
Pricing

ACCC's new milk monitoring role

In April 2000 the Commonwealth Government, under s. 27A of the *Prices Surveillance Act 1983*, directed the Commission to monitor prices, costs and profits of businesses dealing with market milk product sales. As part of the Commonwealth Dairy Industry Adjustment package, \$500 000 is to be paid from a levy on market milk sales to the Commission to undertake the monitoring function. Monitoring will allow the Commission to determine whether the falls in farm-gate prices for raw milk brought about by deregulation are passed on to consumers.

The Dairy Industry Adjustment Bill 2000 sets out a framework to implement an adjustment program for the dairy industry. The dairy industry can be separated into two sectors — market milk (drinking) and manufacturing milk (butter, cheese and other dairy products). State legislation underpinned market milk arrangements providing a guaranteed producer price for milk used as market milk that was about double that for manufacturing milk (in 1999 an Australian average of 51.5 cents compared to 23 cents). State Agricultural Ministers agreed at an inter-governmental meeting on 3 March 2000 to deregulate their market milk sectors in line with the end of the Commonwealth Government manufacturing milk scheme on 1 July 2000.

The main aim of the adjustment program is to help the dairy industry adjust to deregulation by providing for dairy structural adjustment payments and dairy exit payments. These payments will be financed by a levy of 11 cents per litre on market milk, beginning on 8 July 2000. The levy is expected to last for eight years and will be paid by people who purchase market milk for resale in Australia at a retail site. The levy is to apply to all market milk including

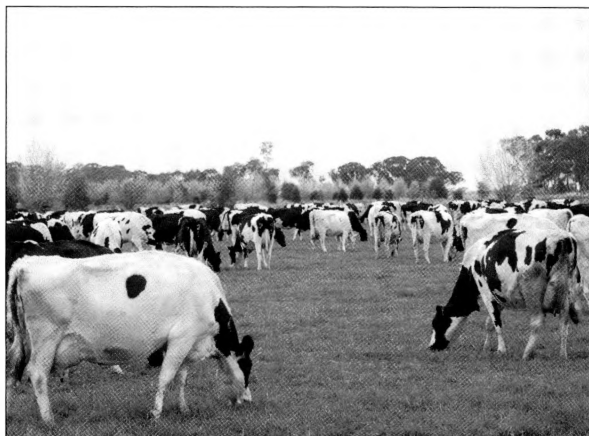
raw milk, white milk, flavoured milk, modified milk and UHT versions of all categories.

Approach to monitoring

Data will be required from all 27 processing companies that produce leviabale milk products although most milk processed in Australia is by the three majors, National Foods, Dairy Farmers and Pauls/Parmalat. Retail data is being collected from the major supermarket chains, petrol convenience stores and other retail outlets, with the GST Division surveying retail prices. The Commission will also commission additional survey work.

The monitoring covered the period before deregulation (April to July) and then for a further six months. However, to understand the changes in the dairy industry it will be necessary to look at some longer term trends. Fortunately a significant amount of public data is available on the dairy industry particularly from the various state milk government authorities.

The monitoring report, due by April 2001, will look at price trends, margin changes of processors and retailers. It will also broadly assess the effect of deregulation on the competitiveness of the dairy industry.



Photograph courtesy of the Australian Dairy Corporation.

Results to date

Before 1 July 2000 the Commission expected the price of milk would fall as a result of deregulation, except in the Northern Territory. The first supermarket survey after deregulation confirmed price falls of between one and seven cents across Australia except in Darwin. However, as expected, UHT prices and some flavoured milk prices rose because they had been subject to slightly different regulatory rules.

Shortly after these initial falls Woolworths announced significant price reductions on their own brand of fresh milk products. Other supermarket chains followed and these reductions are now flowing through to branded fresh milk products.

Generally, deregulation has been much faster in its impact on prices than had been envisaged by the dairy industry and by outside commentators.

Productivity Commission review of the Prices Surveillance Act 1983

Background

The review of the *Prices Surveillance Act 1983* (PS Act) by the Productivity Commission is part of the legislative review process agreed upon in the Competition Principles Agreement. The Productivity Commission received the terms of reference on 14 February 2000. The final report is due on 14 November 2000.

The terms of reference and scope of the inquiry are generally standard for this type of review. However, they also allow the Productivity Commission to:

... consider alternative means (including non-legislative approaches) of achieving the objectives of the PS Act, including changes to the operation of existing price oversight arrangements and alternatives to prices oversight.

The ACCC provided the inquiry with a detailed submission.

Submission outline

The PS Act is the principal Commonwealth legislation governing prices. The submission outlines three distinct phases in the operation of the PS Act. The economic rationale for each of

these phases is significantly different with the PS Act having operated as:

- the price restraint arm of the Prices and Incomes Accord (1983 to the late 1980s);
- part of an expanded micro-economic reform agenda (1989/90 to 1995); and
- a last resort facility where other pro-competitive reforms cannot feasibly be used (1995 to 2000).

However, from 1983 to the present, the PS Act has been subject to minor amendments only, the most significant perhaps being the changes made with the Competition Reform Bill. Rather, while the PS Act itself has remained largely unchanged, the areas in the economy subject to either surveillance or monitoring have been drastically reduced.

While this might indicate that the PS Act has been used flexibly there is now increasing evidence of an incompatibility between the PS Act's origins and the current operation of competition policy. There is a conflict between using the PS Act as a last-resort facility, that is, for those limited parts of the economy where market discipline does not operate and where pro-competitive reforms are ineffective, and the PS Act's reliance on moral suasion and cooperative compliance. Acceptance of the ACCC's decision on a price notification is voluntary, the information-gathering powers and penalties under the PS Act are slight and the PS Act indicates a short sharp process of price determination (for price increases) of 21 days. Such provisions were important to the circumstances operating at the time of inception of the PS Act, but are less appropriate when applied to that part of the economy least influenced by market discipline in 2000.

During the past few years concern about whether the PS Act can effectively deal with the type of pricing issues the ACCC has to analyse in assessing pricing proposals by declared companies has increased. The PS Act was developed to slow the rate of price rises in the economy generally, not as a regulatory instrument for either government monopolies or for newly privatised government infrastructure.

It is becoming harder to administer the notification regime under the PS Act and this is accentuated by a growing conflict between the

original context and objectives of the PS Act as well as the increasingly complex and adversarial nature of economic regulation.

As the PS Act was designed for quite different circumstances it now needs to be revised substantially. The amendments have to take account of recent structural reforms and the new regulatory arrangements.

Since the Hilmer Review was finalised in August 1993 many of its recommendations have been implemented. Access regimes have been established for industries like electricity and gas, the emphasis on corporatisation and competitive neutrality in GBEs has increased, state infrastructure facilities have been restructured and progress made towards seamless national electricity and gas markets. However, structural reforms have not eliminated the role of prices oversight, but rather the reforms have partially changed this role.

Pricing powers are a last resort. They do not deal with the underlying problems of market power and therefore are used when other pro-competitive reforms cannot be implemented. Sometimes, however, prices oversight powers may be appropriate for constraining excessive prices and their effects.

Given the need for some pricing powers the submission proposed various amendments to the PS Act. The submission suggested the PS Act should include the following elements.

Provisions in the pricing powers to regulate prices mainly for monopolies

These provisions do not relate to access pricing as such but the need for final price regulation. They are an adjunct to access legislation and other pro-competitive reforms. Generally, these powers would be used for markets of national significance. Decisions on price regulation should be court enforceable.

The Treasurer, perhaps assisted by an independent review body would decide which monopolies and businesses with significant market power should have their prices assessed. Specific legislative criteria would need to be developed to allow such a decision to be made in a transparent fashion.

A monitoring function as part of the new pricing provisions

Independent of price regulation, Government should be able to determine that certain entities or industries be subject to price monitoring. Monitoring is most likely to suit those areas of the economy where there is a high level of market power and the community is clearly concerned about public detriment. The PS Act needs to contain some power upon reference by the Minister to allow public inquiries to be held in specific circumstances into some industries for which prices are a matter of high public concern.

In addition, the ACCC should continue to be able to make informal preliminary inquiries so it can recommend when monitoring should be conducted.

Monitoring should take place for a prescribed period and its continuance be subject to review by the relevant Minister.

The new pricing provisions should be supported by procedural measures

Various procedural reforms to the PS Act are required. These modified procedures should support the new focus of the PS Act — regulating prices for monopoly utilities. For example, the regulator should have some discretion given the nature of the industry under consideration to choose an appropriate methodology for assessing prices. Also the amended regime should include adequate information-gathering powers and reasonable time limits for assessing prices. The ACCC also considers that a public consultation process should be required for price assessment.

Conclusion

The ACCC and other submissions to the review of the PS Act are available on the Productivity Commission's website at <<http://www.gov.pc.au/inquiry/psa/index.html>>. Before the final report is completed the Productivity Commission will issue a draft report and conduct hearings.

The ACCC is hopeful that this substantial review of the PS Act will lead to amendments that will enhance the ACCC's ability to administer the Commonwealth Government's pricing powers.