



INDEPENDENT CONSUMER AND COMPETITION COMMISSION

2010 RICE INDUSTRY PRICING REVIEW



Final Report

22nd December 2010

Inquiries

Inquiries regarding this review should be directed to Mr. Paulus Ain, Executive Manager for Prices, Regulatory Affairs and Special Projects Division, on telephone 325 2144 or by fax on 325 3980 or via email on pain@iccc.gov.pg . Copies of the Issues Paper, Draft Final Report and Final Report can also be obtained from the Commission's website on www.iccc.gov.pg.

Submissions received by the Commission as part of this review are available for public inspection unless the Commission, based on a request from the relevant stakeholder, considers that all or part of the submission should remain confidential. However, in accordance with the provisions of the ICCC Act, the Commission intends to make this review process as transparent as possible and to this end, submissions are normally available for public inspection unless there are exceptional commercial-in-confidence reasons as to why submissions should be held in confidence.

Citation

ICCC 2010, *Rice Industry Pricing Review – Final Report*, 22nd December 2010, Port Moresby, Papua New Guinea.

About the ICCC

The Independent Consumer & Competition Commission (the Commission) is a statutory body established under the provisions of the *Independent Consumer and Competition Commission Act 2002* (the ICCC Act) to promote competition and fair trading, regulate prices of certain declared goods and services, and to protect consumers' interests, and other related purposes.

The Commission is empowered under the ICCC Act to have one full time Commissioner and two part time Commissioners which forms the ICCC Board. At the time of this Report, the Board comprised of;

Associate Professor Billy Manoka (PhD)	–	Commissioner & CEO
Mr. David Dawson	–	Associate Commissioner (External)
(Vacant)	–	Associate Commissioner (Resident)

FOREWORD

Rice is one of the main sources of carbohydrates in most semi-urban and urban communities in PNG and is becoming a larger component of people's diets in rural and remote areas. In urban areas the price of rice is important as rice consumption constitutes a considerable portion of the average household budget.

Prior to 2003, PNG's rice industry was dominated by one company, Trukai Industries Limited, who was responsible for almost all of the rice in the supply chain. While Trukai remains the largest player in the rice industry, the lack of barriers to entry into the rice market means a number of new importers have entered the market. New entrants to the rice market have seen the range of rice products available in the wholesale and retail sector almost double in recent times. In addition to rice imports, investment in local production has increased significantly. Most local production is consumed by households. However, a small amount of "garden rice" has entered the supply chain.

Substitutes for rice are widely available in PNG and include flour based substitutes such as noodles, pasta, biscuits and bread as well as local products such as locally grown 'garden rice', taro, kaukau, yams, sago, and bananas. While the range of substitutes available varies between different areas in PNG, competition across these products is fierce.

With this degree of competition in the market for carbohydrates the Commission has, over the past decade, considerably reduced the extent to which prices in these markets are regulated. In 2005, the Commission undertook a comprehensive review into the price setting arrangements for rice products. Following this review, the Minister for Treasury determined that prices of Roots Rice should be monitored under the provisions of the *Prices Regulations Act (Chapter 320)* (PR Act) and the *Independent Consumer and Competition Act 2002* (ICCC Act). This meant a move away from price setting regulation to a price monitoring approach. Price monitoring is a relatively light-handed approach used by regulators and one step removed from complete deregulation. The 2005 decision on price monitoring expires on 31st December 2010. As such the Commission has now undertaken an investigation into what would be the appropriate level of regulatory oversight into the future.

The Commission has endeavored to deliver a public and transparent process in establishing the appropriate form of regulation for the rice industry. As part of this process, the Commission released an Issues Paper and a Draft Final Report to elicit responses from the industry and the public more generally. The Commission has considered all submissions received on these reports and would like to take this opportunity to thank all who have contributed to this review process.

Whilst input and technical advice had been sought from relevant stakeholders, the final outcome in the Final Report remains the property of the Commission.



Assoc. Prof. Billy Manoka (PhD)
Commissioner/Chief Executive Officer
Independent Consumer & Competition Commission

21st December 2010

ABBREVIATIONS AND GLOSSARY

ABS	Australian Bureau of Statistics
AML	Associated Mills Limited
FGP	Factory Gate Price
FAO	Food and Agriculture Organisation
GFC	Global Financial Crisis
GFI	Goodman Fielder International (PNG) Ltd
ICCC	Independent Consumer & Competition Commission
ICCC Act	Independent Consumer & Competition Commission Act 2002
LNG Project	Exxon Mobil Liquid Natural Gas project
NRD	National Rice Distributors
NSO	National Statistical Office
PNG	Papua New Guinea
PR Act	Prices Regulation Act (Chapter 320)
Trukai	Trukai Industries Limited

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EXECUTIVE SUMMARY

Background

The Commission currently monitors the factory gate price of Roots Rice products supplied by Trukai Industries Limited (Trukai) and sea and road freight charges for the transport of Trukai rice products to major distribution points in PNG. The current monitoring period expires on 31st December 2010.

In view of the expiration of the current monitoring arrangements, the Commission has undertaken this review to establish whether the current regulatory process should continue, and if so, the shape and form of regulation that should apply beyond 31st December 2010. This Final Report has been prepared with input from a range of stakeholders and interested parties and has included the release of an Issues Paper and Draft Final Report.

Assessment Framework

To assess the current level of competition in the PNG rice and transport market, the Commission developed a tailored assessment framework based on the factors most relevant to the local market. The framework includes barriers to entry (and exit) / import competition, substitutes, competition between existing market participants, countervailing market power and the exercise of market choice by customers. In addition, the Commission has analysed the data reported as part of the existing price monitoring arrangements.

Based on the analysis against the assessment framework and its investigation of the existing price monitoring arrangements, the Commission has made the following findings.

Commission's Finding 1: The PNG rice market exhibits many of the characteristics of an effectively competitive market. However, at this time the Commission considers there to be value in continuing with a form of price monitoring as it retains concerns relating to reduced international prices not yet being passed on to consumer and a range of economy-wide factors such as increased landing costs, increased in-country costs and uncertainty due to investments such as the LNG project.

Commission's Finding 2: The Commission considers it appropriate to cease monitoring the in-country road and sea freight rates for rice products.

Commission's Finding 3: The Commission will now use the FAO Medium Grain index as its main rice price comparator, but will also maintain the use of the existing ABS index to monitor Roots Rice prices. However, if there is a significant divergence between the Roots Rice index and FAO Medium Grain index, the Commission will review these changes in comparison with ABS index and information on the world-wide supply and demand balance. The Commission will also retain the option of requesting information from Trukai to support any changes in price that are not consistent with the FAO Medium Grain or ABS indexes.

Final Determination

The Commission has undertaken a review of the regulatory arrangements applying to the ex-factory gate price of Roots Rice and the road and sea freight of Trukai Roots Rice varieties under the provisions of Section 25A (6) of the PR Act. The ex-factory gate price of Roots Rice and the wholesale and retail

charges for road and sea freight are currently declared as a declared monitored goods and services under Section 32A of the PR Act¹.

The Commission acknowledges the comments and submissions received on its Rice Industry Pricing Issues Paper and Draft Final Report. Having considered these comments and submissions, the Commission has now made its Final Determinations as to the manner in which the price of Roots Rice is to be regulated over the next 5 years.

Under the provision of Section 25C(3) of the PR Act, the Commission has made the following Final Determinations:

- The price monitoring regime which currently applies to the ex-factory gate price of Roots Rice, will continue over the next five years.
- The declaration of the prices and price monitoring arrangements will apply for a five year period from 1st January 2011 until 31st December 2015.
- The regulatory arrangements to be applied will be:
 - price monitoring of the ex-factory price of Roots Rice under the provisions of Section 32A of the Act;
 - The Commission will require Trukai to continue to provide the Commission with quarterly price updates on the prices of all Roots Rice products;
 - The Commission will then compare these prices and any price changes (particularly price increases) to the FAO Medium Grain index, as well as the ABS index developed using the ABS series 6403.0.55.001 - *Average Retail Price of Selected Items, Eight Capital Cities*; and
 - In the event that there is a deviation between the price movements as measured by the Roots Rice index and either of the FAO Medium Grain index or the ABS index, the Commission will undertake an analysis of the differences and other public information to assess why such deviations exist.. The Commission will also retain the option of requesting information from Trukai on costs, revenues and profit margins to support any changes in price that are not consistent with the FAO and ABS indexes.
- In addition any time after 1st July 2013 Trukai will be able to apply to the Commission to have the price monitoring regime removed. Trukai will be required to provide supporting analytical and technical arguments to support their contention that the market is competitive and that price monitoring is unwarranted. The onus of proof will be on Trukai and should be supported by the quarterly returns provided to the Commission over the previous three years, and other information on markets, competition, prices and costs. Until such time as the Commission deems otherwise the price monitoring of the ex-factory Roots Rice price will continue, including while the Commission is reviewing any such information submitted by Trukai.

¹ In Gazette notice No. G194 of 13th December 1997, the wholesale and retail margins for Roots Rice were re-declared under the provisions of Section 10 of the PR Act to ensure the Commission's Final Determinations from its 2005 Review remained. Following the Wholesale and Retail Industry Review of 2009, and in Gazette notice No. G200 of 14th October 2009, this declaration was revoked, but the previous declaration remained in place whereby the factory gate prices of Roots Rice were declared under Section 32A as declared monitored goods under the PR Act.

The Commission's recent reviews into the Rice and Flour Industries

During 2010 the Commission has conducted reviews into the PNG flour and rice markets. Both reviews have been conducted in accordance with the *Prices Regulation Act* which centres on protecting the interests of consumers by ensuring against misuse of market power and encouraging the development of efficient and competitive markets.

The Commission's analysis indicates that the flour and rice markets both exhibit many of the characteristics of competitive markets. However, in each instance the Commission elected to maintain the existing price monitoring arrangements in respect of the ex-factory gate prices. This was due to a combination of factors including specific circumstances in each industry as well as general uncertainties in the PNG economy, due predominantly to the current mining boom and the potential impact on inflation and the supply/demand balance of staple goods.

In deciding to retain the existing price monitoring arrangements, the Commission was guided by its objectives as contained in the *Independent Consumer and Competition Commission Act*. These objectives are to:

- (a) to enhance the welfare of the people of Papua New Guinea through the promotion of competition, fair trading and the protection of consumers' interests;
- (b) to promote economic efficiency in industry structure, investment and conduct; and
- (c) to protect the long term interests of the people of Papua New Guinea with regard to the price, quality and reliability of significant goods and services.

The Commission considers that at this point in time, the overall welfare and long term interest of Papua New Guineans are best served by retaining a degree of oversight of the flour and rice markets given the staple nature of these products.

The decision to maintain a degree of oversight in these markets is related closely to the Commission's concerns regarding the general cost of living in PNG which is increasing more rapidly than wages are rising. This was a matter identified in the Commission's recent review of the housing industry in PNG. As a result of these price increases, many Papua New Guineans are experiencing a real decline in income and are finding it increasingly difficult to balance their personal household budget on a day-to-day basis. This has the potential to cause significant hardship and unrest.

The Commission would like to take this opportunity to state the importance of the Government continuing to support and encourage the development of competitive local markets (as has occurred over the last decade in both the flour and rice industries with reductions in tariffs and other measures) and stress the need for government to invest in infrastructure to support the ongoing development of PNG (eg: maintained roads and bridges). The current mining boom offers an opportunity to invest in the long-term prosperity of PNG, and particularly its everyday infrastructure and thereby enhance the welfare of all Papua New Guineans.

However, it should be noted that in each instance the Commission has included an ability for the major players to approach the Commission in 2013 and seek to have the price monitoring arrangements removed. It is possible that much of the uncertainty that currently exists in the economy may have been resolved by this point in time.

CHAPTER 1 INTRODUCTION

The current price monitoring regulatory arrangements for the rice industry began on 1st January 2006 and will cease on 31st December 2010. With the current regulatory arrangements soon to end, the Commission has undertaken this review to establish the appropriate regulatory arrangements for the future.

This document represents the Commission's Final Report and Final Price Determination and brings to a close this review. In undertaking this review of the Rice Industry the Commission released an Issues Paper and sought comment from interested parties. It then released a Draft Final Report and again sought comment. The analysis undertaken from comments and submissions received have informed the conclusions in the Final Report.

The Final Report is structured as follows:

- Chapter 1 provides background and summarises previous reviews and the review process;
- Chapter 2 contains an overview of the rice industry in PNG;
- Chapter 3 details the Commission's framework for analysis;
- Chapter 4 sets out the Commission's assessment of the regulated segment of the rice industry (the first element of the industry subject currently to regulation);
- Chapter 5 contains the Commission's assessment of the sea and road freight charges that apply to rice products in PNG (the second element of the industry subject currently to regulation);
- Chapter 6 discusses the form of regulation to be applied; and
- Chapter 7 sets out the Commission's Final Determination.

1.1 2005 Review of the Rice Industry

In 2005, the Commission undertook a comprehensive pricing review of the rice industry under the provisions of Section 25A (6) of the PR Act to determine whether price regulation of rice was still necessary given the changes in industry circumstances at that time. The Commission's review consisted of a transparent process with the release of an Issues Paper, Draft Final Report with Draft Determinations and a Final Report detailing the Commission's Final Determinations. Issues considered related to the import, processing and supply of rice as well as wholesaling, distribution and the retailing activities in the industry. The Commission released the Final Report into the Rice Industry Pricing Review on 16th December 2005.

The main findings of the review are summarised below:

- Price regulation continue for the price-sensitive segment of the domestic rice market (namely Roots Rice products from Trukai Industries Limited (Trukai)) but that price regulation be removed for all other rice products;
- For Trukai's Roots Rice products, a price monitoring arrangement be established;
- The price monitoring arrangement be based on:
 - the ex-factory gate price of Roots Rice products under the provisions of Section 32A of the PR Act as compared against a comparator index based on an Australian Bureau of Statistics (ABS) benchmark index; and
 - sea and road freight charges for the main delivery of Trukai Products under the provisions of Section 32A of the PR Act;

- The prior price control for wholesale and retail margins of 10 per cent and 11 per cent respectively, was also retained by declaration of these price components under Section 10 of the PR Act.

In 2009, the Commission undertook the Wholesale and Retail Industry Review to review the competitive situation in the wholesale and retail sectors of the Papua New Guinea economy. One of the recommendations of the Commission's 2009 Wholesale and Retail Industry Review was that the price control of wholesale and retail margins under Section 10 of the PR Act be revoked. The two monitoring processes were recommended to remain.

1.2 2008 Information Request

Between mid 2008 and mid 2009 the Commission's price monitoring showed a rapid increase in Roots Rice prices compared to the ABS benchmark index established under the price monitoring arrangements (refer to Figure 4.1 below). In accordance with Section 32A of the PR Act and the findings of the 2005 Rice Industry Pricing Review, in late 2008 the Commission issued an information request to Trukai asking for an explanation of the reasons for the divergence between the ABS index and the prices of Roots Rice products.

A preliminary assessment of the information provided by Trukai indicated that the divergence was due to a range of factors, particularly the drought in Australia affecting rice production and the spike in international prices of medium grain rice at that time. Given the short time until the conclusion of the existing regulatory period, the Commission determined that these matters would be considered as part of the 2010 comprehensive review.

1.3 Legislative Requirements

The current regulatory arrangements applying to the rice industry are governed under sections 10 and 32A of the PR Act. Under Section 10 of the PR Act the Government, through the Minister for Treasury, has the power to declare that it is necessary that the price of any good (such as rice) or service can be regulated until such time that there is a public disbenefit from regulation. Under Section 32A of the PR Act the Government, through the Minister for Treasury, has the power to declare that it is necessary that the price of any good (such as rice) or service can be monitored for the purpose of reporting such price movements to the Minister from time-to-time, and where price movements suggest it is necessary recommend to the Minister on whether price regulation should resume, or not.

The declaration by the Minister under Section 32A of the PR Act provides the Commission's power to monitor the ex-factory gate price of Roots Rice and the applicable in-country sea and road freight charges associated with the transport of rice to major sea and road destinations. Since late 2009 when the Commission recommended the revocation of the Minister's declaration in relation to wholesale and retail margins for Roots Rice products, there has been no regulation declared for rice goods under Section 10 of the PR Act.

The provisions of Section 25A (6) of the PR Act provides for the Commission to initiate a Review on its own accord when it considers it to be appropriate. Section 25B outlines the process by which a review of a Pricing Order can be undertaken including:

- the timelines for such reviews to be undertaken;
- the requirement to publish details of its decision; and
- the form of decision that can be made as a consequence of such review.

Furthermore, Section 25C (3) of PR Act specifies that as a result of a review, the Commission may

decide to:

- continue to operate the existing price control arrangements in their present form;
- vary the existing price control arrangements; and
- terminate the present price control arrangements via a recommendation to the Minister.

The provisions of the PR Act provide the Commission with some degree of flexibility in undertaking reviews. Under a price monitoring arrangement, if it is evident that price movements are not reflective of appropriate competitive market benchmarks, the Commission can recommend to the Minister for Treasury that the relevant goods or services be re-declared for full price control.

The Commission, in undertaking this Review in accordance with the above provisions of the PR Act, will have regard to the confidentiality and public disclosure provisions of the ICCC Act on information received through submissions and the current and prospective operating environment of the rice industry in PNG.

Under Section 32A of the PR Act, the Government through the Minister for Treasury has declared the following will be subject to price monitoring:

- I. Roots Rice in sizes of 25Kg
- II. Roots Rice in sizes of 20Kg
- III. Roots Rice in sizes of 10Kg
- IV. Roots Rice in sizes of 5Kg
- V. Roots Rice in sizes of 1Kg
- VI. Roots Rice in sizes of 500g
- VII. Roots Rice (chicken flavour) in sizes of 500g
- VIII. The carriage by sea freight and road freight of Trukai rice, Roots rice, Power rice, Natural Brown rice, Trukai Jasmine, Trukai Basmati and Sunlong Gourmet rice branded products supplied by Trukai Industries Limited from its Lae Mill to its twelve depots of Alotau, Buka, Goroka, Mt Hagen, Kavieng, Kimbe, Lae, Madang, Port Moresby, Popondetta, Rabaul and Wewak.

The Commission notes that Roots Rice chicken flavor is no longer produced and that the 500g Roots Rice pack size was introduced in 2008.

1.4 Review Process

This review was initiated under the provisions of Section 25A (6) of the PR Act. The process followed by the Commission to facilitate public comment and transparency at all stages of the review was:

Stage	Action	Date	Status
1	Public announcement of the inquiry and invitation for submissions to be made to the Commission	23 June 2010	Completed
2	Release of an Issues Paper discussing aspects of the review, major issues that the Commission believes need to be considered, and requesting information and comment from stakeholders including the public	23 June 2010	Completed
3	Release of a Draft Final Report and Draft Final Determination and the invitation of submissions on that Draft Final Report and Draft Final Determination - Completed	20 September 2010	Completed
4	The option to hold public hearings or consultation on the Draft Final Report and Draft Final Determination (Lae/PoM)	5-8 October 2010	N/A
5	Submissions on the Draft Final Report and Draft Final Determination due	15 October 2010	Completed
6	Release of the Final Report and Final Determination (including Final Pricing Order).	22 December 2010	Completed

Copies of submissions received by the Commission in the conduct of this review (unless treated as confidential) are available for public viewing at the Commission's office on a 'Public File' or copies can be obtained from the Commission at a nominal cost for photocopying. This Final Report is also a public document and can be obtained from the Commission's office or through the Commission's website on www.iccc.gov.pg.

This report is the final stage in the review process and includes information from submissions received on the Issues Paper, the Draft Final Report as well as information gathered independently by the Commission as part of this broad investigation. The organisations which provided submissions are listed in Appendix B.

CHAPTER 2 THE RICE INDUSTRY IN PNG

Rice is one of the main sources of carbohydrates in most semi-urban and urban communities in PNG and is becoming a larger part of rural and remote diets. In urban areas, rice consumption constitutes a considerable portion of the average Papua New Guinean household budget. The importance of rice is likely to continue and/or increase as it can be stored for long periods compared to local substitutes. Rice farming is also being successfully promoted in rural areas of PNG.

The rice market in PNG was previously entirely dominated by one company, Trukai. Brand loyalty for Trukai products, particularly Roots Rice which was targeted at low and middle income earners in PNG, remains strong. However, a number of new brands have successfully entered the market.

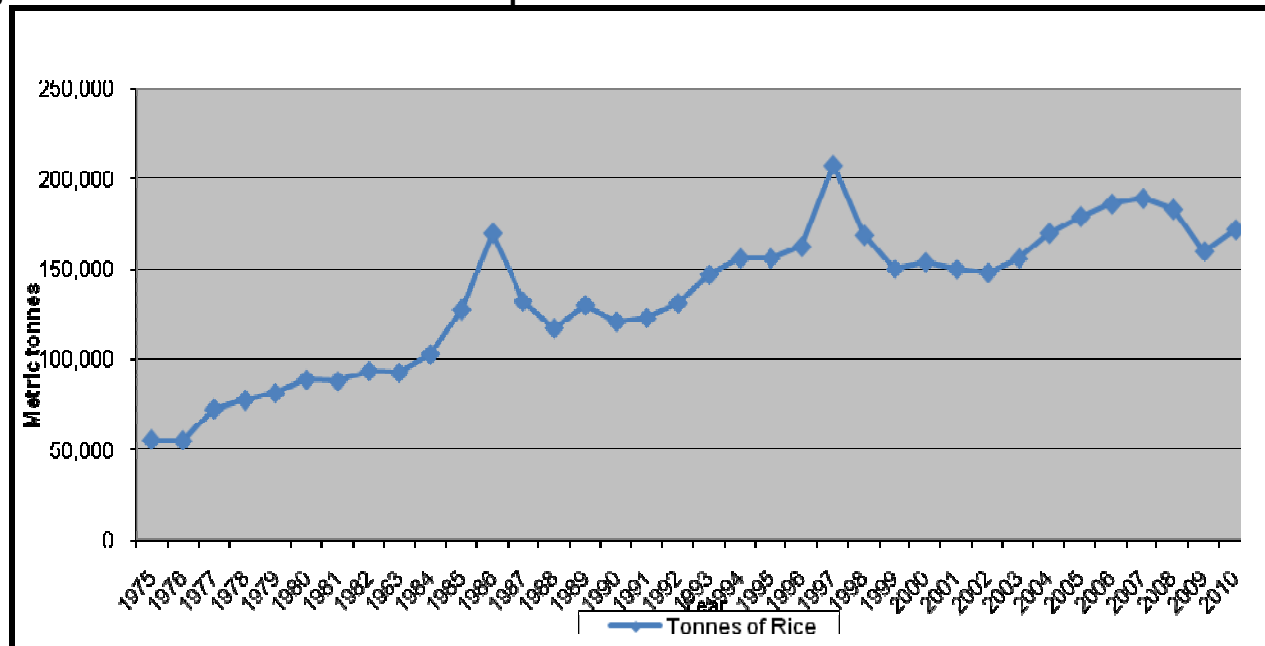
In this Chapter, the Commission has sought to identify and discuss the various aspects of the rice industry in PNG including:

- the market structure;
- Trukai and other importers;
- their relative market shares;
- the wholesale and retail element of the market; and
- the distribution channels to market.

2.1 Market Structure

According to submissions received, an average of 180,000 metric tonnes of rice have been sold in PNG per year since 2006. Estimates for 2010 rice sales are 170,000 tonnes. The Commission notes that domestic production (known as 'garden rice') has averaged 10,000 metric tonnes over the same four year period. The majority of domestic production is used for domestic consumption and/or bartered by farmers so does not enter the formal market in PNG.

Figure 2.1 Estimated Volume of Rice Imported into PNG²



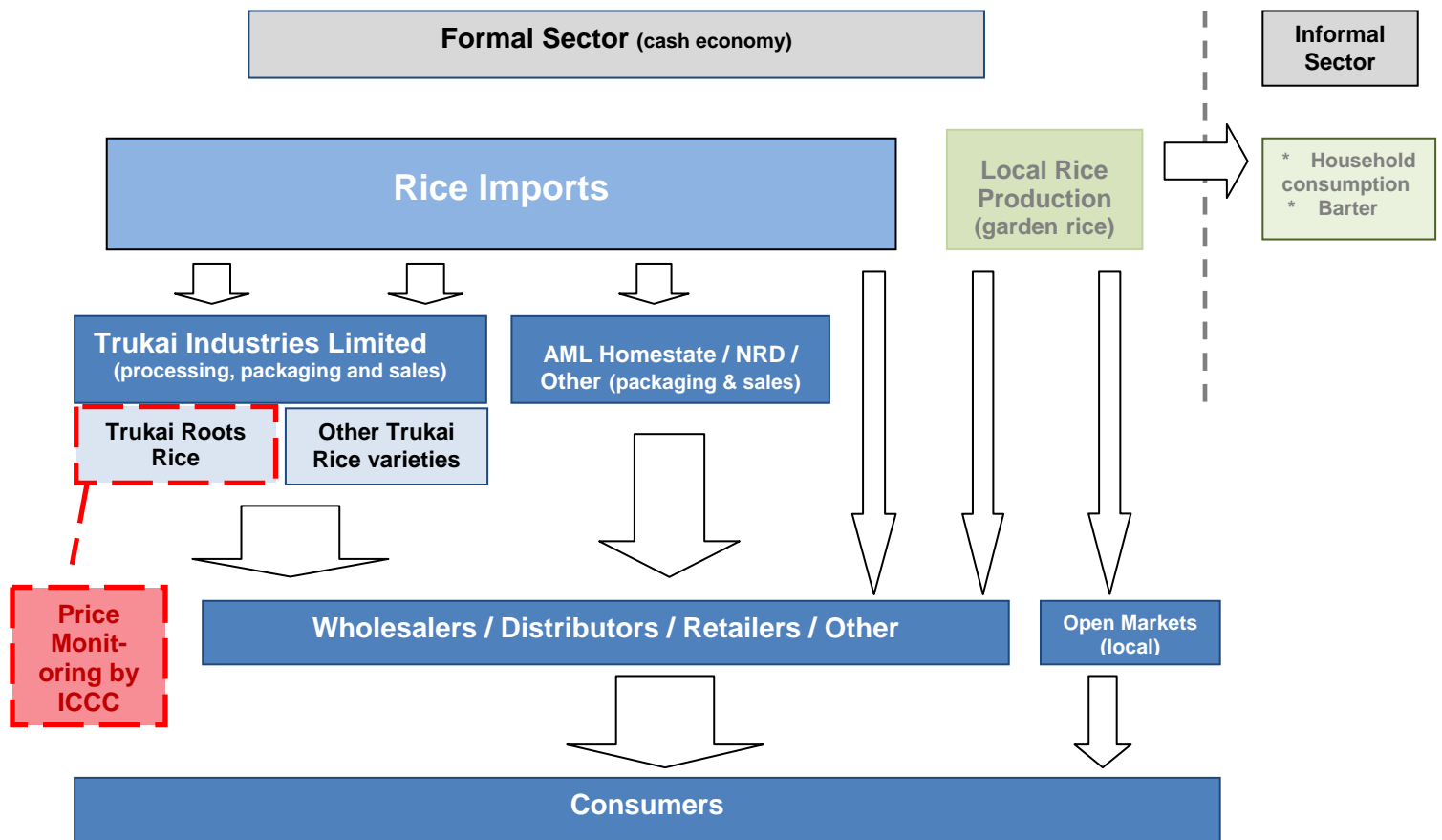
² 2005 Rice Industry Pricing Review – Final Report updated using data submitted in Trukai's Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 18 August 2010

The major players in the rice industry are:

- Major importers – Trukai, Associated Millers Limited (AML), National Rice Distributors (NRD), Homestate Cooperation Ltd, Lam's Trading.
- Other importers – a small number of companies who import packaged rice for wholesale and retail sale.
- Processors – Trukai.
- Wholesalers and Retailers – who supply rice to both commercial and household consumers including garden rice in some areas of PNG.
- Growers – local growers in areas such as Eastern Highlands, Enga, Central, Morobe, East New Britain and the two Sepik Provinces.
- Consumers – rice is consumed across PNG.

The interrelationships between these players in the PNG rice industry and the segment of the industry subject to regulation are shown in Figure 2.2.

Figure 2.2: Basic Market Structure – Rice Market in PNG 2010



The regulated segment of the market (Trukai’s Roots Rice products) account for over 70 per cent of sales in the total rice market.

Local Production

The local production of rice has been encouraged by the PNG Government in recent years through the Department of Agriculture and Livestock, aid agencies and church/NGO groups. This recent policy initiative has been driven by a number of global and domestic factors. The primary reason for the Government’s increased emphasis on local production is for household food security. Increased rice production has been identified as a way to address food security issues in PNG because:

- it can be grown and harvested three times a year; and
- when properly milled, treated and stored, can last for up to three years.

According to estimates received by the Commission during this inquiry, local production of rice has averaged 10,000 metric tonnes per year since 2006. Further consultations suggest that this number may have significantly increased in recent years with rice farming training and extension programs being run by the Department of Agriculture and Livestock through a range of provincial agriculture divisions. This trend is expected to continue. Informal advice provided to the Commission is that the aim of the Department is to increase annual domestic production to 60,000 metric tonnes by 2016.

The Fresh Produce Development Agency estimates that of PNG’s 2010 domestic production:

“some 20 per cent enters the cash economy, another 10 per cent is bartered and 70 per cent is for

subsistence family consumption".³

The local rice that enters the formal cash economy is sold at open markets and trade stores/wholesalers in some rural areas and is known as 'garden rice'. If the production and sale of garden rice continues to increase it has the potential to become a significant component of the formal market.

2.2 Trukai and other importers

Trukai and other importers source their rice from Australia, Thailand, Southern China, Vietnam, the United States, Malaysia and the Middle East.

Imports of rice, unlike some other commodities in PNG, are not subject to tariffs or quotas. The five major importers are discussed in the table below.

Trukai Industries Limited - all Trukai branded products including Roots Rice
<p>Trukai is a PNG based company part owned by Rice Grower's Cooperative Limited of Australia and part owned by the Melanesian Trustee Services Limited as Trustee for the Pacific Balance Fund. It operates a processing facility in Lae, Morobe Province, where it undertakes blending and packaging of rice grain. Trukai is the most established brand of rice in PNG and has operated in PNG since 1970. Trukai's imports include short grain, medium grain and long grain rice which it sources from the international market.</p> <p>Trukai has seven brands including Trukai Rice, Roots Rice, Power Rice, Natural Brown Rice, Trukai Jasmine, Trukai Basmati and Sunlong Gourmet Rice. Trukai operates a National Price List which sees it charge the same price for each variety in the main ports of Lae, Goroka, Port Moresby and Rabaul irrespective of differences in the cost of supplying rice to these areas due to differing freight costs.</p>
Associated Mills Limited (AML) – Mother's Choice rice
<p>AML is a subsidiary of Goodman Fielder International (PNG) Limited which owns 74 per cent of AML's shares. The remaining shares are held by Melanesian Trustee Services Limited on behalf of the Pacific Balanced Fund. AML imports packaged rice, primarily from Thailand, into PNG and distributes it through its distribution facilities in Port Moresby and Lae. AML sells and distributes its rice products under its Mother's Choice brand. AML's Flame brand was sold in PNG until 2007/08 but has been discontinued. All rice is sold ex factory gate with transport charged on at cost.</p>
Homestate Cooperation Limited - all Homestate brands
<p>Homestate Cooperation Limited (Homestate) is a Thai owned company that is based in Lae. Homestate primarily imports rice from Thailand and distributes it from depots in Lae, Port Moresby and Mt Hagen as well as through other wholesalers. Homestate has six varieties: Jasmine, Good White, Good Brown, Star Rice, Super A-1, and Sweet Rice. Star Rice and Super A-1 brands are medium grain rice, all other brands are long grain. All rice is sold ex factory gate from Lae with transport charged on at cost.</p>
National Rice Distributors - Ezycook Rice, Yummi, Trucook and Royal Jasmine
<p>National Rice Distributors (NRD) are based in Lae. NRD imports pre-packaged long grain rice from Thailand and sells it to wholesalers and retailers from its depots in Lae and Port Moresby. NRD has been selling its Ezycook rice brands in PNG since 2003 and has seen increased sales from 2008. As with AML and Homestate, NRD sell rice at factory gate prices and charge transport at cost.</p>

³ Fresh Produce Development Agency Submission on 2010 Rice Industry Pricing Review Issues Paper, 20 July 2010

Lam's Trading – all Golden Phoenix brands

A new importer in the rice market is Lam's Trading. Lams Trading is reported to have entered the PNG market in early 2010. They import rice primarily from Thailand and sell it under the "Phoenix Rice" brand in urban areas including in cities in the highlands.

Importers either import rice that is pre-packaged or in bulk quantities for packaging in PNG. Rice comes in pack sizes ranging from 500g to 25kg and is distributed to major customers such as caterers, wholesalers and retail outlets/supermarkets. To date medium grain rice, the main ingredient of Roots Rice, is preferred by the majority of PNG consumers and makes up over 70 per cent of total rice sales. Roots Rice's popularity comes from Trukai being the main importer in PNG for so long. In effect Trukai has set the preferred standard for 'taste' in terms of pre-packaged rice.

In addition to larger importers, data independently sourced by the Commission indicates that since 2005 there are over 60 companies (supermarkets, wholesalers, catering companies and private institutions) across PNG who have imported rice either for their own use or for resale.

Box 1: Rice Brands and Varieties in PNG

There are a range of brands of rice available in PNG, particularly in urban areas. The table below provides information on brands, rice varieties and where the company usually sources their rice. The Commission notes that importers seek the lowest possible rice price and sources can vary from month-to-month and year-to-year. (Data sourced from consultations as part of this review)

Company	Brand	Variety	Country of Origin <small>(primary source)</small>
Trukai	Roots	Short and Medium grain	Aust/US/China
Trukai	Trukai	Medium grain	Aust/US/China
Trukai	Power	Long grain	Aust/US/China
Trukai	Natural Brown	Long grain	Aust/US/China
Trukai	Trukai Jasmine	Long grain	Aust/US/China
Trukai	Sunlong Gourmet	Long grain	Aust/US/China
Homestate	Star	Long grain broken	Thailand
Homestate	Super A-1	Long grain broken	Thailand
Homestate	Star Jasmine	Long Grain	Thailand
Homestate	Good White	Long Grain	Thailand
Homestate	Good Brown	Long Grain	Thailand
Homestate	Sweet Rice	Long Grain	Thailand
NRD	Ezycook	Long Grain	Thailand
NRD	Yummi	Long Grain	Thailand
NRD	Royal Jasmine	Long Grain	Thailand
NRD	Trucook	Long Grain	Thailand
AML	Mothers Choice	Long Grain	Thailand
Seeto Kui	King rice	Short and Medium grain	Australia
Lams Trading	Golden Phoenix Jasmine	Long grain	Thailand
Lams Trading	Golden Phoenix Rice Jasmine blue	Long grain	Thailand

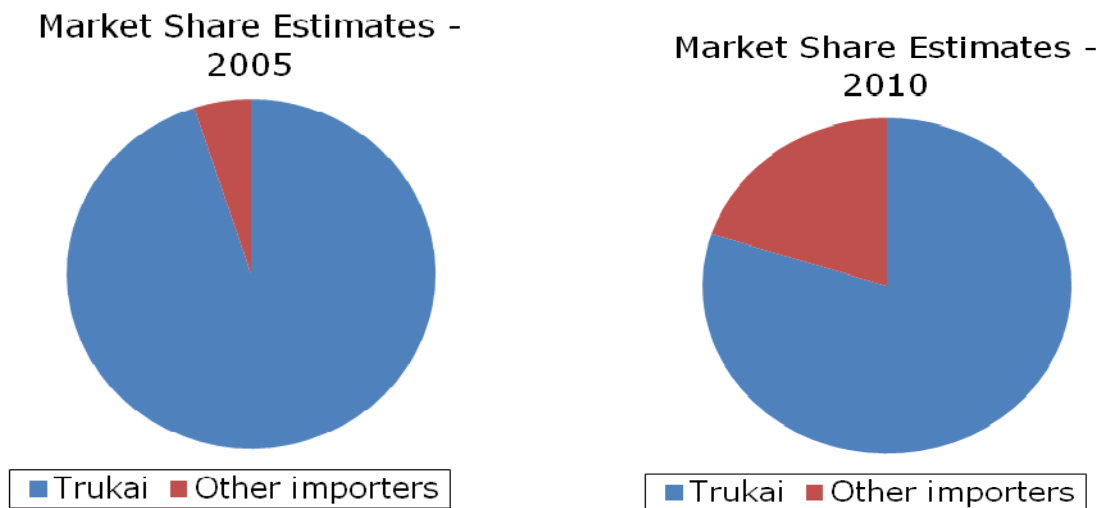
2.3 Market Share

Exact figures on market share in the PNG rice market are commercial-in-confidence. However, submissions and consultation indicate that market share is changing with Trukai losing market share and its competitors (other importers) increasing market share. Based on the Commission's high-level

indicative analysis, since 2000 Trukai has experienced a decline in market share from almost 100 per cent to approximately 95 per cent in 2005 to around 80 per cent in 2010.

Consultations undertaken by the Commission indicate that medium grain rice, primarily Roots Rice, makes up over 70 per cent of sales in PNG. While this is a significant portion of the market the Commission has been informed that it has been steadily declining since more varieties have become available.

Figure 2.3 Market Share Estimates for Trukai in 2005 and 2010⁴



Overall, the Commission notes that Trukai's Roots Rice variety still maintains a large amount of market share. However, the changing market shares and increased number of importers is an indication of competition in the rice industry. This issue is discussed in detail in Chapter Four.

2.4 Wholesale and Retail rice markets

The wholesale rice market in PNG consists of importers and wholesalers. Importers have been discussed in Section 2.2 above - Trukai, Associated Mills Limited, National Rice Distributors, Homestate Cooperation Ltd and Lams Trading. These companies have established warehouses/depots in larger centres such as Port Moresby and Lae. Rice is then distributed to other centres and locations around the country through their depots and authorised outlets. In addition to the importers of rice, the following large wholesale businesses in PNG (who purchase from the importers and then on-sell) are also active in the rice industry:

- Seeto Kui Holdings Ltd (Seeto Kui);
- Patricks;
- BNG Trading;
- TST Trading; and
- Super Value Stores or SVS.

These businesses and other wholesalers supply a wide variety of household products and food items to retailers, including rice. In addition to supplying rice to consumers, Seeto Kui has established their own

⁴ Estimates based on data collected from submissions as well as consultation undertaken by the Commission as part of this review. Exact figures are commercial in confidence.

brand of rice, King Rice. King Rice is a medium grain rice that is purchased from Trukai. It is sold through Seeto Kui distribution networks to other wholesalers as well as retailers.

The retail sector in PNG consists of all formal and informal businesses responsible for selling household products to consumers. The provision and sale of rice products at the retail level is undertaken by supermarkets and smaller stores. Retailing activities are independent from the operations of importer's activities. However, in certain cases retailers also directly import rice and sell it to consumers.

As noted previously, wholesale and retail margins were previously regulated at 10 per cent and 11 per cent respectively. This price control has now been removed as a result of the Commission's 2009 Wholesale and Retail Industry Review.

In addition to rice sold in retail stores, open markets also sell rice directly to consumers. The Commission understands that at this time, the only rice products sold in open markets are excess locally grown rice known as 'garden rice'.

2.5 Distribution channels to market

Rice is normally imported to main depots in Lae (and to a lesser extent Port Moresby) and then distributed to more regional centres using domestic coastal sea and inland road transportation networks. In a limited number of cases, importers import directly to coastal depots, for example Rabaul.

Wholesalers and retailers then purchase rice from these depots and resell it through their various networks. In general, wholesalers and retailers purchase rice at the importer's factory gate with freight arranged and paid for by the rice purchaser. Land deliveries are managed by trucking companies with coastal shipping companies managing sea transport.

Under the current regulatory arrangements, the Commission monitors freight costs provided on a quarterly basis by Trukai Industries. Monitoring is of freight charges from its processing facility in Lae to its eleven depots of Alotau, Buka, Goroka, Mt Hagen, Kavieng, Kimbe, Madang, Port Moresby, Popondetta, Rabaul and Wewak.

CHAPTER 3 FRAMEWORK FOR ANALYSIS

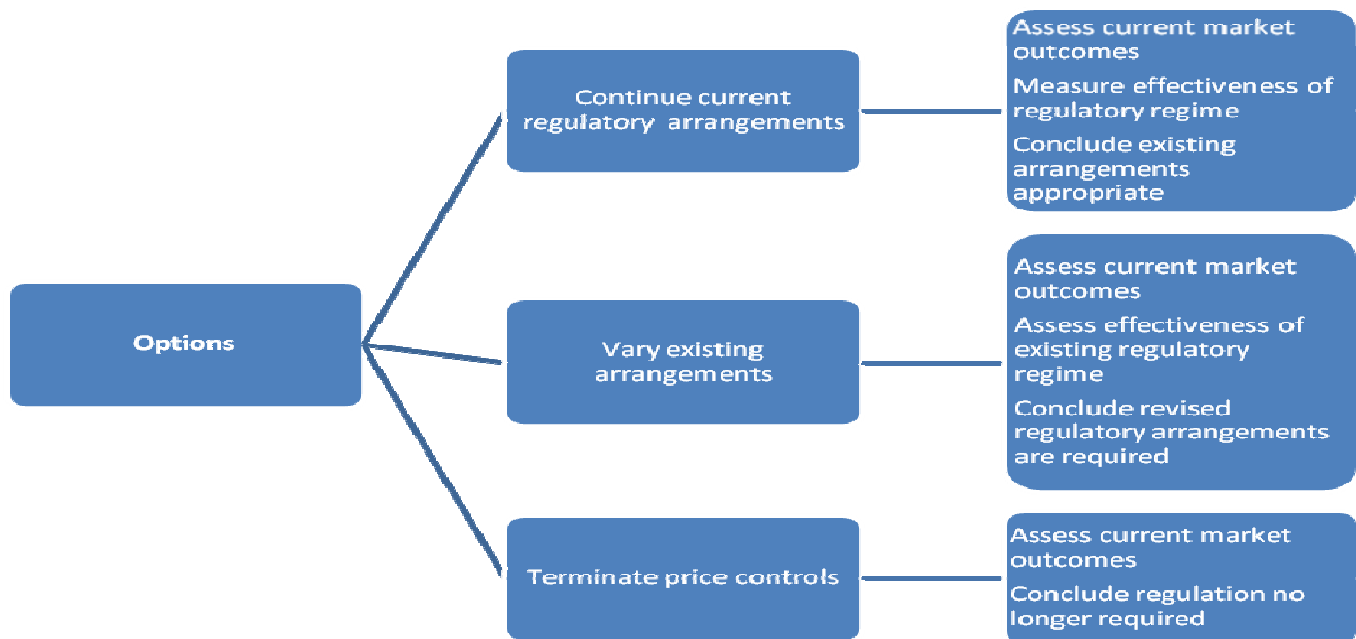
3.1 Introduction

This chapter outlines the analytical framework the Commission will adopt when assessing the state of the PNG rice market. In assessing the market the Commission is required, under the provisions of Section 25C(3) of the *Prices Regulation Act*, to consider whether to:

- Continue to operate price control arrangements in their present form;
- Vary the existing price control arrangements; or
- Terminate the existing price control arrangements.

The steps in this process are represented diagrammatically in Figure 3.1.

Figure 3.1: Commission’s considerations and appropriate steps



In order to make a decision regarding these matters, the Commission must address issues surrounding the competitive nature of the PNG rice market. This chapter:

- discusses the rationale for using competition as the basis for assessing possible changes to the existing arrangements;
- defines what is meant by a competitive market; and
- establishes the assessment criteria the Commission will use when making judgments regarding the competitive state of the market.

3.2 Rational for Competition as the Basis for Assessment

The primary objectives of the Commission as specified in Section 5 of the *Independent Consumer and Competition Commission Act 2000* (ICCC Act) are:

- to enhance the welfare of the people of Papua New Guinea through the promotion of competition, fair trading and the protection of consumers' interests;
- to promote economic efficiency in industry structure, investment and conduct; and
- to protect the long term interests of the people of Papua New Guinea with regard to the price, quality and reliability of significant goods and services.

Competition is normally the most effective way to ensure that the interests of consumers are protected and enhanced. Where competition is effective in promoting economic efficiency, there is generally no need for market intervention in the form of price regulation. Regulated prices will almost always be an imperfect substitute for prices determined by competitive processes and are likely to impose costs and distortions not present in a competitive market. Because regulators have imperfect information, regulated prices are likely to be set either too low deterring investment and innovation, or too high, to the detriment of consumers. Further, regulated prices often lack the flexibility of market prices. Price regulation is therefore justified only where markets are not competitive, where regulation can improve market outcomes, and the benefits exceed the costs.

Section 5 of the ICCC Act also notes that in seeking to achieve the above primary objectives, the Commission shall have regard to the following facilitating objectives:

- to promote and protect the bona fide interests of consumers with regard to the price, quality and reliability of goods and services;
- to ensure that users and consumers (including low-income or vulnerable consumers) benefit from competition and efficiency;
- to facilitate effective competition and promote competitive market conduct
- to prevent the misuse of market power;
- to promote and encourage the efficient operation of industries and efficient investment in industries;
- to ensure that regulatory decision making has regard to any applicable health, safety, environmental and social legislation; and
- to promote and encourage fair trading practices and a fair market.

The common theme of the above primary and facilitating objectives is competition. Competition in the provision of a good exists where there is rivalry (or potential rivalry) between two or more businesses seeking to secure the business of a customer. In order to obtain the business of any individual customer, the businesses are under pressure to offer the most attractive product in terms of price and quality, and in some instances also the level of service.

Competition drives companies to continually seek new and improved ways of providing products and services. Competition can be thought of as delivering more efficient production in three ways.

Productive efficiency. Competition for customers requires that companies continually seek the lowest cost way of producing their products and services. If a new business can enter a market and produce and sell the same product at a lower price, any existing businesses can expect to lose market share and may be forced out of business. Competition therefore compels businesses to continually seek to reduce costs.

Allocative efficiency. Competition for inputs among businesses selling differing products directs resources of the economy to where they are most valuable. This ensures that society as a whole is better off because the limited resources of the economy are being used in the most effective and efficient manner.

Dynamic efficiency. Competition compels businesses to seek new and improved ways of doing things.

For example, if a business is able to invent a new and more efficient way of manufacturing its product (or create an entirely new product), it will benefit by attracting additional customers.

The overall effect of competition is to drive businesses to produce goods and services at least cost, allocate the labour and material inputs to the production of goods and services to where they are most valued, and to seek new and improved ways of serving customers. However, competition is not an end in itself. Rather, competition is in most situations the most effective mechanism by which customers receive low priced, high quality products suited to their needs.

Based on the primary objectives and facilitating objectives of the ICCA Act and the above discussion, it is the Commission's view that competition in the provision of a good, such as rice, is the most effective way to protect the long-term interests of consumers and deliver efficient prices to customers. It is for this reason that the Commission is considering the competitive state of the PNG rice market as an important issue when assessing whether to continue, alter or cease the existing pricing monitoring arrangements.

This approach is evident in other reviews and inquiries undertaken by the Commission such as its recent review into the Wholesale and Retail Market. The conclusion of this review was that there was no longer a need for regulation of wholesale and retail margins, particularly for the staple consumer goods of flour, rice and sugar.

3.3 What is a Competitive Market?

The definition of a competitive market described in textbooks exists rarely, if at all, in the real world. As such, it is necessary for the Commission to adopt a real-world definition that it can be applied usefully. The approach often adopted is to consider whether a market is 'effectively competitive'. Where a market is 'effectively competitive' (sometimes also referred to as 'workably competitive'), there is sufficient rivalry between businesses to ensure that they strive to deliver the goods and services consumers demand at least cost, and for product and process improvement. Effective competition will also ensure resources move relatively freely between and within markets in response to consumer demand and price signals. Consumers in an effectively competitive environment will also have access to a reasonable degree of information to allow them to make choices and participate in the market. Businesses in an effectively competitive market may have a degree of market power associated with product differentiation or innovation, but that market power will not be substantial or sustainable and will be subject to competitive erosion over time. At any particular point in time, resources may not be employed in their most valuable use, prices may deviate from costs and technologies can deviate from the most efficient ones available. However, over time, effective competition will drive the market towards efficient outcomes. Businesses will continuously strive for competitive advantage against actual and potential rivals, they will seek out new profit opportunities to deliver the goods and services consumers want, and the market may always appear to be in a state of disequilibrium and change. This is the very essence of real world dynamic competition.

The Commission's approach to evaluating effective competition is guided by the approach adopted in the development and application of competition law and policy. The following definition of effective competition has been applied by the Australian Competition Tribunal:

"As was said by the U.S. Attorney General's National Committee to study the Antitrust Laws in its report of 1955 (at p. 320): 'The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new or potential entrants in the field, would keep this power in check by offering or threatening to offer effective inducements...'"

Conversely, the Hilmer Committee identified the characteristics of markets in which effective competition

does not exist:

“Where the conditions for workable competition are absent – such as where a firm has a legislated or natural monopoly, or the market is otherwise poorly contestable – firms may be able to charge prices above the efficient level for periods beyond those justified by past investments and risks taken or beyond a time when competitive response might reasonably be expected. Such ‘monopoly pricing’ is seen as detrimental to consumers and to the community as a whole.”

The extent of competition within a market may also vary over time. Maturing markets can be characterised as progressing towards a more competitive state as shown in Figure 3.2.

Figure 3.2: The continuum of competition



In addition, the dynamic nature of markets over time demands that a forward looking approach to the state of a market be adopted. Clearly, regard must be had to evidence of what has actually been happening in a market but the most important question is: what is likely to happen going forward? With the absence of decisions under Papua New Guinea law in relation to the ICCA Act, the Commission has been guided in its analysis by the forward-looking approach of the High and Federal Courts of Australia and the Australian Competition Tribunal. These entities identified the benefits of analysing competition using a forward-looking approach:

“In our judgment, given the policy objectives of the legislation [the Trade Practices Act], it serves no useful purpose to focus attention upon a short-run, transitory situation... This does not mean we seek to prophecy the shape of the future – to speculate upon how community tastes, or institutions, or technology might change. Rather, we ask of the evidence what is likely to happen to patterns of consumption and production were existing suppliers to raise price or, more generally, offer a poorer deal. For the market is a field of actual or potential rivalry between firms.”

The Commission, in its assessment of the PNG rice market, will be guided by the definition of an effectively competitive market while noting that markets change and evolve over time and that a forward-looking approach is appropriate.

3.4 The Commission’s Assessment Criteria

The Commission in considering the competitiveness of the PNG rice market will investigate a wide range of real-world market characteristics. The market characteristics to be investigated are listed and discussed below. Chapter 4 will examine these characteristics with specific reference to the PNG rice market.

- Barriers to entry (and exit) for new participants / Import Competition;
- Substitute products;

- Competition between existing market participants;
- Countervailing market power; and
- Exercise of choice by customers.

3.4.1 Barriers to entry (and exit) for new participants / Import Competition

In any typical market, barriers to entry can be detrimental to effective competition. In simple terms this is because barriers to entry restrict the ability of new businesses to enter a market and compete against existing participants. If barriers to entry are high, then competitive constraints will depend on existing rivals. Barriers to entry can be artificial or natural due to factors such as regulation (e.g. government monopoly, tariffs) or economies of scale in production.

Sunk costs, a potential barrier to exit, can also be a barrier to market entry. Any potential firm considering a large investment in plant infrastructure would also consider its potential costs associated with its exit from the market. If these potential costs were significant, it may reconsider entering the market.

Imported goods can compete with those produced locally. A business that can import a product can avoid the need to establish its own operations locally and may therefore potentially avoid the factors contributing to the barriers to entry and exit discussed above. The extent to which imports may contribute to an effectively competitive market depends on the cost of importing these goods which in turn is reliant on factors such as the cost of shipping and tariffs.

The threat of competition via imports, without the actual delivery of goods, can also increase the efficiency and competitiveness of a market. For example, an existing market participant may be constrained in their actions given that an importer may be able to quickly arrange a shipment and undercut any inflated prices.

In a very real sense import competition, and the potential threat of import competition, may be a more effective check on uncompetitive behaviour than the threat of direct market entry and competition. This is the case given that an importer may be able to source products quickly and without having to incur the costs associated with establishing a factory, thereby avoiding the barriers to entry and exit identified above.

3.4.2 Substitute products

The existence of substitute products can influence the competitiveness of a market. If consumers are not beholden to a specific product and are able to shift their consumption from one product to another, the producer is constrained in their ability to charge above efficient prices. As such, the existence of substitutes can reduce the ability of a producer to take advantage of market power, thereby increasing the competitiveness of a market and the economy overall.

3.4.3 Competition between existing market participants

Competitive markets normally exhibit competition between existing market participants. This competition keeps a continual check on prices and forces the participants to consider new and improved ways of operating in order to maintain and attempt to increase their market share.

Competition between existing market participants is characterised by activities such as businesses actively seeking new customers and businesses developing new products and services.

3.4.4 Countervailing market power

Countervailing market power exists where a consumer either directly or indirectly demands or induces some degree of influence to cause the supplier to amend its supply arrangement or vary the price of its good by succumbing to the demands of the consumers. Countervailing market power exists normally where a customer is a major customer or consumer of the good supplied. As such, it may be the case that some, but not all, customers have a degree of countervailing market power.

3.4.5 The exercise of choice by customers

Competitive markets are normally characterised by an ability of a segment of the customer base to access relevant information and exercise choice in their purchases. The ability of a segment of the customer base to exercise choice and switch between competing products compels producers to offer goods at competitive prices and with a high level of service. If a producer does not offer goods at competitive prices, a decision by customers to switch to alternative suppliers offering more competitively priced goods will lead a loss of market share and may lead to a producer going out of business. The more active customers are in responding to the offers of businesses, the greater the pressure on businesses to set efficient prices.

CHAPTER FOUR – SUMMARY OF THE COMMISSION’S DRAFT FINAL REPORT

4.1 Introduction

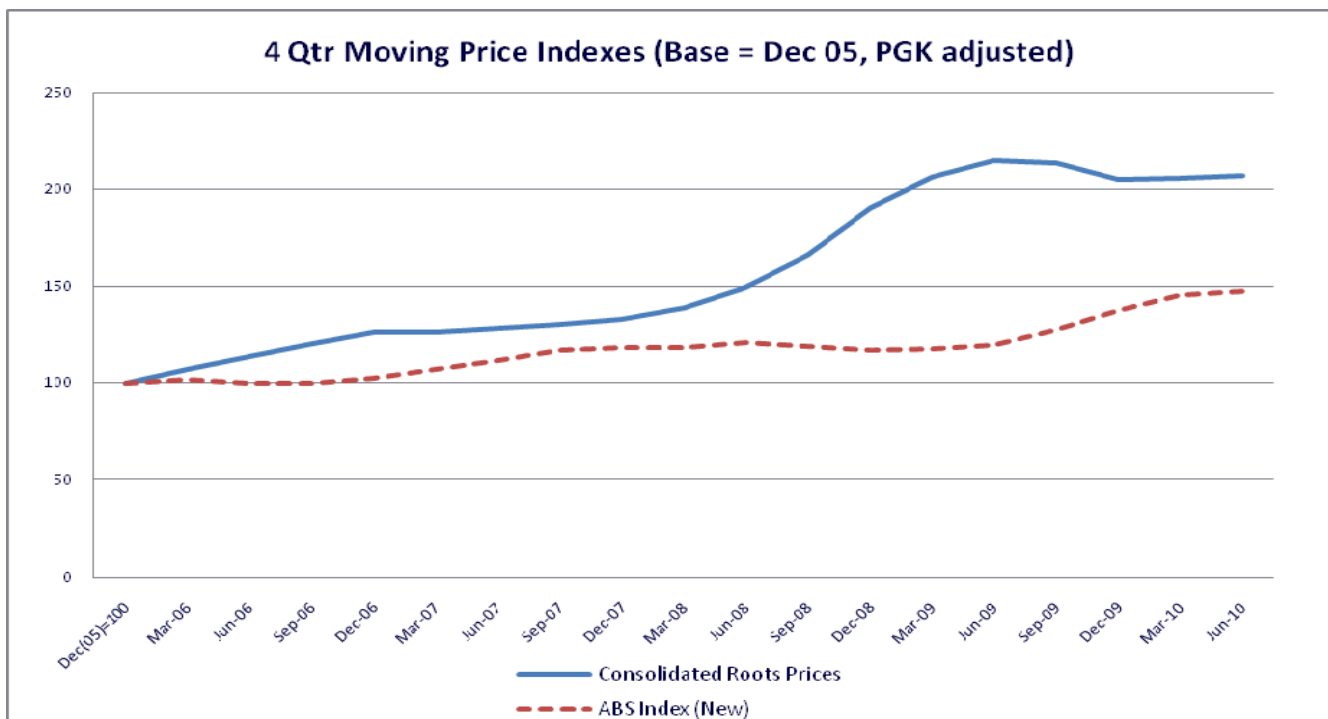
The Commission released its Draft Final Report on 20th September 2010. The Commission’s preliminary assessment of the PNG rice market and form of regulation as described in the Draft Final Report is summarised in this Chapter.

4.2 Commission’s Preliminary Assessment of the PNG Rice Market and Price Monitoring Arrangements

The Commission evaluated the competitive state of the PNG rice market against the five assessment criteria outlined in Chapter 3. The Commission’s analysis against this framework indicated that there was significant competitive pressure in the PNG rice market.

The Commission then considered the outcomes of the rice price monitoring arrangements established in 2005. The consolidated outcomes of these arrangements are shown in Figure 4.1.

Figure 4.1: Consolidated rice price monitoring results

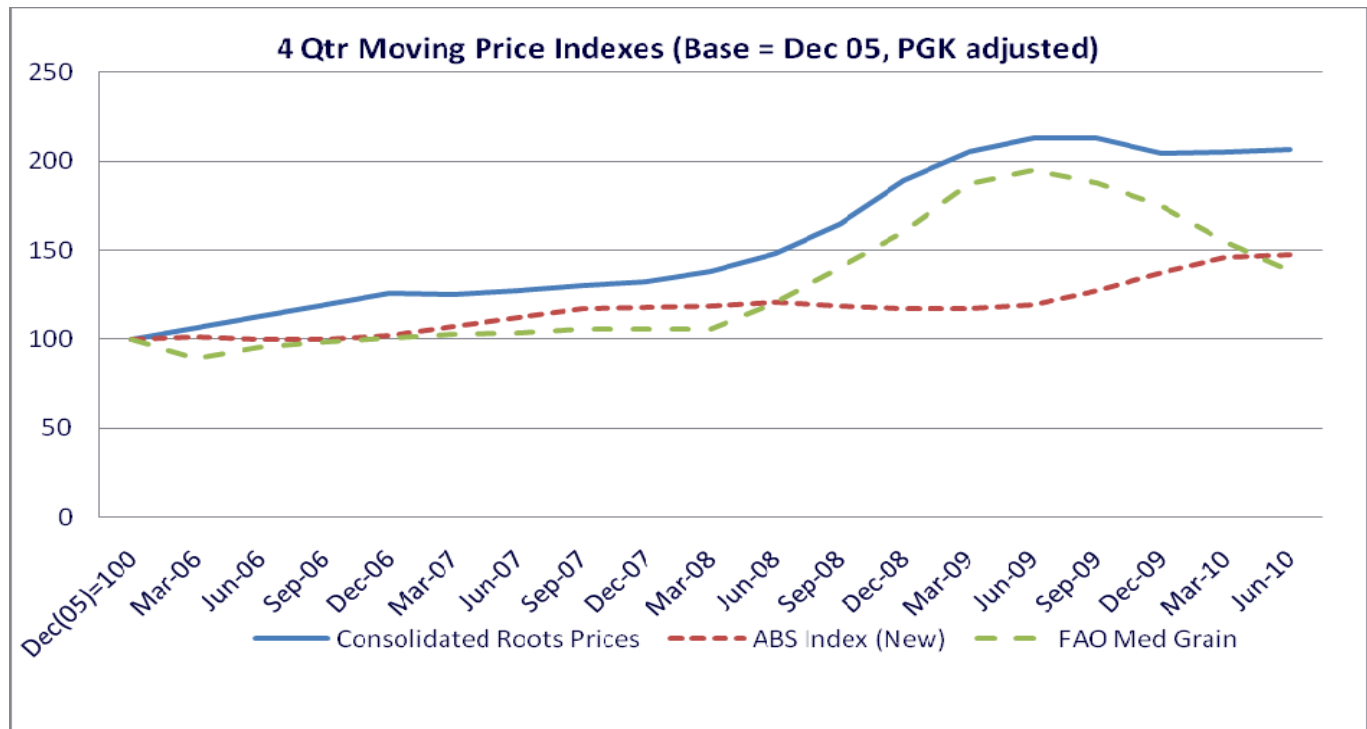


Given the divergence between the Roots Rice index and the ABS index, the Commission was compelled to investigate the reasons for this divergence. In 2008 the commission sought a written explanation from Trukai on the causes of the divergence.

As part of its analysis, the Commission calculated the international price of medium grain rice based on the Food and Agriculture Organization (FAO) statistics⁵ and converted it to PGK to create a medium grain index (given that the ABS index is based on long grain rice). The FAO medium grain index is shown in Figure 4.2.

⁵ Refer www.fao.org.

Figure 4.2: FAO Medium Grain and Price Monitoring



The Commission concluded that the divergence between the ABS index (based on prices for long grain rice) and the PNG index was the result of:

- the spike in international medium grain prices seen in the FAO data; and
- the likely purchasing strategy employed by Trukai to guarantee supply (such that Trukai forward purchased grain when the price for medium grain rice was high).

The Commission’s preliminary finding was that there is value in continuing with some form of price monitoring given recent developments related to increased landing and in-country costs as well as uncertainty in the PNG economy from investments such as the LNG project

4.3 Commission’s Preliminary Assessment of the PNG Freight Market and Price Monitoring Arrangements

The arrangements established in 2005 included the monitoring of sea and road freight charges. The Commission assessed the competitive state of the freight market and evaluated the data received via the monitoring mechanism. Based on this analysis, and the outcomes of the Commission’s 2007 *Review of the PNG Coastal Shipping Industry*, the Draft Final Report concluded that there was evidence of competition in the freight market. As such, the Commission concluded that it was appropriate to cease monitoring freight costs.

4.4 Commission’s Preliminary Assessment of the Form of Regulation

With respect to the rice market, the Commission stated its preference to maintain the existing monitoring arrangements based on the ABS index and the price of the range of Trukai rice products. In addition, the Commission stated its preference to retain the option of seeking additional information from Trukai (and from alternative sources such as the FAO) if the ABS and PNG indexes diverged further. Given the

Commission's finding that the market exhibited many of the characteristics of an effectively competitive market, the Draft Final Report also included an ability for Trukai to approach the Commission after 1st July 2013 and seek to have the price monitoring arrangements removed.

With respect to the freight monitoring arrangements, given the conclusion to cease monitoring freight costs, no form of regulation was necessary.

CHAPTER 5 COMMISSION'S FINAL ASSESSMENT OF THE PNG RICE MARKET AND PRICE MONITORING ARRANGEMENTS

5.1 Introduction

This Chapter:

- sets out the real-world characteristics of the PNG rice market against the assessment criteria developed by the Commission;
- analyses the market based on the information obtained via the price monitoring approach developed in 2005; and
- presents the Commission's findings.

5.2 Discussion against the Commission's Assessment Criteria

The discussion in the following Sections is based on the following approach:

- Commission's analysis in the Draft Final Report;
- Submissions on the Draft Final Report; and
- Commission's Final Conclusions.

5.2.1 Barriers to entry (and exit) for new participants / Import Competition

There are no tariffs applicable to the import of processed or unprocessed rice into PNG as these have been removed over recent years. As such, there are no artificial barriers to entry for an importer considering entering the PNG market relative to a local manufacturer. A potential importer can swiftly enter the market as long as it can source rice that meets PNG health standards for vitamin enrichment and can successfully arrange for import, storage, distribution and marketing of its product.

Commission's Analysis in the Draft Final Report

The Draft Final Report noted comments in response to the Issues Paper. In response to the Issues Paper, Trukai noted that there are no legislative or other barriers to entry and AML stated that:

There are no current barriers to entry for competition. Regulatory provisions for the set up of business for entry into the market are not intrusive and that potential entrants have regulatory framework appropriate to facilitate business entry or exit based on commercial risk considerations.⁶

In preparing the Draft Final Report, the Commission investigated whether the requirement that all rice be vitamin enriched was acting as a barrier to entry to the rice market. Consultation with rice importers determined that the vitamin enrichment process is relatively simple and inputs are widely available. This means that potential importers can easily source vitamin enriched rice that meets PNG's import standards. As such the Commission determined that vitamin enrichment does not represent a significant barrier to entry.

The Commission stated that because there are no artificial barriers to entry into the PNG market, imports (and potential imports) have the ability to exert significant competitive pressures on those businesses

⁶ Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, Associated Mills Limited - Goodman Fielder PNG, 23 June 2010

already operating in the PNG rice market. Based on an analysis of information provided by the Internal Revenue Commission (IRC), over 60 different businesses have imported rice since 2005. Import volumes range from amounts to service one catering facility to bulk purchases by the larger rice importers. Imports are sourced from different countries depending on volume availability, price and security of supply.

The Commission also noted that the number of major importers has also increased over recent years. Information provided by Trukai, NRD, Homestate and AML demonstrated that competition between the different rice brands, which includes different rice varieties (medium and long grain), has significantly increased over the last five years. The information provided is summarised in Table 5.1.

Table 5.1 Number of major rice brands in PNG 2005-2010⁷

Importer	Number of Brands 2005	Number of Brands 2010
Trukai	6	5
Homestate	2	6
NRD	1	4
AML	1	1
Lams Trading	0	2
King	0	1
Total	10	19

In the Draft Final Report the Commission noted that over the last five years, the number of rice brands and varieties had increased from 10 to 19. Based on the evidence available, the Commission stated that it was clear that importers are active in the market. In addition to importers entering the market, the Commission stated that it understood that there is interest from domestic and international companies in establishing further rice milling or processing facilities in PNG.

The Commission concluded that based on the evidence available there are minimal barriers for a new entrant to enter PNG and begin supplying rice. The Commission stated that this conclusion was supported by the increase in the number of participants in the market and the information that companies were considering the establishment of further rice milling and processing facilities in PNG.

Submissions on the Draft Final Report

The Institute of National Affairs stated that:

The ICCC report is correct in that the PNG rice market has no real artificial imposed barriers to entry. In fact this has long been the case, in that, although Trukai Rice long held a dominant position in the industry, there were no officially sanctioned restrictions to entry.⁸

The Institute of National Affairs also stated that:

There has been a requirement of vitamin enrichment, but, as the ICCC report states, this is a simple and low cost process and should not restrict market access by firms wishing to enter PNG's market.⁹

⁷ Trukai's Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 18 August 2010; Homestate Submission to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 24 August 2010; Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, Associated Mills Limited - Goodman Fielder PNG, 23 June 2010; consultation with NRD.

⁸ INA submission on the Draft Final Report, pg 1.

⁹ INA submission on the Draft Final Report, pg 1.

Commission’s Final Conclusions

The Commission maintains its view that there are minimal barriers to entry for a prospective market entrant.

5.2.2 Substitute products

The existence of substitute products can reduce the ability of a producer to take advantage of market power, thereby increasing the competitiveness of a market and the economy overall.

Commission’s Analysis in the Draft Final Report

In the Draft Final Report, the Commission considered whether there were any substitutes which exerted competitive pressure on the rice market and therefore constrained the ability of Trukai to charge inflated prices for its Roots Rice products.

In most urban and semi-urban areas potential substitutes to rice are flour or flour based products such as bread, biscuits and noodles/pasta. These products are generally imported and available from the same retailers who offer rice. In response to the Issues Paper AML stated:

There are adequate sources of alternatives to rice as a source of carbohydrates within PNG. Evidence of this is provided by the sizeable flour market and the growth in imported noodle categories. Locally cultivated foodstuffs also continue to offer alternatives¹⁰.

The Draft Final Report stated that locally grown rice and fresh produce represented a real substitute for imported rice. The Commission stated that this was particularly the case in urban centres outside Port Moresby or rural areas where local products are often cheaper than imported rice and are readily available in local open markets and supermarkets. In Port Moresby, the high cost of transportation and the perishable nature of these products make them expensive relative to rice. As a result, the Commission noted that these local carbohydrates are not necessarily consumed as substitutes to rice in Port Moresby.

Possible substitutes for imported rice		
Port Moresby	All Other Areas	
<ul style="list-style-type: none"> • Flour • Bread • Noodles • Pasta 	<ul style="list-style-type: none"> • Flour • Bread • Noodles • Pasta • English potatoes 	<ul style="list-style-type: none"> • Bananas • Kaukau • Taro • Yams • Garden rice

In its submission on the Issues Paper, the Fresh Produce Development Agency stated that:

There has always been competition between rice and flour on one hand with local vegetable substitutes. Traditionally cheap and stable prices for rice and flour have not given much evidence of this happening.

The above has changed with the occasional spike in agricultural prices affecting rice. The trigger for domestic competition to affect the level of rice sold occurred when the supermarket price of rice rose above K3.00 a kilo.¹¹

The Commission stated that the statement from the Fresh Produce Development Agency suggested that there is a switch in demand from imported rice to other goods when the price of imported rice reaches a

¹⁰ Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, Associated Mills Limited - Goodman Fielder PNG, 23 June 2010

¹¹ Fresh Produce Development Agency Submission on 2010 Rice Industry Pricing Review Issues Paper, 20 July 2010.

certain point. It is the Fresh Produce Development Agency's view that rice prices above K3.00 per kilo trigger increased substitution of vegetables for consumption over rice.

The Commission concluded that consumers have a variety of options depending on where they live. It noted that it is likely that these alternatives exert a degree of competitive pressure on the sale price of rice. In urban centres outside Port Moresby and rural environments the Commission stated that it considered that a range of substitutes were readily available, and due to their relative affordability, represented a real alternative to imported rice. However, in Port Moresby where local substitutes are relatively expensive, the Commission stated that it thought it unlikely that the range of substitutes available was able to exert sufficient pressure on rice prices to ensure that they always reflected the underlying cost of production.

Submissions on the Draft Final Report

The Institute of National Affairs stated that:

The growing domestic rice supply is also notable, but at this stage should not be exaggerated, as it remains largely for local non-commercial supply, although of modest value (but relatively high input cost) with respect to food security.¹²

Commission's Final Conclusions

The Commission maintains its view that in urban centres outside Port Moresby and rural environments there are a range of substitutes, and due to their relative affordability, they represent a real alternative to imported rice. However, in Port Moresby where local substitutes are relatively expensive, the Commission maintains its position that it is unlikely that the range of substitutes available are able to exert sufficient pressure on rice prices to ensure that they always reflected the underlying cost of production.

5.2.3 Competition between existing market participants

Competition between existing market participants keeps a continual check on prices and forces participants to consider new and improved ways of operating.

Commission's Analysis in the Draft Final Report

The Draft Final Report noted that while Trukai remains the dominant player in the market, importers are actively seeking to maintain and expand their market shares. The Draft Final Report noted that the clearest form of competition is price competition and that prices of rice in the PNG market vary between retail outlets, locations and with the type of rice being sold. Analysis undertaken by the Commission and provided in submissions on the Issues Paper demonstrated that brands directly competing with Trukai are often cheaper than Trukai's products. In the case of Homestate's Star Rice, which Homestate believes is the main competitor to Roots Rice, Star Rice was cheaper than Roots Rice in all locations where price data is collected. This was also the case for Homestate's Super A-1 rice variety which is cheaper than Star Rice. The Commission noted that the pricing of Star and Super A-1 rice at this level was an indication of price competition between market participants.

In the Draft Final Report the Commission stated that competition between existing suppliers is also characterised by the development and offering of new and differentiated products and services. In the case of rice, the Commission identified that a range of rice varieties are available such as medium grain, jasmine rice, brown rice, long grain and glutinous rice. It was also noted that in the past Trukai had sold chicken rice and basmati rice but that it has recently withdrawn these products from the market.

¹² INA submission on Draft Final Report, pg 2.

With respect to the businesses actively seeking to maintain or expand market share, the Draft Final Report stated that there was clear evidence of competition between importers. While exact figures on market share in the PNG rice market are commercial-in-confidence, high level indicative analysis undertaken by the Commission indicated that Trukai is losing market share - since 2000, Trukai has experienced a decline in market share from almost 100 per cent to approximately 95 per cent in 2005 to around 80 per cent in 2010. Trukai's submission on the Issues Paper stated that:

*Competitors have been able to gain significant market share of the market. This competition has squeezed TIL [Trukai] and had significant influence on the pricing of Roots Rice.*¹³

In addition, the Draft Final Report noted that importers are attempting to gain additional customers through innovative marketing and advertising strategies. In PNG, advertising centres around brand recognition but also includes product placement in retail outlets, advertising of price discounts, quality and product range. More recently, some importers have bundled rice with free samples of other products as a means of attracting new customers. From the level of advertising in all forms of media, supermarkets as well as sponsorship, the Commission stated that it is clear that the different importers believe that customers may alter their purchasing behaviour based on differences in price, product range and quality. When discussing competition in the market, Homestate's submission on the Issues Paper stated:

*Competition in distribution of rice products is rife among the major distributors. This is evident from the amount of advertisements and promotions made by the companies in the media and on site in selected wholesale outlets.*¹⁴

The Commission concluded that price competition as well as advertising and marketing initiatives indicated that there is competition between existing suppliers in the market. The Commission also noted that it expects that competition will increase with further new entrants, such as Lams Trading which entered in early 2010.

Increasing sophistication in PNG's rice market

The rice market in PNG is becoming increasingly sophisticated with the entry of new rice importers, rice varieties and increased substitution options.

Increased sophistication has resulted in changing market shares and consumers switching brands based on price. This phenomenon has been relatively slow in the PNG market because of consumers taste preference and loyalty for Roots Rice, a medium grain rice. Roots Rice remains the most popular brand in PNG because Trukai has actively marketed it to low and medium income earners for over 20 years - in essence Trukai set the 'taste' for rice in PNG.

The findings of this review show that market shares are changing and that Roots Rice's market share is steadily declining. This demonstrates that consumers' demand for rice is becoming increasingly price sensitive in PNG and that people's taste preferences may be changing with customers willing to switch from medium to long grain rice. Switching is likely to continue and increase if the price of Roots Rice remains high compared to long grain alternatives. According to FAO data, over the last five years, the international price of long-grain rice has, on average, been US\$200 cheaper per tonne than medium grain rice.

Market sophistication has also increased with the promotion of locally grown rice. In rural and semi-urban areas, competition is evident where locally grown rice and fresh fruit and vegetable substitutes are readily available. Substitution is another factor that rice importers into PNG need to consider.

¹³ Trukai's Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 18 August 2010;
¹⁴ Homestate Submission to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 24 August 2010

Submissions on the Draft Final Report

Trukai stated that:

We would like to reiterate that our competitors are growing market share rapidly, and commercially this will enforce the strictest price controls on Roots Rice.¹⁵

The Institute of National Affairs stated that:

... it is unrealistic to envisage that Trukai could restore its former level of market dominance, now that many other major and minor players have entered the supply chain, and that market preferences for rice have diversified.¹⁶

Commission's Final Conclusions

The Commission maintains its view that competition between existing market participants is strong in the PNG rice market. While Trukai remains the dominant player in the market, other importers are actively seeking to maintain or expand market share.

5.2.4 Countervailing market power

Countervailing market power exists where a customer is able to exert influence over a supplier to cause the supplier to amend its supply arrangement or vary the price of goods. The extent of this countervailing power is reliant on the availability of alternative supply options of similar quality and quantity. Countervailing market power is most likely to exist for large customers although individuals can potentially exert countervailing powers through their consumption behaviour.

Commission's Analysis in the Draft Final Report

In the Draft Final Report, the Commission stated that the evidence available indicated that there are alternative supply options in the rice market given that:

- there are a variety of rice importers;
- rice is easily and widely distributed across PNG; and
- the threat of direct importation exists.

The Commission noted that wholesalers and retailers have the ability to exercise countervailing market power by negotiating with suppliers for discounts or to tailor supply arrangements to meet their needs. The Commission understands that some importers offer discounts to long term customers as well as approach wholesalers and retailers to discuss preferred supply arrangements.

The Commission stated that end-use customers have the potential to benefit from any countervailing market power at the wholesaler and retailer level as a proportion of any cost savings would be passed through as lower retail rice prices.

The Commission concluded that based on the submissions received and its independent investigations, countervailing market power appears to exist to a limited degree in the rice market.

Submissions on the Draft Final Report

The Commission received no submissions which addressed the matter of countervailing market power.

¹⁵ Trukai submission on Draft Final Report, pg 3.

¹⁶ INA submission on Draft Final Report, pg 2.

Commission's Final Conclusions

The Commission maintains its view that countervailing market power appears to exist to a limited degree in the rice market.

5.2.5 Exercise of choice by customers

The exercise of choice by customers is normally an indication of a competitive market.

Commission's Analysis in the Draft Final Report

In the Draft Final Report, the Commission noted that the PNG market for rice has been dominated by Trukai since 1970 with other players only entering after 2000. The Commission stated that during Trukai's three decades as the single supplier of rice in the PNG market, generations of consumers have become accustomed to Trukai brands, their taste and cooking characteristics. This is particularly the case with Trukai rice and Roots Rice brands. The Fresh Produce Development Agency in response to the Issues Paper noted that:

Trukai has also invested in significant marketing and research to develop brands that are suitable to the taste and preferences of the average consumer through their various rice brands.¹⁷

The Commission stated that the introduction of new brands of rice allows consumers to alter their purchasing behaviour and switch from one brand to another, potentially placing a significant competitive constraint on producers.

In the Draft Final Report, the Commission also noted that the willingness of consumers to switch brands based on price is also potentially increasing due to the increasing cost of living, particularly in urban areas of PNG. Major costs such as utilities and real estate are increasing and any associated adjustments in incomes are not commensurate with the rising costs of living. Over time this situation is reducing the average Papua New Guinean real household disposable income meaning expenditure decisions have the potential to be driven more by price rather than brand. These factors are likely to affect Roots Rice as it is traditionally consumed by low to middle income earners and is typically not the cheapest rice product on offer.

The Commission stated that there was direct evidence of exercise of choice by consumers as demonstrated through the changing market shares discussed. The Commission also stated that indirect evidence of the exercise of choice by customer was demonstrated through increased marketing and advertising activities being undertaken by the different brands, different prices for different brands and products and the declining market share of Trukai.

Submissions on the Draft Final Report

The Commission received no submissions which addressed directly the matter of the exercise of customer choice.

Commission's Final Conclusions

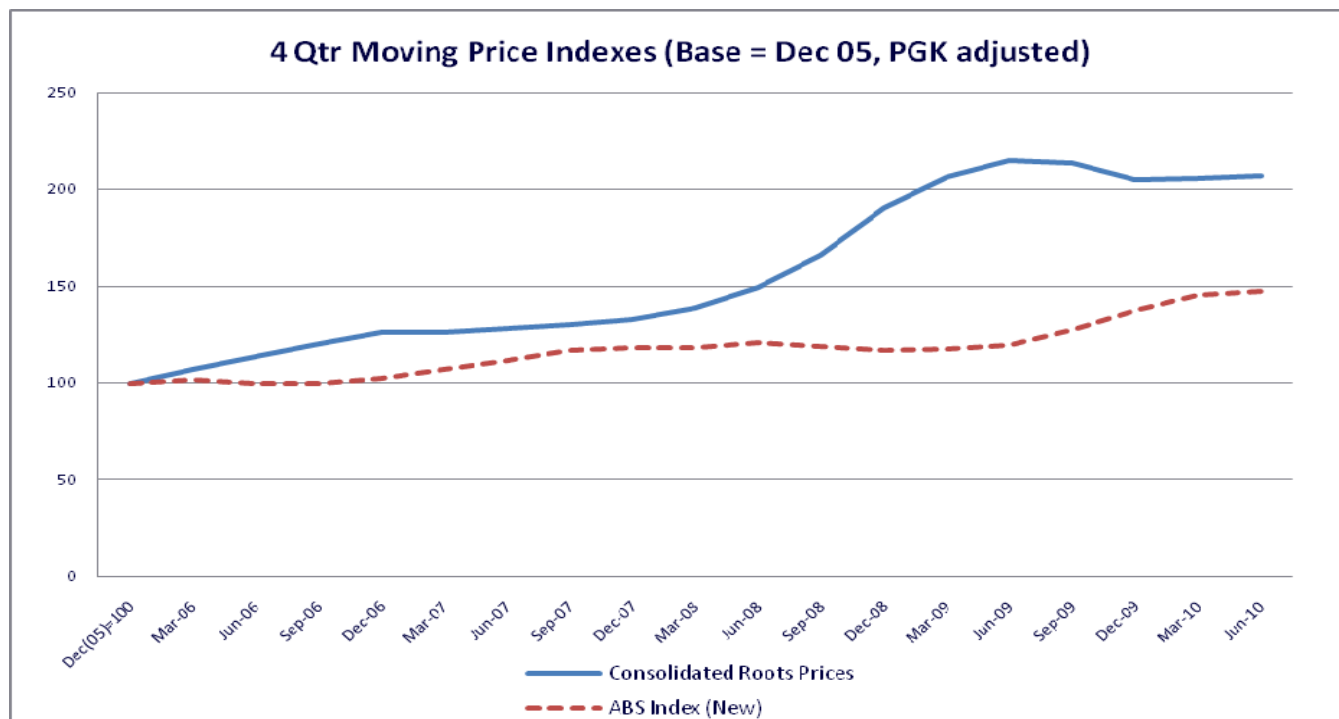
The Commission maintains its view that there is direct evidence of exercise of choice by consumers as demonstrated through the changing market shares. In addition, there is indirect evidence of the exercise of choice by customers as demonstrated through increased marketing and advertising activities being undertaken by the different brands, different prices for different brands and products and the declining market share of Trukai.

¹⁷ Fresh Produce Development Agency Submission on 2010 Rice Industry Pricing Review Issues Paper, 20 July 2010.

5.3 Analysis of Market Data – Price Monitoring

In 2005 the Commission developed a price monitoring arrangement based on the ex-factory gate price of Roots Rice, which is a medium grain rice. This price is monitored against an index based on the price of long grain rice in Australia as reported by the Australian Bureau of Statistics (ABS) on a quarterly basis. The consolidated results of the price monitoring arrangement is shown in Figure 5.1.

Figure 5.1: Consolidated price monitoring results



Commission's Analysis in the Draft Final Report

The Draft Final Report stated that due to the divergence between the Roots Rice index and the ABS index as shown in Figure 5.1, the Commission was compelled to investigate the reasons for this divergence.

In the Draft Final Report, the Commission noted that it had initially sought an explanation from Trukai in 2008, and that based on the information presented at that time, the Commission concluded that it was appropriate to maintain the existing arrangements until the 2010 review (this review) where it would consider all the information available.

Analysis of price monitoring outcomes

In the Draft Final Report, the Commission based its analysis on Trukai's response to the 2008 information request as well as further work undertaken by the Commission as part of this review. Based on this analysis, the Commission concluded that the divergence between the Roots Rice index and the ABS index could be explained by two factors:

- uncertainty in the international market which saw international prices of medium grain (Japonica) rice spike; and
- purchasing strategies employed by Trukai to guarantee supply.

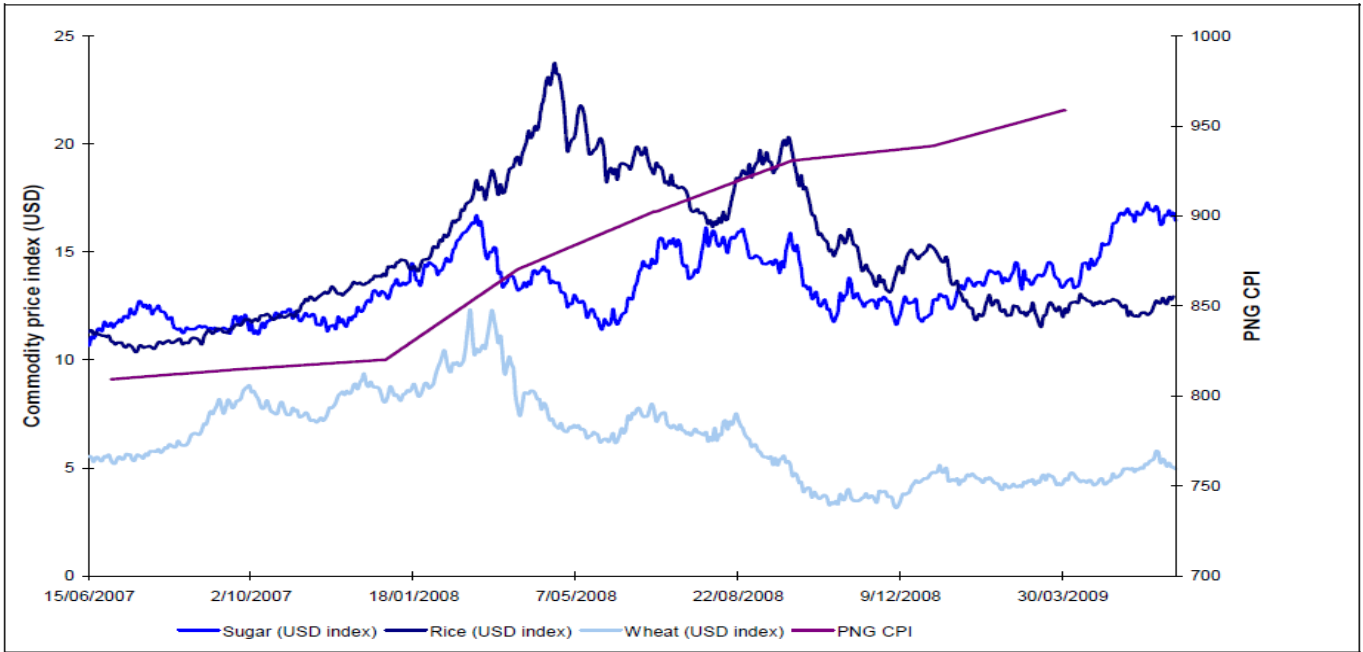
In addition, it was realized that the ABS index was based on a long grain rice product and that there were world wide differences in pricing for different rice grain and types. With respect to uncertainty in the international market and the resulting price spike, the Commission concluded that it was caused by a range of factors including:

- In early 2008 Australia experienced a drought which saw production of medium grain rice decrease significantly. This limited Trukai’s options for sourcing medium grain rice used in Roots Rice from Australia;
- India, in an attempt to ensure internal food security, imposed restraints on rice exports through a minimum export price;
- Egypt and China reduced medium grain exports to guarantee internal food security; and
- The worldwide commodity price boom (as shown in Figure 5.2 below) placed upwards price pressure on a number of food commodities, including rice.

These factors put upward pressure on world medium grain prices and Trukai (as a price taker in world markets at that time), saw a reduction in the number of available sources for bulk rice and increases in its import price to PNG.

The Draft Final Report contained Figure 5.2 as shown below which includes the price of rice, wheat and sugar and shows that the price of each commodity spiked at the same period. The figure also shows an increase in PNG CPI.

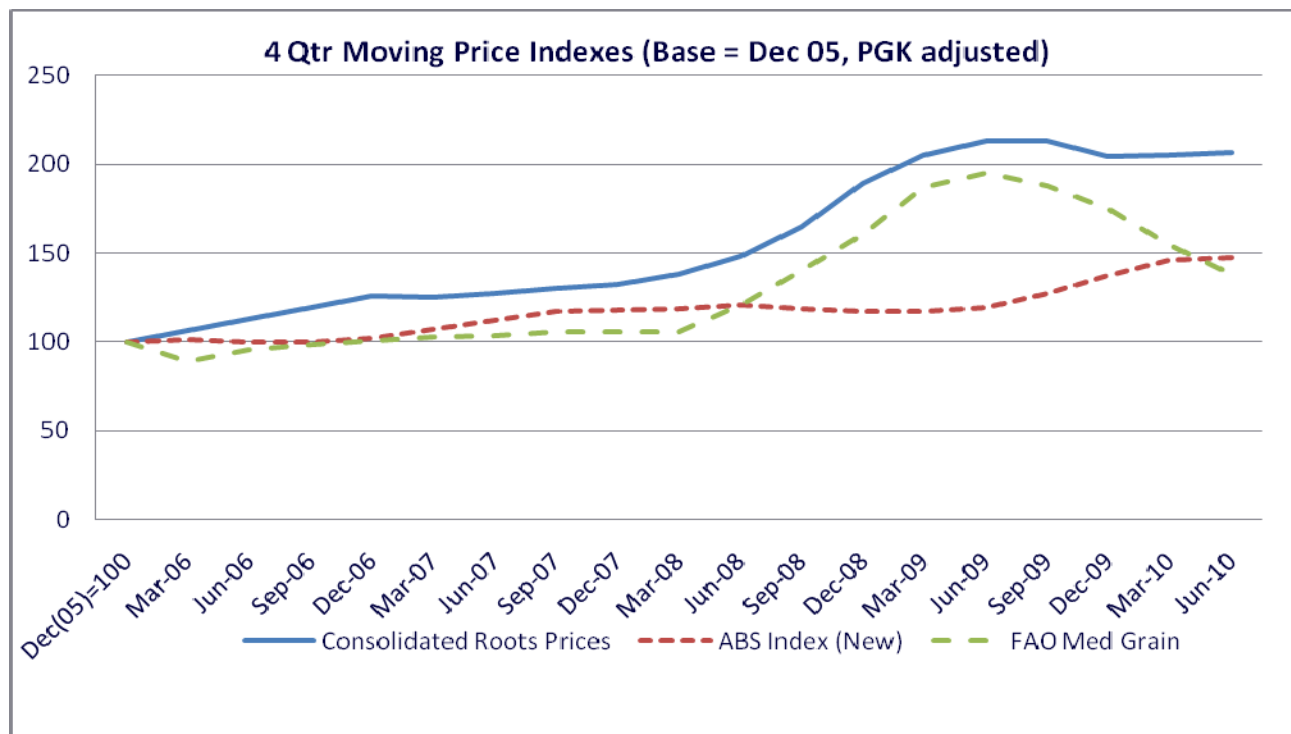
Figure 5.2: International Sugar, Rice and Wheat Prices and PNG CPI



FAO Medium Grain rice prices

In order to better analyse the combination of these factors with respect to its price monitoring arrangements, the Commission calculated the international price of medium grain rice based on FAO statistics and converted it to PGK to create a medium grain index. The index was used to supplement the ABS long grain price monitoring arrangements. The information from the three indexes was combined into a single figure, and is shown in Figure 5.3.

Figure 5.3: FAO Medium Grain and Price Monitoring Indexes



In the Draft Final Report, the Commission made the following observations:

- The rate of change in the Roots Rice index and the ABS index in the initial two years of the regulatory period is consistent with the FAO medium grain index. This finding supported the view that the minor divergence between the ABS index and Roots Rice index in their initial stages was due to a ‘settling down’ period in releasing rice prices to a monitoring approach.
- The Roots Rice index appears to track the FAO medium grain index, especially during the price spike in 2008-2009. This observation supported Trukai’s 2008 submission that its costs increased during this period, and that there was a divergence in prices for medium and long grain bulk rice. The Commission noted that during this time the Roots Rice index did not follow the ABS index because of differences in the long grain and medium grain markets and Australia’s ability to limit more effectively the impact of the international price spike on domestic prices (due to Australia’s more mature market and its ability to supply more rice than its internal market demand).
- The FAO medium grain index has fallen during the first half of 2010 while the Roots Rice price index has shown no such decline. Consultation and analysis undertaken by the Commission in preparing the Draft Final Report identified long-term supply contracts as the likely driver for this divergence. The Commission concluded that the existence of long-term supply contracts (commenced near the peak of the price spike) appear to have created a lag between the reduction in the world price as shown in the FAO medium grain index and the price of Roots Rice. The Commission stated that it expected the price reductions in medium grain rice would soon be passed on to consumers once the long-term contracts expire and Trukai is able to purchase rice at a reduced international price. The Commission included in the Draft Final Report the following box discussing the nature of long-term supply contracts.

Long-Term Supply contracts

Long-term supply contracts are part of standard business procedure and reduce the uncertainty associated with meeting supply over future periods by locking in a given price and thereby providing smooth prices over time for end-use customers.

In times when the international spot price of a product is rising, forward purchasing allows a business to source its product more cheaply than the prevailing market price and potentially offer its products at a 'discount' to the world price. However, the downside of such an approach is that if prices fall, a business may be buying a large amount of the product above the current market price. In these instances, there may be a lag between the price paid by the business and the lower international price being available to pass on to consumers.

Forward purchasing before a price decline can create an opportunity for new entrants to enter the market by sourcing their product at the lower international price. In response, the incumbent must respond by reducing its price (effectively selling its product at a loss) or run the risk of potentially losing market share until such time as the existing contract expires and it can enter into a new contract at the reduced international price.

Other factors

In addition to the above factors, the Commission noted in the Draft Final Report that Trukai was also experiencing higher costs for landing freight as well as 'in-country costs' for energy, labour, ports services and transport services and concluded that these cost increases may be contributing to the delay in price reductions.

The Commission stated that evidence presented to it indicated that landing costs have increased over recent years. The Commission noted that this was consistent with its understanding of these areas. The Commission cited examples such as its recent approval of increases in charges for PNG Ports' regulated services and costs. The Commission also noted that congestion is increasing at ports in PNG, especially in Lae. In regards to the differences in the Roots Rice and ABS indexes, the Commission stated that these PNG-specific costs are cost increases to which Australian rice distributors are not exposed. The Commission also stated that Australian distributors are also not exposed to international freight cost fluctuations (to the extent that rice is produced within Australia).

With respect to the in-country costs, the Commission stated that it understood that these costs have also been increasing. The Commission cited increases in labour costs (including skilled labour costs as well as increases in the national minimum wage), energy costs and other operating costs across PNG. The Commission noted that these cost increases are reflected in the sharp increases in CPI in Figure 5.2 above, and may in part be due to the pressures within the economy due to the large investment in the LNG project. In addition, the Commission noted that it is also likely that costs associated with advertising and marketing are increasing as the existing importers compete to maintain and grow market share, particularly in response to the increasing threat of relatively cost competitive imports.

Summary

In the Draft Final Report, the Commission concluded that the divergence between the ABS index and the PNG index is explained by the above factors. That is, the initial rise in the price of Roots Rice was the result of the spike in international prices. The more recent divergence, where price reductions have not flowed through to the PNG market, is consistent with Trukai's stated and expected purchasing strategy (as it appears it has forward purchased grain when the price was higher than it is now). The Commission stated that it expected this lag to end in the near future and the price reductions to flow through to PNG consumers.

Submissions on the Draft Final Report

The Institute of National Affairs supported the Commission's assessment of the existence of long-term supply contracts and made the following statement.¹⁸

In early 2008 major grain and various other food prices rose rapidly as a result of significant shortages of production in some of the world's major grain supplying countries, but further stimulated by a panic over food security in some countries in South and SE Asia, where export restrictions were imposed, further distorting international markets, combined with some speculative activity on the markets.

Indeed, although prices rose above the ABS index, PNG's rice prices were initially kept significantly below the international upward trend for staple grains, owing partly to long term supply contracts by leading importer, Trukai Rice (formerly Rice Industries). Conversely, the appreciating kina in late 2008/early 2009 failed initially to reduce the high rice prices as rapidly as expected, partly because the lag from long term contracts.

In response to the Commission's preliminary findings in the Draft Final Report, Trukai made a submission which is summarised in the following box.¹⁹

¹⁸ INA submission on the Draft Final Report, pg 1.

¹⁹ Trukai submission on the Draft Final Report, pg 1 & 2.

Summary of Trukai's Submission on the Draft Final Report

Trukai stated that it supported the Commission's assessment framework and the analysis which concluded that there are significant competitive pressures in the PNG rice market.

Trukai also stated that its interpretation of the Draft Final report was that, despite the Commission finding there to be significant competitive pressures in the PNG rice market, price monitoring is to continue because:

1. the Roots Rice prices have not tracked against of the nominated indexes; and
2. the relatively recent developments related to landing and in-country costs as well as uncertainty in the PNG economy.

Trukai made the following comments with respect to these two factors:

1. Correlation against the index

- As we are the largest supplier of rice in the market we do not have the luxury of ordering just in time and holding minimal stock in PNG. TIL is expected to feed the nation – something we are proud of and will continue to do.
- Roots is a medium grain based product. The medium grain trading market is much smaller than our competitor's long grain market. Further, medium grain is grown in fewer countries than its long grain competitor and has one crop annually verses long grain that has 3 per year. Therefore, medium grain is more price sensitive based on demand and Trukai has to plan well in advance to secure annual supply.
- The above 2 factors mean that TIL need to have a longer term view of supply. This comes at a cost; forward purchasing risk and cost of financing and holding.

We believe that Roots is more likely to realign with the FAO Medium Grain Index over time.

2. Increased costs on-shore and uncertainty

We agree that there is an issue in PNG with increasing onshore costs and uncertainty. Both of these issues are dictated by government policy and direction. All of our consumers are impacted by these factors in most things they do and consume every day. This issue is far wider than Trukai, the rice industry or our substitute product markets and as such is not some thing we can control. Trukai's competitors have significantly lower on-shelf pricing that ensures TIL cannot "profit" from increased costs or uncertainty. TIL continues to improve and rationalise its operations to reduce its cost base.

Trukai concluded that:

Based on the above factors and the evidence in our first submission, we believe that Price Monitoring should cease. If the Commission ultimately decide to continue Price Monitoring, TIL supports the Commissioners decision to allow Trukai to apply to have pricing removed from 1 July 2013.

We would also like to reiterate that our competitors are growing market share rapidly, and commercially this will enforce the strictest price control on Roots Rice.

Commission's Final Conclusions

The submissions from both the Institute of National Affairs and Trukai support the Commission's conclusions in the Draft Final Report that the divergence between the Roots Rice index and the ABS index is explained by:

- uncertainty in the international market which saw international prices of medium grain (Japonica) rice spike; and

- purchasing strategies employed by Trukai to guarantee supply.

The Commission notes that a continuation of pricing strategies whereby Trukai continues to price above the index is likely to lead to increased competitive pressure as Trukai's prices will be higher than those of its competitors. This ultimately will lead to the erosion of Trukai market share under current market conditions. This will be a benefit to consumers through access to lower prices but may also come at added risk of disruption in supply when worldwide supply constraints arise.

5.4 Commission's Final Findings

The Commission is required to come to a view on the competitive state of the PNG rice market to inform its decision on the need and, if necessary, the form of any ongoing price regulation in the PNG rice market.

To assess the current competitive state of the PNG rice market, the Commission developed a tailored assessment framework based on the factors most relevant to the local market. The Commission's conclusion on the five assessment factors follows:

Factor	Comment
Barriers to Entry/Import Competition	<p>Tariffs on the import of rice (whether it be raw, milled or pre-packaged) have been reduced to zero over recent times. There are also no quota restrictions on the maximum amount of rice imports per year. As such, there appear to be no barriers to entry.</p> <p>Evidence provided to the Commission clearly shows that import competition is strong, with new players entering the market and other companies from abroad expressing interest in setting up processing in PNG or importing pre-packaged rice.</p>
Substitutes	<p>Possible substitutes for rice differ between Port Moresby and areas outside the Capital. In urban centres other than Port Moresby and rural areas real substitutes include flour and flour based products as well as local products such as taro, yams, kaukau, English potatoes and cooking bananas. In Port Moresby only flour and flour based products are readily substituted for rice.</p> <p>In addition, locally grown rice appears to be increasing. This is especially the case in the highlands where anecdotal evidence indicates that locally grown rice is available in retail shops and at market stalls. Moreover, the government has a policy of increasing local rice production under its 2004 rice policy.</p> <p>The Commission is of the view that:</p> <ul style="list-style-type: none"> - in Port Moresby - while substitutes are present, the importance of rice in people's diets and the price of substitutes means substitution alone does not put significant pressure on rice prices - in urban centres other than Port Moresby, rural and semi urban areas – substitutes are widely available and competitively priced.
Competition Between Participants	<p>The number of rice suppliers has increased from one in 2000 to five in 2010. This includes an additional player (Lam's Trading) who has entered the market in recent months. Anecdotal evidence provided to the Commission also suggests that new entrants are expected in the near future.</p> <p>The number of brands and varieties of rice products on the market has increased from 10 in 2005 to 19 in 2010. This represents competition between the major importers. Market share data reveals that Trukai's market share has been eroded from 100 per cent in 2000 to 95 per cent in 2005 to approximately 80 per cent in 2010. This trend is expected to continue for some time.</p> <p>Other evidence available to the Commission demonstrates that:</p> <ul style="list-style-type: none"> - rice importers are competing in the form of product differentiation, by offering buyers' discounts, and through advertising to end-level consumers - Wholesale and retail outlets appear to be willing to stock rice from any rice supplier as

	<p>long as it is priced at a level which is expected to sell.</p> <ul style="list-style-type: none"> - All suppliers have stated they consider the market to be competitive and none have suggested that Trukai is abusing its position as the dominant player, or that exclusivity agreements, if they exist, are significantly limiting competitive activity. <p>The Commission's conclusion is that competition between existing market participants is exerting competitive pressures on the PNG rice market.</p>
Countervailing Market Power	<p>There appears to be a small degree of countervailing market power for larger customers who have the option of negotiating discounts.</p> <p>Small customers have a degree of countervailing market power to the extent there are substitutes (as discussed above) and that there is adequate knowledge among consumers of this potential.</p> <p>Overall, the Commission considers that countervailing market power, while it exists, is limited.</p>
Customer Choice	<p>Customers have a range of available options in terms of price, quality and products. However, customers appear to have a taste preference for medium grained rice.</p> <p>The Commission found that while no formal data was available on the exercise of choice by customers, the fact that the rice importers were investing in advertising in attempts to maintain and grow market share indicated that customers were willing to exercise choice in their purchases. The Commission's conclusion is that the exercise of choice by customers is exerting market pressures on the PNG rice market and the evidence provided via submissions on the increase in the number of rice brands and varieties from 10 in 2005 to 19 in 2010 is further proof of the existence of customer choice.</p>

The Commission's analysis against its assessment framework indicates that there are significant competitive pressures in the PNG rice market despite the dominance of Trukai. However, before concluding that the market is effectively competitive, it is necessary for the Commission to consider the evidence provided through the price monitoring arrangement established in 2005. The analysis undertaken by the Commission revealed the following:

- The price monitoring arrangements identified a divergence between the benchmark index and the prices being charged for Roots Rice.
- Analysis of the market conditions and an assessment of Trukai's experience show that the spike in international prices from early 2008 until early 2009 was the cause of divergence. The divergence between the ABS index and the Roots Rice index resulted from one index being based on medium grain rice and the other being based on long grain rice combined with different levels of maturity in each market. The Commission notes that the price spike was not restricted to rice markets but affected many commodities around the world. This cost increase flowed through into increased rice prices as Trukai were sourcing their rice from the international market. As a result of the GFC, international rice prices have now returned to levels consistent with historical prices. However, a corresponding fall in rice prices has not yet eventuated in PNG because of forward purchasing by Trukai to guarantee supply. Other cost increases in PNG such as landing and in-country costs have more recently also contributed to this lag. The retention of high rice prices is not reflected in the ABS index as these costs of production are PNG-specific.

The Commission's analysis indicates that the divergence between the ABS index and the Roots Rice index appears to be explained by the above factors. As such, and given that the Commission's analysis against the assessment framework found there to be significant competitive pressures in the PNG rice market, it is the Commission's view that the PNG rice market exhibits many of the characteristics of an effectively competitive market.

Given this conclusion, the next decision the Commission must make relates to whether it is appropriate to remove price regulation or whether there remains a need for some form of regulatory oversight.

In its analysis above, the Commission has identified that, while the market exhibits many of the characteristics of an effectively competitive market, there are a range of issues which are yet to be resolved to the satisfaction of the Commission. The most substantive of these matters relate to reduced international prices not yet being passed on to customers in PNG. In addition, the Commission has concerns with respect to relatively recent developments related to increased landing and in-country costs as well as uncertainty in the PNG economy from investments such as the LNG project.

As such, the Commission considers at this time there to be value in continuing with some form of price monitoring. This finding is consistent with that in the Draft Final Report and is contrary to the position espoused by Trukai. While the Commission acknowledges the arguments put forward by Trukai, especially that the recent developments with respect to increased landing costs, increased in-country costs and uncertainty due to investments such as the LNG project affect the economy as a whole, it maintains its position that there is value in maintaining some form of price monitoring.

The relative merits of maintaining some form of price monitoring were captured in the submission of the Institute of National Affairs in response to the Draft Final Report. The submission stated that:

As Roots Rice holds a decreasing portion of the market and with many other international and local rice suppliers in the market, monitoring of a single product seems increasingly anachronistic. Nevertheless, rice is a staple food for households, particularly in urban areas, and, as the report [Draft Final Report] highlights, competition with other traditional staples (notably sweet potato and other root crops) is less available in certain urban centres, notably NCD, than in most other centres and rural areas, largely because of PNG's poor infrastructure and high domestic transport costs to main staple food supply areas. Continued monitoring of rice prices by ICCC in NCD, particularly, therefore retains merit whilst a single supplier retains over 70% of the market of such a key staple,²⁰

Based on the evidence and circumstances at this time, the Commission considers it appropriate to maintain some form of price monitoring given its remaining concerns and makes the following Final Finding.

Commission's Final Finding: The PNG rice market exhibits many of the characteristics of an effectively competitive market. However, at this time the Commission considers there to be value in continuing with a form of price monitoring as it retains concerns relating to reduced international prices not yet being passed on to consumer and a range of economy-wide factors such as increased landing costs, increased in-country costs and uncertainty due to investments such as the LNG project.

The proposed price monitoring arrangement is discussed in Chapter 7.

²⁰ INA submission on Draft Final Report, pg 2.

CHAPTER 6 COMMISSION'S FINAL ASSESSMENT OF THE SEA AND ROAD FREIGHT PRICE MONITORING ARRANGEMENTS

6.1 Introduction

In addition to monitoring the ex-factory gate price of rice, the Commission's 2005 review initiated a monitoring arrangement for domestic sea and road freight charges for the transport of all Trukai rice brands.

6.2 Existing Arrangements and Outcomes of Price Monitoring Arrangements

As discussed in Section 2.5, rice is normally imported to main depots in Lae (and to a lesser extent Port Moresby) and then distributed to more regional centres using domestic coastal sea and inland road transportation networks. In a limited number of cases, importers sometimes import directly to coastal depots, for example Rabaul.

Under the current regulatory arrangements, the Commission monitors freight costs provided on a quarterly basis by Trukai. Monitoring is of freight charges from its processing facility in Lae to its eleven depots of Alotau, Buka, Goroka, Mt Hagen, Kavieng, Kimbe, Madang, Port Moresby, Popondetta, Rabaul and Wewak. The outcome of the Commission's freight monitoring arrangements is at Figure 6.1 and Figure 6.2.

Figure 6.1 – Sea Freight Indexes for Roots Rice

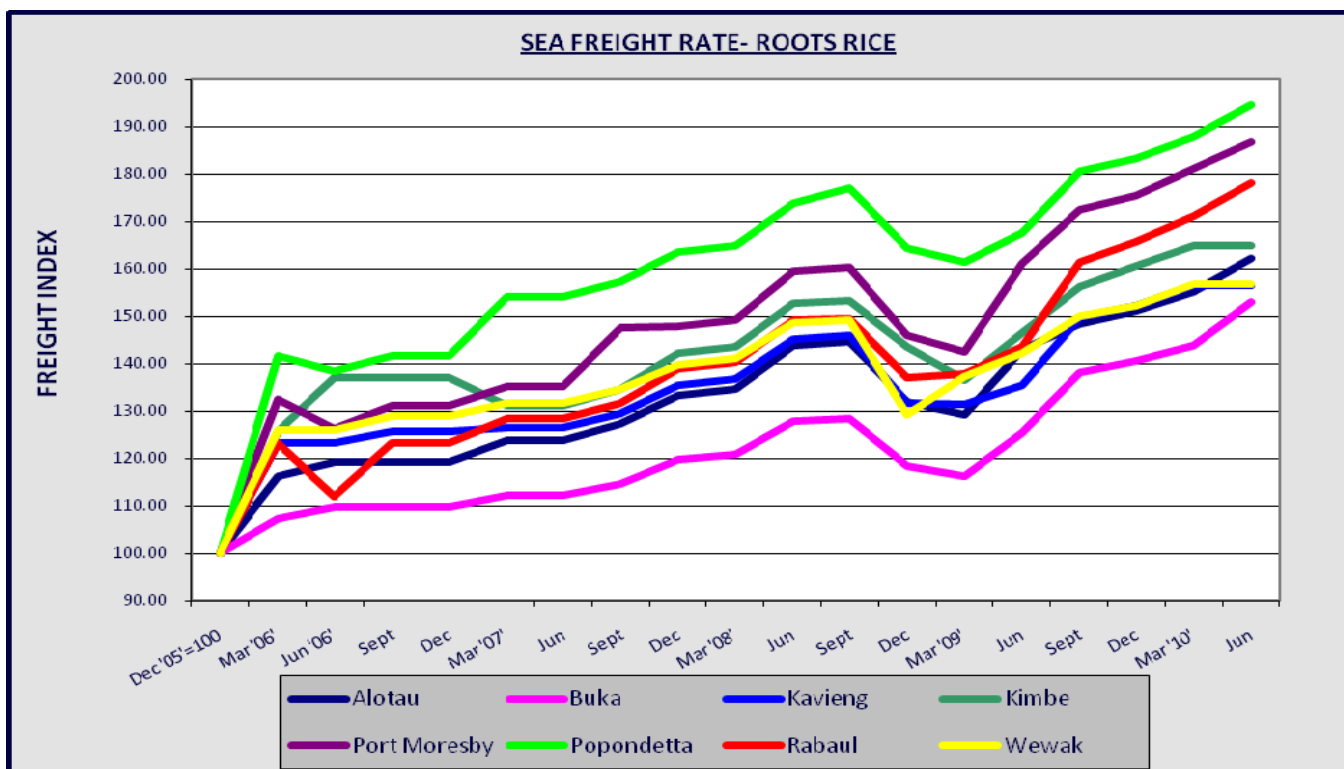
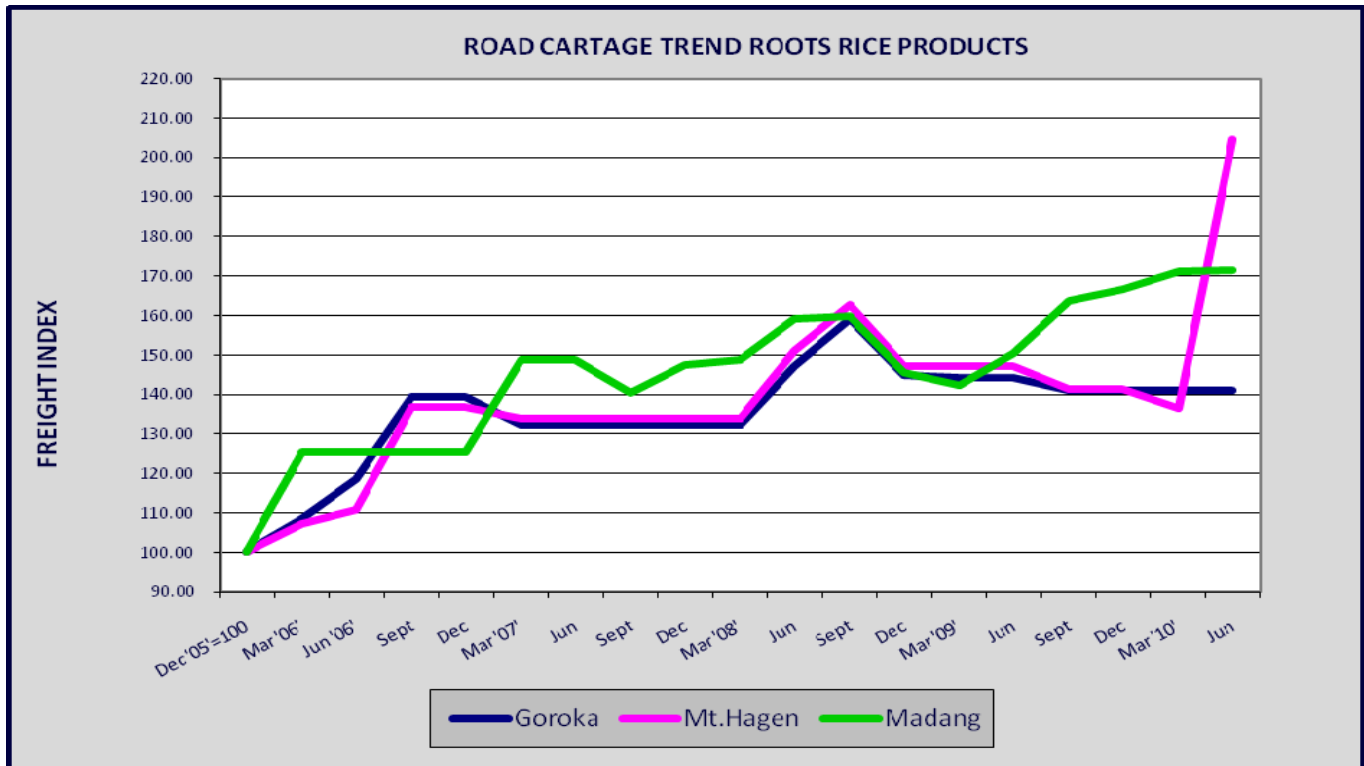


Figure 6.2 – Road Freight Indexes for Roots Rice



The Commission's monitoring indicates:

- a generally consistent trend in freight prices;
- a gradual increases in the price of the majority of sea freight routes; and
- road freight prices have increased over the monitoring period, including a recent spike in prices for transport to Mt Hagen.

6.3 Commission's Analysis in the Draft Final Report

In the Draft Final Report, the Commission noted that transport and logistics within PNG are independent of the operation of rice importers. As such, even if freight costs increase significantly, importers are not responsible for, or in a position to explain, the cost increase.

Submissions received by the Commission on the Issues Paper presented views both in favour of retaining freight cost monitoring and arguments to remove monitoring. Arguments that supported continued freight monitoring focused on consumer protection in general rather than issues specific to the rice industry. The submissions suggested that more data on the impact of freight markets on consumers was required.

Arguments to remove monitoring were based on rice importers' experience regarding the presence of competition in the freight market and that importers are not responsible for determining freight charges.

Trukai in response to the Commission's Issues Paper noted that the distribution channels are complex and that, depending on the location, products can be transported and handled by more than four transport operators. Trukai also noted that competition is healthy in the freight market with new entrants offering discounted rates to capture market share. Trukai submitted in response to the Issues Paper that:²¹

... price monitoring of domestic freight rates should be terminated.

²¹ Trukai's response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, 18 August 2010

AML also argued in favour of removing the freight monitoring arrangement.²²

AML does not influence or manage pricing related to freight however AML supports the removal of monitoring of freight rates per the current system as has been implemented recently for the flour category.

In preparing the Draft Final Report, the Commission sought views on competition in the freight market from wholesalers and retailers. All stakeholders who discussed freight stated that the market is competitive and that they were free to choose which freight company to use.

In addition to submissions on freight monitoring, the Commission noted its 2007 Review of the PNG Coastal Shipping Industry which found that there are limited barriers to entry in the coastal shipping market and that there is competition in the sea freight market, albeit there were also significant cross-ownership linkages which might affect competitive pressures in the coastal shipping market. The Commission noted that set up costs (sunk costs) such as the purchase or lease of trucks or ships are substantial. However, the Commission also noted that the resale potential of trucks and ships means that new companies can recover a large proportion of their sunk costs relatively easily.

The Draft Final Report also noted the Commission's 2010 Flour Review which removed the monitoring of freight charges for flour based on there being a number of freight operators in the market who compete for market share through pricing arrangements. This view was supported by information provided to the Commission that a new entrant in the freight market, Carpenters Shipping, is offering significant discounts on certain routes.

The findings of the 2010 Flour Review also noted that there is an opportunity for small customers to use their own transport to purchase flour from major distribution points. This opportunity also exists in the rice industry which has 14 large distribution centres.

The Draft Final Report also noted that in some instances rice importers can avoid domestic freight charges altogether by importing directly to coastal depots or distribution points such as Rabaul and Alotau.

Based on the above analysis, the Commission concluded that it was appropriate to cease monitoring the in-country sea and road freight rates for rice products.

6.4 Submissions on the Draft Final Report

Trukai stated:

*We strongly agree with the Commission's decision to eliminate the need to monitor the Freight rates*²³

6.5 Commission's Final Findings

To assess the current competitive state of the freight market, the Commission has adopted the framework developed in Chapter Three. The Commission's conclusions on the five assessment factors with respect to the freight industry are as follows:

²² Response to the Independent Consumer and Competition Commission Rice Industry Pricing Review Issues Paper, Associated Mills Limited - Goodman Fielder PNG, 23 June 2010.

²³ Trukai's response to the Draft Final Report, pg 1.

Factor	Comment
Barriers to Entry	<p>The Commission's 2007 Review of the PNG Coastal Shipping Industry found that there are limited barriers to entry in the coastal shipping market; the Commission's analysis as part of the Flour Industry Pricing Review and as part of this review indicates that this is also the case in the road freight market. Domestic and international freight companies are free to expand into new markets in PNG and compete against existing participants. The Commission understands that as recently as June 2010 a new entrant has began freight services in PNG. The Commission does however note the significant inter-relationships between local shipping and stevedoring companies, but at present has no evidence that this affects competition in coastal shipping arrangements.</p> <p>The Commission also notes that set up costs (sunk costs) such as the purchase or lease of trucks or ships are substantial. However, the resale potential of trucks and ships means that new companies can recovery a large proportion of their sunk costs relatively easily.</p> <p>From this discussion the Commission concludes that there are not significant barriers to entry (or exit) in the freight market.</p>
Substitutes	<p>Substitution is not a major element of competition in the freight market. However, consumers of freight services can substitute the use of formal freight arrangements (freight companies) for informal transport options. Informal options include, consumers or groups of consumers:</p> <ul style="list-style-type: none"> - using their own vehicle to purchase rice from the factory gate - borrowing or hiring a vehicle to purchase rice from the factory gate. <p>The Commission concludes that while substitution is limited in the freight market, if freight prices are too high consumers can use alternative options. This represents competitive pressure and a form of price cap from the price of substitutes.</p>
Competition Between Participants	<p>Evidence available to the Commission demonstrates that freight companies are competing via service agreements / contracts and discounts as well as through some advertising to consumers. Recent advertising by a new entrant in the PNG freight sector has shown discounts of up to 40 per cent on some freight routes. A clear indication of competition.</p> <p>The Commission therefore finds that competition between existing market participants is exerting competitive pressures on the PNG freight markets.</p>
Countervailing Market Power	<p>Evidence available to the Commission, and findings of the Coastal Shipping Industry review, shows that larger freight customers such as resource projects, wholesalers and large retailers are able to exert a degree of pressure on freight companies through negotiating contracts / service agreements at discounted prices. These can be either long or short term.</p> <p>The Commission's conclusion is therefore that there is a degree of countervailing market power, hence competitive pressure, in the freight market in PNG.</p>
Customer Choice	<p>The Commission is aware of significant consumer choice in the sea and road freight markets with over five large / medium sized companies and a range of smaller operators offering services to wholesalers and retailers. These consumers have access to relevant price and product / service information and are active in the market in seeking cost-reflective prices by switching between different freight providers based on prices and or services offered.</p> <p>The Commission's conclusion is therefore that the exercise of choice by customers is exerting competitive pressures on the sea and road freight markets in PNG.</p>

This evidence available to the Commission indicates that there is competition in the sea and road freight markets. In addition, the Commission is conscious that it has not received complaints about freight pricing from consumers. Furthermore, and perhaps most crucially, importers have no control over freight charges. While the importers may arrange for transport on behalf of customers, they are not responsible for transport costs.

Therefore, it is the Commission's view at this time is that it is appropriate to cease monitoring freight costs of rice given that the market appears to be competitive and that importers are not responsible for determining freight charges.

Commission's Final Finding: The Commission considers it appropriate to cease monitoring the in-country sea and road freight rates for rice products.

CHAPTER 7 FORM OF REGULATION

The Commission has determined that it is appropriate to remove the price monitoring arrangements as they apply to road and sea freight charges. However, having determined that price monitoring of the rice market should continue, the Commission must determine whether the existing monitoring arrangements are appropriate going forward.

7.1 Price Monitoring of Ex-Factory Gate Prices

The Commission monitors the ex-factory gate price of Roots Rice based on an ABS benchmark index developed using data on the average retail price of 1kg long grain rice in Australian capital cities, subsequently adjusted by the Australian dollar/Kina exchange rate. The ABS data is from ABS series 6403.0.55.001 - *Average Retail Price of Selected Items, Eight Capital Cities*.

The rice products that the Commission monitors are:

Product	Pack Size (kg)
Roots Rice	25
Roots Rice	20
Roots Rice	10
Roots Rice	1
Roots Rice	0.5

Noting that Roots Rice (chicken flavor) was discontinued in 2008.

The ABS Benchmark Index

This ABS index was adopted in 2005 as it was identified based on historical correlation as a:

- good proxy for movements in the price of rice in PNG; and
- useful mechanism to identify unusual market conditions in the PNG rice market.

Monitoring prices against this ABS benchmark provides the following advantages:

- The information used to compile the index is available publicly and is easy to access;
- The index is relatively easy to apply and does not impose a significant regulatory burden on industry; and
- The use of an indexed-based monitoring approach avoids many of the financial modelling complexities of detailed cost allocation.

However when the ABS index was developed it was recognised that other factors such as different tax rates and international freight charges may need to be considered. In addition it is for a long grain rice product and the Roots Rice is a medium grain product.

The discussion of the ABS, FAO Medium Grain and Roots Rice indexes in Section 5.3 demonstrates that the Roots Rice price tracked well against the ABS index until unusual market conditions in mid 2008 and tracks well against the FAO index when the market was volatile. The Commission notes that Roots Rice index tracked against the FAO index when the market was volatile because they are both medium grain indexes and because the rice market in PNG is small by world standards, meaning importers are more exposed to price volatility. Despite this correlation, after the world medium grain market price eased the Roots Rice index does not follow either the ABS and FAO indexes closely.

Due to uncertainty around the ABS index as well as the FAO index, the Commission considered the merits of using alternative options such as purchasing rice market data on medium grain rice from AC Neilson in Australia or the Creed report which is produced in USA. These indexes are based on pricing data collected by private organisations on retail and export prices respectively. While there is value in this type of approach the fact that the data is not publically available and it is unknown how long it will be

collected for lead the Commission to conclude that the use of a publicly available index remains the best approach.

7.2 The Commission's Final Findings

The Commission notes that the existing arrangements have proved effective as they have provided the trigger for the Commission to seek further information from Trukai in 2008 and have assisted in analysis in this review. As such, the Commission concludes it is appropriate to maintain the use of the existing ABS index. In addition, the Commission notes that it considers it appropriate to assess any significant divergences between the ABS and Roots Rice indexes against the FAO medium grain index.

The FAO medium grain index is calculated using the quarterly rolling average methodology as adopted for the ABS index. The data is sourced from the 'US California Medium Grain' rice prices as shown in the 'Rice Export Prices' table of the quarterly FAO Rice Market Monitor.²⁴

The analysis of the ABS, FAO and Roots Rice indexes will assist in identifying any correlation between international market volatility and the Roots Rice price and may avoid the need for the Commission to seek additional information from Trukai.

The Commission believes that a regulatory period of five years is appropriate as it provides a degree of certainty to industry while at the same time ensuring that a further review is undertaken within a reasonable timeframe. However, any time after 1 July 2013 Trukai will be able to apply to the Commission to have the price monitoring regime removed. Trukai will be required to provide supporting analytical and technical arguments to support their contention that the market is competitive and that price monitoring is unwarranted. The onus of proof will be on Trukai and should be supported by the quarterly returns provided to the Commission over the previous three years. Until such time as the Commission deems otherwise the price monitoring will continue, including while the Commission is reviewing the information submitted by Trukai.

Commission's Final Finding 3: The Commission will use the FAO Medium Grain index as its main price comparator, but will also maintain the use of the existing ABS index to monitor Roots Rice prices. However, if there is a significant divergence between the Roots Rice index and the FAO Medium Grain index, the Commission will review these changes in comparison with the ABS index and information on the world-wide supply and demand balance. The Commission will also retain the option of requesting information from Trukai to support any changes in price that are not consistent with the FAO Medium Grain and ABS indexes.

With respect to the possible future of price monitoring arrangements, the Institute of National Affairs made the following statement:

if it [Trukai's market share] falls significantly below this level [over 70%] the function of routine monitoring probably should shift to those responsible for monitoring overall food security, notably utilising the disaggregated components of the CPI basket, with ICCC retaining a more general watchful eye on the market.²⁵

While it is inappropriate at this time to speculate on the possible market oversight arrangements should the current arrangements cease, the Commission notes the comments from the Institute of National Affairs.

²⁴ See <http://www.fao.org/economic/est/publications/rice-publications/rice-market-monitor-rmm/en/>

²⁵ INA submission on Draft Final Report, pg 2.

CHAPTER 8 THE COMMISSION'S DETERMINATION

8.1 Final Determination

The Commission has undertaken a review of the regulatory arrangements applying to Roots rice and road and sea freight of Trukai Roots Rice varieties under the provisions of Section 25A (6) of the PR Act. The ex-factory gate price of Roots Rice and the wholesale and retail charges for road and sea freight are currently declared as declared monitored goods and services under the provisions of Section 32A of the PR Act.

The Commission acknowledges the comments and submissions received on its Rice Industry Pricing Issues Paper and Draft Final Report. Having considered these comments and submissions, the Commission has now made its Final Determinations as to the manner in which the price of Roots Rice is to be regulated over the next 5 years.

Under the provision of Section 25C(3) of the PR Act, the Commission has made the following final determinations:

- The price monitoring regime which currently applies to the ex-factory gate price of Roots Rice, will continue over the next five years.
- The declaration of the prices and price monitoring arrangements will apply for a five year period from 1st January 2011 until 31st December 2015.
- The regulatory arrangements to be applied will be:
 - price monitoring of the ex-factory price of Roots Rice under the provisions of Section 32A of the Act;
 - The Commission will require Trukai to continue to provide the Commission with quarterly price updates on all Roots Rice products;
 - The Commission will then compare these prices and any price changes (particularly price increases) to the FAO Medium Grain index, as well as the ABS index developed using the ABS series 6403.0.55.001 - *Average Retail Price of Selected Items, Eight Capital Cities*; and
 - In the event that there is a deviation between the price movements as measured by the Roots Rice index and either of the FAO Medium Grain or the ABS index, the Commission will undertake an analysis of the differences and other public information to assess why such deviations exist. The Commission will also retain the option of requesting information from Trukai on costs, revenues and profit margins to support any changes in price that are not consistent with the FAO and ABS indexes .
- In addition any time after 1st July 2013 Trukai will be able to apply to the Commission to have the price monitoring regime removed. Trukai will be required to provide supporting analytical and technical arguments to support their contention that the market is competitive and that price monitoring is unwarranted. The onus of proof will be on Trukai and should be supported by the quarterly returns provided to the Commission over the previous three years. Until such time as the Commission deems otherwise the price monitoring of the ex-factory Roots Rice price will continue, including while the Commission is reviewing the information submitted by Trukai.

APPENDIX A – SECTION 21 (2A) PR ACT

When making an order under subsection (1) of the PR Act, the Commission shall have regard to:

- A. the need to protect consumers and users of the declared goods or services from misuse of market power in terms of prices, pricing policies (including policies relating the level or structure of prices) and the standard of the declared goods or services;
- B. the cost of making, producing or supplying the declared goods or services;
- C. the desirability of encouraging greater efficiency in relation to making, producing or supplying the declared goods or services;
- D. the need to ensure an appropriate rate of return on any investment in relation to the declared goods or services;
- E. the borrowing, capital and cash flow requirements of persons making, producing or supplying the declared goods or services;
- F. considerations of demand management and least- cost planning;
- G. existing standards of quality, reliability and safety of the declared goods or services, and the desirability of encouraging improvements in those standards;
- H. the effect any proposed order on general price inflation over the medium term; the economic and social impact of anti proposed order; and
- I. any other matters the Commission considers relevant.

APPENDIX B – LIST OF SUBMISSIONS ON RICE INDUSTRY PRICING ISSUES PAPER AND DRAFT FINAL REPORT

Issues Paper

Submissions were received from:

- Associated Mills Limited (Goodman Fielder International PNG)
- Department of Industry and Commerce
- Department of Treasury
- Fresh Produce Development Agency Ltd
- Homestate Co-operation Limited
- Solomon Ralph Yamb
- Trukai Industries Limited

Draft Final Report

Submissions were received from:

- Department of Industry and Commerce
- Institute of National Affairs
- Trukai Industries Limited

In addition to the formal submissions on the Issues Paper and Draft Final Report, the Commission also received informal advice during the consultation process from a number of interested parties.

APPENDIX C – PRICE MONITORING OF FACTORY GATE PRICES

