby resources are not employed in their most profitable end use.

## 4.2 Effectiveness of the Poultry Meat Industry Act in Meeting its Objectives

The objective of the Poultry Meat Industry Committee is to obtain voluntary agreement between growers and processors on industry issues under consideration (i.e., terms and conditions of transactions or contracts and the standard rearing fee). The success of the process depends heavily on group dynamics, personalities, the negotiating skills of each member and Chairman, and existing market conditions affecting the industry (Public Bodies Review Committee 1987).

Evidence suggests that the *Poultry Meat Industry Act 1986* has not achieved its objective of obtaining voluntary agreement between growers and processors on most industry matters largely because of the highly competitive nature of the industry and the immense diversity in individual circumstances and aspirations of growers and processors alike. In the absence of government intervention, these forces would typically create the incentive for the best allocation of scarce resources through enterprise-specific marketing arrangements.

As negotiation is required on an industry-wide basis, the Committee effectively polarises the industry to the point where decisions on industry matters are frequently made by the Chairman or the consumer representative – rather than by negotiation between growers and processors as originally intended. While decisions are made by the Chairman or consumer representative in good faith, the decisions are inevitably second-best because these parties have a limited knowledge of industry matters.

Where issues are resolved by negotiation, they are only resolved after extensive management input and lengthy delays. Furthermore, it is not uncommon for individual enterprise groups to reach agreement on issues only to find that the issues cannot be agreed on an industry basis or are deferred or subject to protracted discussion and change because it does not suit another processor or processor's growers. These flaws are inherent and, therefore, would not be overcome by changing the composition of the Committee.

In addition, the Committee's responsibility to set the rearing fee for contract growers has not been successfully achieved because the PMIC is unable to enforce its decision under current legislation. There have been a number of instances where individual processors have refused to pay the gazetted rearing fee since 1986, particularly during adverse economic conditions. Nevertheless, any attempt to strengthen the compliance powers of current legislation is considered to be an undesirable option.

## 4.3 Impact of Price Determination on Market Efficiency

The *Poultry Meat Industry Act 1986* requires the Poultry Meat Industry Committee to ensure a reasonable minimum return to growers while encouraging industry efficiency by considering the cost of growing, annual throughput, existing market conditions affecting the industry and other variables. These objectives involve a substantial trade-off between market efficiency and some arbitrary definition of equity.

A "reasonable minimum return" to a grower could mean a price for services which also provides an adequate return on capital. That fee will differ between growers according to their level of efficiency and their perception of an adequate return. For a processor, using the growers' services as an input, a "reasonable minimum return" could relate to price expectations for the final product or to the price at which services are available from an alternative source (i.e., company

or leased farms). Thus, the definition of a "reasonable minimum return" is largely in the eye of the beholder (Industry Commission 1991).

The NSW Chicken Growers' Association (NSWCGA) argues that, as growers have little input into production and marketing decisions, it is reasonable for growers to expect guaranteed full recovery of rearing costs over time. The model fee simply represents the average total cost of production, which is the minimum price required by growers to remain viable in the long term. Moreover, as the rearing fee accounts for 11 per cent of total production costs (ex-factory), the NSWCGA considers that regulation of this relatively minor component would have minimal impact on the prospects of this industry as a whole.

It is apparent that in providing a service, growers have little input into production and marketing decisions made in the New South Wales poultry meat industry. In this regard, the poultry meat growers' situation is similar to those individuals providing services to other industries (e.g., contract grain harvesters, contracted cement truck drivers and contract cleaners). As returns in these industries are not guaranteed, there is little justification for ensuring full cost recovery to growers in the New South Wales poultry meat industry.

Although the rearing fee represents only 11 per cent of total production costs (ex-factory), current pricing arrangements have significant implications for the long term viability of the New South Wales poultry meat industry, particularly the growing sector. This is largely attributable to the fact that current arrangements tend to alter price expectations and obstruct the communication of market signals, which are crucial in guiding resources to their most profitable end-use.

For example, under current arrangements, the incentive for growers to preserve market flexibility is reduced as the pricing arrangements subsumes some of the risk associated with marketing. In a competitive market, it is in both the growers' and processors' interests to locate in regional "production centres". Growers would generally choose (*ceteris paribus*) to locate near groups of processors in order to preserve flexibility with respect to potential purchasers of their growing services. Equally, processors would find it necessary to locate within reasonable distances from existing processors and growers to be able to attract contract growers. History tends to demonstrate the location of growers and processors in such clusters.

Under industry-specific legislation, however, individual processors and growers tend to become more dispersed and geographically isolated, in some cases to capture benefits of reduced input costs by locating in grain producing regions. The cost of this dispersion and isolation is, from the growers' perspective, a loss of market flexibility.

Therefore, under a deregulated environment growers who had foregone opportunities to locate near other processors would potentially be vulnerable to the decisions made by their processor. This vulnerability is, of course, what the existence of the Act is predicated upon. It is therefore possible for industry-specific legislation to significantly increase grower vulnerability and foster dependence on government intervention.

The price determination process in the New South Wales poultry meat industry has further implications for the efficiency of resource use:

**(a) Price Determination Based on Average Cost of Production:**

While it is acknowledged that the model fee represents only one source of information into the determination of the standard rearing fee, the establishment of a single fee for the whole growing sector based on average cost of production is likely to be both inefficient and inflexible.

There are significant differences between individual farms in factors such as input costs, accounting practices, opportunity cost values for land and labour, wealth and debt levels. The inflexibility of the model farm does not allow these differences and short term fluctuations in values to be taken into account when the rearing fee is determined, resulting in reduced market efficiency.

Moreover, although the relative efficiency of contract growers is considered, current arrangements do not encourage efficiency relative to alternative sources of grower services (i.e., company or leased farms). This is largely because the definition of "inefficiency" is set arbitrarily and the standard contract specifies a fixed range for individual rearing fees, thus limiting the scope for price variation. Also, the sanctions for inefficiency are predetermined and offer processors and growers limited scope to explore alternative methods for rewarding good performers and penalising poor performers.

According to NSW Agriculture (1992), the cost differential between contract, company and leased farms over the past ten years has fallen to a negligible level to the point where the option of growing on company or leased farms is becoming a more profitable alternative.

Establishment of a standard rearing fee according to average total cost also suggests that resources would be employed in the growing sector beyond the most profitable level for the industry and society.

In the absence of industry-specific legislation, the rearing fee would be determined by private negotiation on the basis of the individual grower's marginal cost of production. In this instance, processors would secure growing services from the least-cost provider(s). Over the long run, inefficient growers would be forced to lower their marginal cost of production or leave the industry.

Under current arrangements, however, individual growers are provided with a secure return for their services and capital relative to other agricultural enterprises, implying that inefficient growers would be more inclined to remain in the industry. While such action typically leads to a reduction in market efficiency, it also imposes a further cost on society as these resources may not be used in their most profitable end-use.

The price determination process would also increase the cost of entering the industry to potential growers. As the expected return to services is guaranteed within a specific range, the degree of risk involved in the enterprise would be significantly lower. This factor would normally be capitalised into the prices of production rights (i.e., the growing contract), land and other specialised inputs so that a new entrant would need to secure capital for purchase of a farm beyond that required in the absence of government intervention.

**(b) Amendments to the model fee based on existing market forces and annual productivity:**

In the absence of industry-specific legislation, competitive market forces would continually determine the rearing fee to reflect changing market conditions, thus allocating resources to their most efficient use. Individual processors would increase or decrease their number of contract growers depending on fluctuations in productivity, with growers shifting between processors as required. While excess shed capacity would still occur according to the cyclical nature of production, competitive market forces would secure the most efficient allocation of resource for the industry and society.

Existing legislation, however, tends to impede this process of structural adjustment for three reasons. Firstly, the definition of what constitutes a "market force" is applied arbitrarily within the Committee. Frequently, the Chairman is presented with confidential information so that a successful negotiation would be achieved. The Chairman's interpretation of what constitutes a "market force", however, may be significantly different to that of growers and processors alike. The lack of a more robust definition increases the potential for misinterpretation and, therefore, the communication of inaccurate market signals.

Secondly, the Committee's negotiation of rearing fees six monthly is likely to convey inaccurate information to the growing sector during the interim, thereby distorting decisions on resource allocation within the growing sector. Moreover, the negotiation process would undoubtedly dampen market signals to growers and involve a considerable delay in response, thereby leading to a significant reduction in market efficiency.

Finally, current arrangements create an incentive for individual processors to maximise productivity only through their own contract growers. As processors operate in a commercial environment, they are usually unwilling to utilise a competitor's excess capacity because the throughput discount would subsequently improve that competitor's productivity and income on existing farms.

Moreover, processors are not required to pay growers a premium on the standard rearing fee if annual throughput is lower than that specified in the model because this would necessitate the termination of a certain proportion of contracts to increase throughput on remaining farms. At present, growers contracted to processors experiencing low throughput have also negotiated a decrease in the rearing fee and a cut in throughput to prevent the suspension of contracts. While it is recognised that growers in this situation would face significant hardship, maintenance of excess growers in this manner would undoubtedly lower the long term viability of all contract growers.

## **5. CONCLUSION**

Reflecting developments in industry policy, legislation in the New South Wales poultry meat industry has been evaluated with the purpose of assessing whether the stated objectives of legislation are justified on efficiency criteria and the impact of existing marketing arrangements on the efficiency of resource use.

It is concluded that there is little justification in providing specific assistance to the contract growing sector to overcome the potential for abuse of market power because of changes in the nature of the industry since legislation commenced. It is perceived that there has been a reduction in barriers to entry in the processing sector, a commensurate improvement in competition within the industry and a greater recognition of the mutual dependency between growers and processors.

Maintaining specific legislation to prevent the presumed potential for abuse of market power by individual processors at an unknown time unnecessarily imposes significant regulatory costs on society. The Poultry Meat Industry Committee's attempt to mimic market forces and determine transactions at administered prices rests heavily on a number of arbitrary instruments. Although current pricing arrangements attempt to incorporate some measure of efficiency, these criteria fail to adequately accommodate competitive market forces. Moreover, current arrangements impede structural adjustment by providing a guaranteed return to growing within a specified range.

As there is no immediate threat to the public's interest from abuse of market power by processors, the preferred policy option would be to encourage industry competitiveness by minimising artificial barriers to entry into the processing sector and more stringent application of existing trade practices and fair trade laws when abuse of market power is clearly demonstrated.

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