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POULTRY FARMERS ASSOCIATION

SUBMISSION

Review of the Marketing of Eggs Act 1945 As required under the States' obligation to the National Competition Policy

**This updated submission is based on the PFA's submission to
The Birchmore Review, which concluded
That WA consumers would not benefit from a deregulated egg industry**

March 98

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Attachments 1, 2 and 3 ---Relationship between retail prices and producer return.

Attachment 4 --- Comparison of retail prices NSW and WA following deregulation. in NSW

Attachment 5 --- Comparison of retail prices all states.

Attachment 6 --- Cost of establishing a model farm.

SUMMARY OVERVIEW:

INTRODUCTION

The Poultry Farmers Association of WA provide this submission to the Review of the Marketing Of Eggs Act as required under the National Competition Policy, and respectfully requests that the opportunity to provide further clarification be made available during the course of the Review.

Dramatic change has occurred in the Australian Egg Industry over the last decade, with full deregulation in some States and changes towards cooperatives and large private companies in others. This combined with the Council of Australian Governments (GOAG) endorsement of the principles for developing National Competition Policy, and the introduction of Mutual Recognition, means that there is a much more competitive environment in the market place today.

DEREGULATION

Deregulation in the Eastern States has not been of benefit to the consumer.

(Attachments 1, 2 and 3)

Sufficient time has now passed for the full effects of deregulation and its accompanying compensation to producers in New South Wales to be assessed. Deregulation has not maintained lower on average prices to consumers, but has meant much lower returns to producers. This has increasingly pressured viability of farms and resulted in many leaving the industry. The outcome has been a chaotic supply demand situation with shortages necessitating importation. (Fortunately with most being imported from WA)

Furthermore the structural change which took place (although accompanied by producer compensation) occurred with very little strategic planning. Consequently, the assessment of any likely impact in terms of employment, industry development, exports and future planning was limited. This meant that the objective and achievement of international competitiveness was largely ignored.

WESTERN AUSTRALIA

The WA situation, although not deregulated, has continued to meet the demands of competition. The more competitive environment and the broad statements of principle from COAG do not raise any cause for objection. It is considered that the Western Australian system not only operates in a competitive environment but also provides the "Least Cost Path" from producer to customer/consumer without unnecessary regulations or barriers.

The WA system has been pro-active in meeting new demands or changing circumstances. The policies of the Western Australian Egg Marketing Board, trading as Golden Egg Farms (GEF), combined with producer and consumer support of the current marketing system - including the disciplines and obligations imposed on and accepted by producers has enabled the WA Egg Industry to develop domestic and export markets.

Also, while being responsive to local consumer requirements GEF has exported eggs and egg product to the Eastern States including in times of their shortages.

Given the changes in other States, it may perhaps be easy for some in WA to conclude that the Marketing of Eggs Act of WA must be fundamentally altered so that the system can meet competition in the market place. The PFA *does not* accept that view. GEF already in a competitive market situation and the current system provides benefits to all stakeholders of the industry.

GOLDEN EGG FARMS

The Western Australian Egg Marketing Board, operating as Golden Egg Farms does not operate at a loss and does *not* carry a debt structure. It would appear that some other States did not operate in an appropriate and business-like fashion, and their governments found it easy to view their debt and losses as liabilities to the community.

The GEF is a leader in the Australian industry and has performed efficiently during the 1980s and 1990s. It has provided consumers with quality graded eggs at competitive prices, and has pursued the opportunities of marketing a range of eggs and egg products. It has not required any Government sourced cash inputs, or does it require or have any Government guarantees.

COMPETITIVE MARKETING

The flexibility of the current system allows Golden Egg Farms to provide a stable supply to regions of WA and to export eggs or egg product to interstate markets in short supply, as well as overseas. At the same time, it has maintained a reasonable, but competitively determined, return to producers.

Quality Assurance accreditation to International ISO standards has been achieved and there has been no demand by consumers for the removal of the regulated system. A comparison with other states prices indicates they are receiving value for their money.

LEAST COST PATH

There is a clear definable "Least Cost Path" from producer to customer/consumer and should any changes be contemplated, it would need to be demonstrated that the least cost path is not jeopardised. The key fundamentals of Collection, Grading, Quality Control, Packaging Distribution, Promotion and Marketing need to be maintained in the WA Egg Marketing System.

Competition can occur and in fact already exists within some of the above functions and activity.

CONCLUSION

Benefits to producers, consumers and the economy in this State can be best achieved by maintaining the existing system with its flexibility and, as has been demonstrated, improving the current WA competitive system rather than merely and simplistically following the Eastern States' line of deregulation.

Deregulation in the Eastern States has caused localised supply and demand problems. Furthermore, consumers have not received lower prices

Golden Egg Farms has been responsive to consumers, developed many new products, investigated and developed new market opportunities, and at the same time operated cost-effectively. In association with producers, productivity has also been improved. The average wholesale price of eggs has been maintained at less than the rate of inflation.

The Western Australian environment is different in that the major sector (about 80% of the market) centres on the main population area of the Perth metropolitan region. However, legislation and GEF policy development has reflected the demands of producers and consumers by providing opportunities for competition.

There are however a number of issues which have been identified as placing some restriction on competition.

1 VESTING: Control of eggs by GEF.

2 LICENSING: Bird numbers and entry to the industry.

3 PRICING: Wholesale and retail prices

4 PAYMENT: Determination of a price to producers.

The Poultry Farmers Association of WA submits that, with minor changes, the current system and arrangements for Egg Marketing in WA result in benefits to both the producers and the public, which far out-weigh any detriment of lessening of competition caused by these arrangements.

1 VESTING

All eggs are under the control of GEF. (However, there are already extensive exceptions enabling direct sales to retailers and the public.)

GEF has satisfied objectives of the legislation, as determined by the Birchmore Review, and the respective requirements of consumers, retailers, manufacturers and producers, specifically by providing flexibility within the current system;

- to ensure the efficient marketing and distribution, on a continuing year-round basis, of high quality eggs and egg products at competitive prices;
- to identify and capitalise on opportunities for increased egg consumption;
- to facilitate economies of scale and stability in the industry and a competitively determined return to efficient producers;
- to adjust egg production to meet changing requirements and sales demand;
- to facilitate adoption of new technology within the industry;
to provide leadership in the adoption of "worlds best practice";
- to meet potential export opportunities;
and to cater for further product development.

WA has a relatively small and limited domestic market and requires Vesting to ensure economies of scale and consequential critical mass. Moreover, because of GEF's economies of scale, there is a "least cost path" from production to customer /consumer.

The following sections are all part of this least cost path and as such are interdependent.

MARKETING

Supermarket sales account for about 75% of total consumer purchase of shell eggs. Other outlets include small corner stores, produce markets and egg farms. Consumer requirements are constantly monitored and particular attention is given to public health, quality, hygiene, grades and packaging to ensure consumer demand is met. GEF have initiated changes to the packaging and grades to provide a range of customer options and to meet the competition provided by importation of egg product from the Eastern States.

Consumers have the capacity to switch to other food products should they consider eggs too expensive, but they have shown no inclination to do this. Total egg consumption has continued to increase at a rate as fast as the rate of population growth despite competition from alternative foods.

This has no doubt been due, in part, to the fact that egg price increases have been much slower than the rate of inflation. The pricing policies of GEF take into account the competitive aspects of the Eastern States market place.

The various grades, packs, and varieties such as free range, vegetarian, brown and different weights and sizes have all been introduced to provide consumer options. Furthermore, with the introduction of Mutual Recognition, competition on grades and packaging is readily available to the consumer from interstate importation.

Because of the centralised vesting system a range of customer/consumer preferences can be accommodated.

PRODUCT DEVELOPMENT

New products have been initiated including salted yolks, sugared yolks, hard boiled eggs, shape-up which is derived from egg white, scrambled eggs and vegetarian eggs, have all achieved considerable success.

The egg white (fat and cholesterol free) product - the Cutting Edge launched locally has also achieved sales in Eastern States markets. Product development has also led to egg pulp use for the manufacture of ice cream for the Japanese market.

The centralised grading floor has enabled the use of eggs, which are of good quality, but because of blemishes are less cosmetically appealing. These include rough or misshapen and eggs which are more susceptible to cracking, produced from older birds.

GRADING, HANDLING, STORAGE & PACKAGING

At the Palmyra plant, the grading, handling, packaging and distribution of shell eggs, allows the efficient transfer of hundreds of millions of eggs from the farms to the consumers. Indeed, it is estimated that the Palmyra plant grades more eggs (around one million eggs per day) than any other single grading floor anywhere in Australia.

Alternative grading packing and distribution could be initiated, however the scale of operations would mean a misallocation of resources and result in increased cost.

PROCESSING

The centralised plant has made it possible to operate an egg pulp plant in WA.

With changing worldwide trends, egg pulp is proving to be the growth market.

The egg industry in WA is only just large enough to support one sophisticated egg pulping plant. Evidence to support this, is that there are only two sophisticated plants which service Eastern Australia. Should the industry in this State be deregulated and egg marketing become fragmented, it is unlikely under current circumstances that sufficient continuous supply would be available for egg pulping to continue. This would be unfortunate as egg pulp and products are one of the cornerstones of future consumption and sales growth within Australia and overseas markets.

PRODUCT DEVELOPMENT AND EXPORT

Shell export market opportunities continue to be assessed for their viability, however, information provided to the PFA indicates best opportunities appear to be for egg product rather than shell

High quality must be maintained for export. Product to be exported from WA is offered at a price that will meet that markets' requirements, and specific contracts to fill orders may also be issued to producers at different prices. All producers have the opportunity to participate. A marginal costing basis enables many producers to be competitive in these markets, by making

use of capacity, excess to seasonal production requirements, and at those times when they can hold older birds into a longer production life.

GEF has had considerable success with export marketing into South East Asia, however it is only with the centralised scale of operation, which provides sufficient critical mass and a quality product that exporting is a viable option.

HEALTH AND QUALITY

Quality Assurance is maintained through quality control at all levels and all health aspects are monitored. Testing is also undertaken for pesticide residue levels, particularly important in free-range production. Should a breakdown of quality ever occur, it could be rapidly traced back to the poultry farm in question, and appropriate action taken to safeguard consumers.

It is pertinent to note that GEF was the first egg organisation to attain ISO accreditation.

All eggs are stamped and identified with the producers' code, which enhances a clear trace-back system. This will become increasingly important as the risk of importing disease increases and Quarantine and Inspection procedures come under pressure.

An independent quality, health-monitoring system could be introduced however it could not be achieved without additional cost.

COLLECTION AND DISTRIBUTION

To obtain economies of scale, a collection and a distribution system operates in the Greater Metropolitan area. This Metropolitan system operates to and from the Golden Egg Farms' store under a contract system. Pick-up and delivery in some country regions, where necessary, is also organised by contract.

To ensure that the least cost path is maintained tenders are called for contracts for both collection and distribution. The most efficient and effective system is therefore provided within the obligations of the centralised system, however it is also within a competitive environment.

On average around one million eggs are collected from farms every day. Following grading and packing which is undertaken on average within 48 hours, eggs are distributed to retail outlets. Retail outlets can pick up from the centralised plant however most prefer to have eggs delivered direct to store under GEF's Chill-Chain system.

BENEFITS OF VESTING AND THE CENTRALISED SYSTEM

There are many benefits from vesting and the centralised system, including;

- economy of scale and required critical mass for stability and development
- a range of options for consumers in packaging and grades of eggs

- the introduction of new products
- the accommodation of a range of customer/consumer preferences
- all costs can be identified from producer to consumer
- enhancement of opportunities for processing and export development
- a trace back system for quality assurance or disease control
- human health, quality, hygiene and health are constantly monitored.

ALTERNATIVES

Each of the activities could be undertaken individually or independently. However these activities are interdependent and would be more costly to implement if undertaken out-side a centralised system.

CONCLUSION

There are benefits to producers, consumers and the economy of the State by the centralised system of collection, grading, marketing and distribution undertaken by GEF

The least cost path from production to customer could not be maintained, and based on Eastern States experience, result in lower returns to producers and increased prices to consumers.

Without the centralised system there would be fragmentation of a smooth flow of eggs from the producer to the consumer.

2 LICENCE/CONTRACT

The Egg Industry in WA under a licence system has been a stable viable industry and has provided growers with the confidence to expand and adopt new technology, as this becomes available. Farm sizes have increased, with the family farm remaining the basis of the Industry. Industry has maintained its independence from seeking restructure assistance.

All producers consigning eggs to GEF receive the same price for similar grades of eggs; however, they do not have the same earning capacity. More efficient growers have lower per unit costs of production and earn more than less efficient growers. Structural change has been significant in response to the competitive pressure already being imposed.

Farm size also continues to adjust to current economic pressures. (as below)

Size/Bird Numbers:		Farm Sizes in WA		
		Number of Farms		
		1971	1993	1997
1 -	500	261	39	15
501-	1000	50	9	9
1001-	2000	44	10	5
2001-	5000	90	21	6
5001-	10,000	49	32	26
10,000	21,000+	11	33	44
		Total 505	144	105

Capital investment in a commercial egg production farm is substantial with production sheds being highly specialised and having virtually no alternative use. Accordingly a reasonable degree of stability and predictability is required to ensure future investment.

Most of the larger poultry farms are situated in the outer metropolitan region. Limitations on expansion may be imposed by the Environmental Protection Authority and the Department of Urban Development and Planning in this region in future. This may increase costs if farms are forced to relocate. (Costs of a model farm –Attachment 6.)

Unlike other States, the Western Australian population and market is centred on the metropolitan area. However, to ensure supply/demand, the licensing system ensures that sufficient flexibility exists to take account of all likely situations.

Special Licences exist (east of the Rabbit-proof fence) to ensure an opportunity for market supply in those regions. The producer must hold a licence to be able to sell eggs.

Remote Area Licences exist north of the 26th Parallel. These licences are held under Ministerial approval and are aimed at appropriate bird numbers to meet the market requirement in northern most parts of the State.

Note: The above arrangements do not impose a charge or establish a price. They do however, require a grading certificate and are required to observe the Egg Grading and Packing Code, which maintains quality assurance to the consumer.

Supplementary Licence Quota which is issued, is required to meet seasonal adjustments or special demands (such as during special events) Eggs produced under the licence system and supplementary licence are paid at the same rate.

Specialty Contracts are issued to meet a particular market, or an extraordinary demand. Generally these are for product eggs which would give a lower return than table eggs, (eg eggs for processing). These contracts can involve the issuing of a contract for a set quantity and a number of weeks to meet the supply/demand necessary. They can also be used to meet unusual demand in the Eastern States, such as shortages, which have been experienced since deregulation or for export markets.

Permitee Sales: Most producers hold a permit to sell eggs direct to the public or businesses outside the GEF's distribution area, or as approved by the Board. The Board does not however, set the price at which a producer sells those eggs. Where Local Special or Permitee sales do not meet requirements, Golden Egg Farms are in a position to "top up" supplies.

In the event of a disease outbreak in a particular region or area, supplementary supplies can be arranged by GEF to ensure continuity of supply to all customer consumers.

Entry to the industry is either by purchase or a new lease system, which was recently introduced.

ALTERNATIVES

An alternative would be to have an open production system, however given the size of the Western Australian markets an open system would be unlikely to provide sufficient security for future investment. Nor would it provide a constant reliable supply to the market as shown by the Eastern States experience of shortages and consequent price increases.

The preferred alternative is to initiate further flexibility into the current licence/contract system.

There are two matters previously identified and supported by both the Poultry Farmers Association and the Minister for Primary Industry, which would provide further flexibility to the license system and are in the process of being implemented.

The PFA consider that the current upper restrictions on licensed bird numbers be increased to 75,000 birds- this would enable larger efficient farms with excess capacity to develop further.

The PFA also considers that the allowance for the purpose of producing eggs for own use and localised sale, be increased from 20 up to 50 birds.

This would enable a service to rural communities from a localised source. A licence or other obligation mechanism should however be applied to maintain monitoring quality control distribution and regular supply.

CONCLUSION

The flexibility of the current system enables participation to meet market requirements without volatility of supply, as well as opportunity for expansion as market demand requires.

Given the size of the WA industry and the limited opportunity for expansion on the domestic market, the licence /contract system is the best method of developing an export and product market, without a waste of resources.

New markets cannot be developed from an unpredictable surplus of the domestic market. This was proven from the previous experience of overproduction in Australia and exporting was undertaken in an unplanned manner.

3 PRICING WHOLESALE AND RETAIL

Golden Egg Farms has been responsive to consumers, initiated new products, investigated new market opportunities, operated cost effectively, and with producers, improved productivity. In this State the average wholesale price of eggs has been maintained at less than inflation and the retail wholesale margin has remained relatively stable.

Deregulation, where the removal of a centralised system has occurred, has had a number of unintended effects on the industry. The "benefits to consumers" from deregulation in NSW so strongly promoted by the Industries Commission and other policy analysts (based on 1989-92 data) has now been proven to be false in the longer term. In fact consumers have not benefited. The retail price has increased and retail margin for shell eggs previously around 10% to 15% under regulation, has now jumped to around 90% to 100%, providing a gain to retailers at the expense of both producers and consumers. (Attachments 1, 2 and 3)

The theoretical assumption that deregulation creates competition, which produces economic benefits which will be passed on in lower prices to consumers, and hence "consumer benefit" has not eventuated in those States where deregulation has occurred.

A previous "desk top study" undertaken by the WA Office of Industry and Regulatory Review which recommended the deregulation of the egg marketing arrangements (in the community interest) appeared to be based on that same theoretical assumption. That study, undertaken during 1992, compared retail prices in NSW and WA from Sept 1988 (prior to deregulation) until June 1992 (after deregulation). If that study had been undertaken one year later a completely different picture would have been seen to be emerging. (Attachment 4)

In NSW this showed retail prices have continued to rise, with the margin increasing between consumer prices and returns to producers because of major supermarket buying power. The buying power exists because there are only a few major retail chain stores and a large number of fragmented sellers.

Therefore the power to establish wholesale pricing is considered essential to balance the "market power" of major supermarket chain stores. Because the WA production sector has very limited alternative markets to the metropolitan region it is vital that market power remains with GEF.

As GEF is not a Company it does not make profits and all returns less costs are returned to producers. The flexibility and efficiency of the current centralised system in WA maintains a "least cost path". Hence the disparity between producer return and retail price which has occurred in the Eastern States has not occurred in WA. Furthermore retail prices have remained more than comparable with other States. (Attachment 5)

RETAIL PRICE

Although GEF has the power within legislation to set retail price, they have not used that power since 1985. Accordingly this power should be removed.

BENEFITS

The wholesale price is determined and based on competitive pressures of alternative foods and competition from (or potential for it to occur) eggs and egg products from the Eastern States.

Consumer price choice is provided through wholesale pricing of products based on grade, sizes, quality and packaging.

GEF provides a balance to counter the huge purchasing power of major supermarket chain-store groups. However this wholesale price determination does take account of the competitive environment of alternative foods and potential import of product from the Eastern States.

ALTERNATIVES

The alternative would be an open pricing system or with markets tendering out for supply either from a centralised source or from individual production units. However, again due to the size of the WA market (notwithstanding the major portion is the Perth metropolitan region) there would be a chaotic supply demand situation and the least cost path would also disappear.

Fragmentation of the industry would occur and the stability for all stakeholders would disappear, creating uncertainty for future investment.

CONCLUSION

Wholesale prices are competitive and have risen at less than inflation. Retail prices have consistently been less than retail prices in the Eastern States, which has benefited the consumer. Furthermore all returns from wholesale less costs to grade pack and distribute are returned to the production sector with flow on benefits to the WA economy.

4 PRICING –PRODUCER PRICE DETERMINATION

In keeping with a competitive environment, the producer prices have not been determined by the cost of egg production data since the late 1980's. In fact, in recognition that the market place is the determination of price, the Committee has not met since mid-1991 and has been disbanded.

It should also be emphasised that the licence values were never included in the Cost of Production calculations, so the Cost of Production calculation, when it was used had not been inflated by the licence value.

The value of hen licences or "goodwill" is often used as an indication that producers are making "excess" profits. Obviously if there were no profits there would be no goodwill, as in all business enterprises. In those States that have deregulation goodwill exists as part of the entitlement to sell through a marketing group.

In some instances licences are purchased by producers with surplus shed capacity or producers wishing to expand production. New farmers entering the industry have paid for the licence as part of the goodwill capital input. Most new entry is because of lifestyle expectations, family business opportunity and security. But none of these factors have been a determinant or influenced the producer price for eggs.

The determination of a producer price, as in all other competitive business, is based on the commercial reality of the market place, with the price dependant on meeting supply demand and competitive pressures of alternative competition.

However, GEF does utilise premiums or discounts within that pricing regime to influence the quality and grade of the eggs produced.

All producers also have the opportunity to participate in contract pricing and/or spot pricing for particular niche markets or development of value added products. WA does not have the production volume or critical mass to develop these markets from erratic surplus production. A surplus production regime would result in a miss-allocation of resources, inefficient production and resultant cross subsidisation.

Furthermore given the lead-time necessary to increase production (estimated 8 months unless from older birds) planned production at a known price is essential for producers to commit themselves to a contract.

Production therefore needs to be planned to meet market requirements and to provide the continuity necessary to service developing markets. The centralised system and pricing structure used by GEF enable forward planning for both the domestic and export markets.

It is therefore no coincidence that WA with its flexible and centralised system accounts for more than 80% of Australian exports even though WA production is about 9% of the Australian total

Producers, under their permittee licence, which allows direct sales can also determine the price of their own shell eggs which provides another indicative source of competition and alternative for the customer/consumer.

From producer data GEF have estimated that around 10% of eggs are sold direct to customer /consumers in this manner.

BENEFITS

A number of competitive opportunities for producers exist within the current system.

Commercial realities of the market place determine the producer return for the various market segments.

Direct market signals are conveyed to producers through premiums and discounts for grade and quality and spot pricing arrangements.

ALTERNATIVES

The alternative without a centralised system would be for individual producer pricing (which already exists under permittee sales as indicated above) or through a tender system. This would destroy the least cost path and lead to a more chaotic supply demand system.

CONCLUSION

Producer price determination under the centralised system has provided producers with the security and stability to expand and continue to invest in the future knowing that all returns less costs are returned to the production sector.

Furthermore, because of the existing competitive environment, and dominance of the major supermarket chain stores, lower prices to producers would not be passed on to consumers.

5 ALTERNATIVES AND OVERALL CONCLUSION

In WA the centralised system is the most effective and efficient way of maintaining service, quality and a least cost path from producer to consumer. It also maintains continuity and stable supply of eggs to all regions of WA, at competitively determined prices to consumers and returns to producers.

The system also provides the economies of scale and critical mass necessary for WA to compete against the larger states, maintain value adding, develop egg products and export expansion.

Accordingly any alternatives considered must maintain a centralised system and also meet the demands of competition.

As GEF, including its assets and infrastructure, is currently the centralised system, a Privatised Company or Cooperative are possible appropriate structures.

Accordingly the “goodwill” built up by producers through the current system could be maintained via shares in a privatised Company or Cooperative.

However, given the size of the WA market, any fragmentation of the centralised system would place the interdependency of the various functions at risk. It would only require minimum loss of throughput to undermine the critical mass so essential for future development.

Under a Company or Cooperative structure GEF’s directors would have an obligation to ensure a return on investment to shareholders. As such they would also be obliged to exert full market power albeit within the confines of a competitive market environment including alternative foods, imported eggs, egg product and pulp egg.

However, as experience in the Eastern States shows competition at retail is pitched at “the maximum the market will bear”, which would mean a price increase to consumers in WA.

CONCLUSION

The WA egg market is only large enough to maintain one efficient and effective centralised system. – Currently GEF. Because GEF operates in a competitive environment there is currently no reason for major change.

However with population growth, export development and further expansion or amalgamation of production units the market may in years to come grow to a size that can support viable alternatives.

The intervening period should be used to consolidate GEF as a strong competitive and commercial enterprise and continue to grow as the leading viable exporter with benefit to the Western Australian economy.

The Poultry Farmers Association of WA (Inc) submit that with minor changes, the current centralised system for Egg Marketing in WA result in benefits to producers, consumers and the economy of the state which far out weigh any detriment caused by these arrangements.