

The Hon Ian Callinan  
Commissioner  
Equine Influenza Inquiry

26 March 2008  
Matter 81277380  
By email

Dear Mr Callinan

## Further submission on behalf of Mr Michael Moore

This submission, which we have prepared on behalf of Mr Michael Moore, supplements the submission previously provided to the Equine Influenza Inquiry (**Inquiry**) by Mr Moore on 7 January 2008.

As you are aware, we have been advising Mr Moore in relation to the potential competition law issues arising from the prohibition in Australia on registering or racing thoroughbred horses bred using artificial insemination techniques (the **Prohibition**). We are currently progressing the matter with the Australian Competition and Consumer Commission (**ACCC**).

As part of our competition law analysis, we are considering the economic effects of the Prohibition. These effects are relevantly summarised by the 1987 American article, "*Barriers to entry in the market for stud services: government and 'non-profit' institutions in collusion*"<sup>1</sup> (the **Coelho article**). A copy of the article is attached to this submission as Attachment 1. We have engaged Dr Phillip Williams of Frontier Economics to prepare an updated analysis of the economic effects of the Prohibition in Australia. Dr Williams' preliminary views are consistent with the findings of the Coelho article. We would be happy to provide you with a copy of Dr Williams' report once it is finalised in mid to late April.

Considerable evidence has been presented to the Inquiry in relation to the use of artificial insemination techniques in the Australian thoroughbred industry. The economic analysis of the Prohibition provides relevant context to this evidence and, in our view, is highly relevant to the Inquiry's Terms of Reference.

This submission sets out a high level overview of the relevant economic effects that result from the Prohibition as it operates in Australia.

### 1 Monopoly distortions

The operation of the Prohibition effectively creates monopoly distortions in the thoroughbred industry. The owners, breeders, trainers and other industry participants that benefit from these monopoly distortions are strongly motivated to retain the Prohibition in Australia.

The value of a thoroughbred race horse is dependent not only on its genetic endowment, ie its breeding lines, but also its own racing success. Used in breeding, a successful race horse is worth many times its potential race winnings because its offspring will be able to win many more races and in turn breed more offspring.

<sup>1</sup> Coelho, Philip and McClure, J, 'Barriers to entry in the market for stud services: Government and 'non-profit' institutions in collusion' *Equine Inquiry*, Vol XXV, October 1987, pp 659 – 670.

In February 2008, Mr John Digby gave evidence to the Inquiry that the top 5 – 10 percent of breeders control 25 percent of all brood mares and stallions in Australia.<sup>2</sup> The Prohibition restricts the supply of high quality thoroughbreds and enables this small concentration of owners of high quality horses to charge monopoly prices for stud services.

In our opinion, the introduction of artificial insemination would dramatically increase the productivity of a given stallion, as it would not be required to be physically present during mating. This view is supported by the Coelho article, which estimates that the number of foals sired by a stallion could increase by close to 5000 percent using artificial insemination techniques.<sup>3</sup>

By increasing access to high quality horses for breeding and therefore increasing the number of high quality thoroughbred horses produced, the demand price for stud services will decrease and move closer to the marginal cost of those services. This was acknowledged by Mr Michael Ford in his evidence to the Inquiry in February, when he stated that it was 'inevitable' that the value of sires would reduce as a result of the introduction of artificial insemination.<sup>4</sup> The economic rents accessed by the owners of race horses will also be reduced due to the increase in competition in the racing market - offspring of high quality horses will have to compete for prize money against a pool of horses of increased quality.

By removing the Prohibition, monopoly rents will be reduced in the market for breeding and racing horses in Australia. Although economic efficiency therefore supports the introduction of artificial insemination into the Australian thoroughbred industry, many significant and powerful industry participants who benefit from the monopoly distortions are, of course, likely to strongly oppose it.

## **2 High barriers to entry**

In addition to the stud fee, those seeking to breed a thoroughbred also bear significant costs associated with obtaining access to stud services. Natural mating requires the mare to be transported to and from the stud where the stallion stands. The mare is also required to be agisted at the stud for approximately 3 months. The associated costs of stud services will be even greater where the owner of the mare must additionally bear part of the transportation and quarantine costs for stallions that have been imported from overseas.

The combination of the stud fee and associated costs result in very high barriers to entry to both the thoroughbred breeding and racing markets in Australia. Prospective entrants face a very high marginal cost of entering the market and breeding a thoroughbred with a lower quality stallion, due to the lower likelihood of producing a high quality, and therefore 'successful', foal.

In our view, by increasing the number of horses that could be bred through high quality stallions (as described at 1 above), artificial insemination would effectively decrease barriers to entry. As the likelihood of producing a high quality foal increases, the marginal cost (and risk) of entering the market decreases.

Once again, despite the clear economic inefficiencies resulting from the Prohibition, the small concentration of industry participants who benefit from those inefficiencies will be a force to be reckoned with in relation to any proposal to remove the Prohibition.

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<sup>2</sup> Transcript of Inquiry, *Commission of Inquiry into August 2007 Outbreak of Equine Influenza*, (John Digby, 6 February 2008, p 3054)

<sup>3</sup> Coelho, p 667


<sup>4</sup> Transcript of Inquiry, *Commission of Inquiry into August 2007 Outbreak of Equine Influenza*, (Michael Ford, 19 February 2008, p 3770)

As stated in Mr Moore's previous submission to the Inquiry, there is substantial evidence to suggest that the outbreak of equine influenza in Australia was caused by the transportation of shuttle stallions from overseas. There was also a significant risk that the influenza would subsequently spread interstate due to the fact that shuttle stallions and mares are transported throughout Australia for breeding. The shuttling of thoroughbred horses interstate and overseas is necessary due to the operation of the Prohibition. Artificial insemination techniques, which would remove the requirement for horses to travel and breed naturally, could potentially limit the spread of equine influenza and other diseases.

However, as demonstrated by this submission and the attached article, the Prohibition results in economic distortions which benefit a small concentration of powerful and significant participants in the Australian thoroughbred industry. Despite the inefficiency of the Prohibition and the risk it creates in relation to the spread of equine influenza and other diseases, there will always be strong industry support for its retention.

Please do not hesitate to contact us in relation to this submission or if you would like a copy of Dr Williams' final economic report.

Yours sincerely

  
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