SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

PRODUCER BOARD ACTS REFORM BILL

APRIL 1997

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1. Summary

1.1. To secure a viable future, the industries covered by the Bill must match the rates of improvements in innovation and productivity of other sectors in a better performing economy. Otherwise, they will lack profitability and be unable to compete successfully for resources.[1] The sectors must therefore be freed from all unnecessary handicaps and distractions.

1.2. In recent years there has been a growing shift in thinking about appropriate institutional and regulatory arrangements for the primary sectors, and a wider recognition of the extent to which the pervasive role and powers of the boards have cast a shadow over the meat and wool sectors. The sea-change in perceptions about the role of the boards in competitive and open markets has overtaken the outcome of the 1994 review of institutional arrangements in the meat and wool sectors undertaken by Federated Farmers and the introduction of the Producer Board Acts Reform Bill. There is now a great deal of questioning about whether the boards are needed at all, including by people who are close to them.

1.3. The factors that make the industries covered by the Bill in any sense special are minimal. The very limited grounds for intervention that exist do not warrant retention of the full paraphernalia of the boards. Moreover, their retention would guarantee a continuation of the byzantine manoeuverings, pressures and industry politics which divert commercial effort in these industries in a way that few others have to suffer from.

1.4. The submission of the New Zealand Business Roundtable is that the Committee should recommend either:

- that the boards be wound up with their assets sold and distributed to levy payers; or
- that the boards be reconstituted as companies with shares allocated to producers (for example, on the basis of previous levy payments).

1.5. If producers wish to continue to fund promotion or research through a compulsory levy, they could use the provisions of the Commodity Levies Act 1990, modified as necessary to address its weaknesses.

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[1] The Meat Board, for example, has presided over an industry that has seen a trend decline in real beef and sheepmeat prices since the early 1970s, while the board has enjoyed an upward trend in levy income.

2. Overview

2.1. This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

2.2. The NZBR has taken a close interest in the subject of agricultural marketing regulation. The system of regulation that governs the export of the major agricultural products and underpins the operation of the producer boards affects, directly or indirectly, nearly half of New Zealand's export trade. It therefore has a major impact on the performance of the whole economy. Unlike most other areas of government regulation, this set of interventions has merely been tampered with in the last 10 years.

2.3. Because of the economic importance of the topic and the lack of attention given to it by successive governments, the NZBR undertook a major independent evaluation of the present forms of intervention, including those in the meat and wool sectors. This was published in October 1992 under the title *Agricultural Marketing Regulation: Reality Versus Doctrine*. It concluded that the poor performance of the meat industry over the previous decade reflected the fact that it was a victim of politics and vested interests which dominated industry developments at the expense of commercial incentives and marketplace outcomes. Likewise, it found that the pervasive influence of the Wool Board overhung the entire marketing system for wool like a giant shade tree, leaving the commercial participants stunted and fragmented.

2.4. The Producer Board Acts Reform Bill (the Bill) is a partial recognition of the problems which have plagued the primary sector. The Bill provides for:

- the functions of the meat, wool and pork industry boards to be redefined to: increase demand for industry products; conduct or fund research and development; encourage the adoption of more efficient processes and practices in the boards' respective industries; and collect, process, maintain and make available information to help production, investment, processing, product development and marketing decisions;

- a function of the Meat Board to facilitate exports to markets where there are imposed restrictions or requirements that directly affect access of New Zealand meat;

- powers to be granted to the Meat Board to license exporters, impose requirements on exports in certain circumstances (including allocation of access to tariff quota markets), set quality standards for export meat, and maintain a carcass description system. The previously restrictive export licensing regime is to be changed to a permissive regime of 'on demand' licensing;

- new accountability arrangements for the boards; and

- in the case of the Meat Board, for the inclusion of processors' and exporters' representatives on the board of directors.

3. What problems does the bill address?

3.1. The general policy statement which accompanies the Bill gives an indication of its background and purposes:

- the boards are intended to adopt a role of facilitation rather than intervention and direction, thus opening up the opportunity for more cooperative action with other industry participants. The general policy statement asserts that "interventions with the potential for limiting growth are being removed" (page iii); and

- a goal of greater accountability of the boards to producers. The objects of the boards are intended to strike a balance between the boards' accountability to their levy payers, their responsibility to the wider industry, and the national interest.

3.2. The NZBR endorses the observation in the general policy statement that, given the size of the sectors subject to the legislation, it is crucial that the regulatory environment is conducive to the development of competitive and innovative industries.[2] The Bill is a recognition that the previous (and potential future) use of existing statutory controls in the primary sector has left it poorly placed to compete for resources against other less encumbered and more dynamic sectors of the economy. The meat and wool sectors have been squeezed by a combination of a rising exchange rate, higher wages and higher prices for land and other assets. These are all signs of economic success, but they make life difficult for lagging industries.

3.3. No industries in New Zealand have suffered more than meat and wool down the years from government and producer board meddling. Uncertainty about the use to which regulatory powers might be put has discouraged investment, including foreign investment, in the industry. In the case of both meat and wool, this has led to industry fragmentation and a weak commitment to long-term marketing strategies.

3.4. It is not just direct intervention in the meat and wool sectors that has harmed their performance. Spillover effects from inappropriate regulatory arrangements in other sectors, notably the dairy sector, have also severely affected the profitability of meat and wool farmers and caused a misallocation of resources that affects the economy at large. This has been manifested in the conversions of farms to dairying. If conversions reflected a response to genuine underlying trends in the economy they would not be a cause for concern. But the large distortions that exist in the dairy industry as a result of the bundling of on-farm and off-farm returns mean that the changes in land use are being driven to a significant extent by artificial factors rather than the realities of international market demand. Over-production of milk and under-production of products which require similar resources are now clearly apparent, as are the difficulties faced by the Dairy Board in coping with the growth rate in milk production. A study commissioned by the NZBR estimated the costs to the New Zealand economy from the pricing distortions alone in the dairy industry to be $145 million annually.[3] The dynamic losses in economic efficiency arising from the Dairy Board's monopoly on export sales could easily be larger.

3.5. The history of interventions in the primary sector and their wider effects suggest the following imperatives in considering the Bill:

- the wider community has a valid interest in regulatory arrangements that apply to a particular sector.[4] It is sometimes argued that producers in the meat, wool or dairy sectors should have the primary input in what regulatory arrangements should apply to their sectors. However, this view ignores the costs imposed on the wider community from those arrangements, for example the effects of the dairy industry structures referred to in the previous paragraph. Little progress on tariff reform would have been made since the mid-1980s, for example, if views that reflected the interests of protected manufacturers had determined the outcome; and

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2 Page iii.

3 Tasman Asia Pacific and ACIL (1996), 'The Economy-wide Effects of Bundling Milk and Non-Milk Returns', Wellington, New Zealand Business Roundtable.

4 Wider community interests are reflected, to some extent, in the objects of the boards (for example clause 6) where the Meat Board must have regard to the desirability of the meat industry "…making the best possible net ongoing contribution to the New Zealand economy". However, general statements such as these are notoriously difficult to interpret and beg the question of whether it is (or should be) within the Board's power to affect the contribution of the meat industry to the national economy.

- there needs to be a more thorough scrutiny of the grounds for statutory intervention based on a contemporary approach to public policy analysis than has occurred in the past. Earlier mistakes, or pointless tampering with existing statutory controls (like previous changes to accountability arrangements in the meat and wool sectors) would have been avoided if these criteria had been applied.[5]

3.6. The Bill therefore provides a unique opportunity to address current statutory impediments to the profitable development of the meat, wool and pork industries in the light of sound public policy criteria.

4. Grounds for Statutory Intervention

4.1. Market transactions predominate in our economy and those of most of the developed world. No one enters into voluntary transactions without expecting to benefit. Accordingly, market transactions provide a means of coordination among a myriad of producers, intermediaries and consumers. The interdependence of marketers and producers has been described as follows by one commentator:

> From an international point of view, historical development implies that the control of the system will rest with the marketers and processors with contracts being formed with the producers in order to achieve the required level and quality of supply. This does not imply that the producers are necessarily disadvantaged in such a system as the business of the processors and marketers depends upon the product supplied by the producers and the quality and reliability of that supply. The whole system becomes interdependent and must be seen in this way, rather than as a confrontational process.[6]

4.2. The interdependence and coordination of willing buyers and sellers in most markets is something that occurs without compulsion. The question is whether coordination that occurs through producers, processors and marketers acting without compulsion is insufficient on public policy grounds and must be supplemented by statutory interventions of the type contained in the Bill. In other words, is there any valid reason why these industries should be subject to different rules from those which now govern commerce in almost all other sectors of the economy, including much of the primary sector?

4.3. Equity issues aside, there are widely accepted public policy grounds for evaluating existing or proposed interventions by governments in the interests of promoting community welfare. The central role of the government in relation to the production, sale and distribution of agricultural products, including meat, wool and pork products, is to establish a regulatory framework which encourages individuals and firms to take decisions that will make the best use of scarce economic resources. The government's role in this regard is no different than for any other economic activity. Possible grounds for statutory intervention include:

- reducing the costs of individuals and firms transacting with each other;

- funding the provision of public goods which will be inadequately provided by the market;

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5 An example is tampering with legislation to give effect to the outcome of a previous review of accountability arrangements for the Meat and Wool Boards undertaken by the Weir Committee.

6 Sheppard, R (1993), 'Agricultural Restructuring Effects: an Industry Perspective', Paper presented to the New Zealand Agricultural Economics Society Conference, 1-2 July.

- providing that firms earn sufficient rewards from goods and services that yield wider community benefits (referred to as externalities) to ensure that they are adequately supplied;[7]

- promoting competition; and

- promoting the provision of goods and services which are likely to be under-supplied because of difficulties in obtaining information.

4.4 With the support of appropriate legislation to address the issues noted above, markets involving transactions by willing buyers and sellers are best able to allocate resources to their most productive uses. The onus should be on those who argue for special rules for the meat and wool sectors to establish a positive case for any interventions, based on sound analysis.[8] In particular, it is necessary to show that:

- one of the grounds for intervention listed above applies to the production and exporting of meat and wool;

- if those grounds do not apply, there are unique aspects of meat and wool products that distinguish them from other products and justify statutory interventions;

- any intervention produces benefits that are greater than any costs; and

- the statutory interventions set out in the Bill are the most appropriate.

4.5. In the remainder of this submission, the foregoing criteria are applied to assess whether a positive case can be made for the statutory interventions and powers set out in the Bill.

5. Research and Promotion

5.1. The Bill provides in clauses 7, 90 and 132 that functions of the boards include increasing the demand for their respective products (including, presumably, through marketing and promotion) and undertaking research. Expenditures on research and promotion are the most commonly cited examples in the agricultural sector of services which have some of the elements of a 'public good'. Public goods or services exhibit both of the following features:

- it is difficult to exclude non-payers from the enjoyment of the benefits of the goods or services; and

- the extra cost (and therefore the price) of providing such goods or services to an additional user is very low or zero. In a narrow sense, the cost of providing street lighting for the extra passer-by would be zero. The extra cost of providing wool promotion to one more grower would likewise be close to zero.

5.2. Pure public goods are rare, if not non-existent, although many goods exhibit some of their features, such as some aspects of research and development (for example, because of the difficulty of excluding non-payers from the enjoyment of services funded by payers). If left to the private market, arguably not enough of these goods would be supplied.

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7 Conversely, fees or taxes might be justified if firms do not face all the costs they generate.

8 This is in contrast, for example, to a starting presumption that all commerce should be fully regulated and goods and services should be provided by the state.

5.3. Against this, however:

- mechanisms exist to exclude non-payers from the benefits of promotional expenditure where it is economic for funders of promotion to use them. Examples include the development of brands and trade or quality marks. These represent property rights which are given statutory protection through trademarks and patents. Rules protecting brands or trade-marks enable the person who invests in promotion or quality improvement linked to a brand or quality standard to capture most (if not all) of the benefits of that expenditure. Non-payers do not derive any direct benefit since they are denied use of the brand or quality mark. The implications of the development of stronger patent, licensing and copyright arrangements which have made it easier for companies to capture and protect the benefits of research were noted by the Industry Commission in Australia. The Commission concluded that stronger property rights were a contributing factor to a new climate that provided greater opportunities for research by individual companies;[9]

- interventions could prevent the development of alternative mechanisms which may be more effective in the longer term. The imposition of levies to fund generic promotion or research, for example, may displace research or promotion that would otherwise be undertaken directly by stakeholders. Since processors and other intermediaries face stronger incentives and have better information than producer boards to optimally tailor promotion to market needs (including incentives to decide whether to fund promotion at all), producer-funded generic promotion is likely to be a poor driver of success; and

- even if non-payers cannot be excluded, it may still be worthwhile to invest since the pay-off may be high enough to make it worthwhile.

5.4. It might also be argued that expenditure on research gives rise to externalities which are not captured by the funder of the research. Supposed externalities are widespread and do not necessarily imply the need for intervention. As observed by Nobel laureate Ronald Coase:

> The ubiquitous nature of 'externalities' suggests to me that there is a prima facie case against intervention, and the studies on the effects of regulation that have been made in recent years in the United States, ranging from agriculture to zoning, which indicate that regulation has commonly made matters worse, lend support to this view.[10]

5.5. Even in markets where externalities might exist, such as the provision of computer communications networks, competing firms often cooperate by standardising technologies or protocols without government intervention. Externalities might also be ignored by consumers and producers because of inadequately defined property rights (such as patent rights). In these cases, better defined property rights are likely to be a preferable alternative to centrally determined subsidies or taxes.[11]

5.6. As well as increasing costs incurred by producers, arrangements to fund favoured research and promotion projects through compulsory levies increase the risks producers face. The levies that fund

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9 Industry Commission (1994), *Meat Processing*, Report No 38, Australian Government Publishing Service, Melbourne.

10 Coase, R H (1988), *The Firm, The Market and the Law*, Chicago, The University of Chicago Press.

11 It is notable that property rights in respect of board-funded activities are often quite weak. For example, calls are being made to franchise the 'Fernmark'. There may also be some doubt about the strength of property rights in respect of the Meat Board's carcass grading system.

the Meat and Wool Boards represent a significant proportion of the before-tax net income of producers. The average sheep and beef farm is likely to pay a levy of around $2,200 to fund the Wool Board in 1997.[12] Additional levies to fund the Meat Board are around $1,100.[13] Total levies of around $3,300 represent approximately 12 percent of forecast 1997 net profits before tax (this amount excludes the forgone returns to producers on reserves held by the boards).

5.7. The bulk of levy receipts is used to fund promotion and research by the boards. It is doubtful whether many producers would voluntarily choose to fund these activities to the extent of 12 percent of their net income compared to using the resources for other purposes. The benefits (and costs) of levies paid by producers are, in reality, shared with consumers and the processors of the commodity. The producer's share is determined by the relative responsiveness (elasticity) of supply and demand for the commodity to changes in prices.

5.8. This raises the likelihood that the benefits producers derive from promotion and research into off-farm processes are less than their share of costs. It is unusual for producers of raw materials to finance the promotional budgets of processors and marketers. Depending on the price responsiveness of products, all or a proportion of levies paid by producers represent a wealth transfer to intermediaries and final consumers.

5.9. A recent study on the impacts of brand and generic advertising on meat demand in the United States concluded that, relative to increases in advertising expenditures, considerably smaller percentage reductions in beef prices are necessary to induce equivalent increases in consumption.[14] This implies that funding of promotion may provide much lower yields to producers than expenditure (including research) aimed at reducing on-farm production costs. Another commentator has argued that "…producers should prefer a research-induced decrease in production costs to an equivalent promotion-induced increase in retail price and to a decrease in marketing costs".[15]

5.10. There is a difference between advertising that is observed to be successful because it induces increased demand, and profitable advertising. For example, an expansion in domestic demand may merely divert product from the export to the domestic market. If export and domestic prices are similar, then average prices (and hence revenue to producers) do not increase. Pre-advertising profits are reduced by the amount of the advertising expenditure.[16]

5.11. If nothing else, this potential implication shows the naiveté of the thinking behind the proposed function of the boards to increase demand for their industries' products. Even if this could be achieved by a continuation of the traditional emphasis on promotion, which is improbable, the pursuit of such a goal may reduce producers' net income.

5.12. Commercial judgments about the allocation of resources among promotion, research and other activities are made by businesses every day. However, compulsory levies paid to fund a variety of research, promotion and other board activities are a cumbersome mechanism to address the trade-offs

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[12] 5 percent of forecast wool revenue of $43,100 from an average all classes sheep and beef farm (MAF, 1996, *Situation and Outlook for New Zealand Agriculture*, Wellington, p.54).

[13] *Rural News*, March 10 1997.

[14] Brester, Gary and Schroeder, Ted (1995), 'The Impacts of Brand and Generic Advertising on Meat Demand', *American Journal of Agricultural Economics*, 77, p. 969-979.

[15] Wohlgenant, M K (1993), 'Distribution of Gains from Research and Promotion in Multi-Stage Production Systems: The Case of the US Beef and Pork Industries', *American Journal of Agricultural Economics*, 75, p. 642-51.

[16] This issue is noted in Piggott, R R, Piggott, N E and Wright, V E (1995), 'Approximating Farm-Level Returns to Incremental Advertising Expenditure: Methods and an Application to the Australian Meat Industry', *American Journal of Agricultural Economics*, 77, p.497-511.

involved. Accountability arrangements provide little protection against the risk that, as in the past, the resources of producers will be devoted to a narrow range of risky schemes. Resources may be over-committed to currently fashionable marketing or other strategies which, with the passage of time, prove to be ineffective.

5.13. The dynamics of continuously changing markets mean that no one person or organisation can know for sure whether resources are best spent on on-farm or off-farm development, whether research which reduces on-farm costs should be favoured over promotion, or whether generic or branded promotion provides superior returns. In other sectors, diverse and competing approaches by producers, processors and other market participants making their own investment choices allow successful strategies to emerge over time. However, these opportunities are thwarted in the industries covered by the Bill since the legislation continues to place decision-making on the use of substantial producer-financed resources in the hands of a few.

5.14. The grounds for intervention to fund research and promotion that differ from those of most other industries are weak, and any benefits are unlikely to exceed associated costs. Promotion and research should be the responsibility of those who directly benefit and who are best placed to make the trade-offs involved. At most, producers should have access to the mechanics of the Commodity Levies Act 1990 (modified if necessary) if sufficient numbers decide to collectively fund promotion and research.

6. Mandatory Grading and Quality Standards

6.1. The Bill provides in Part VII for the Meat Board's current grading powers to be replaced by the power to establish carcass description systems, with the point of compulsion shifting from the point of export to the meat processing plant. Under Part VI the Board will have powers to set quality standards for export meat quality that do not relate to hygiene or importing countries' sanitary requirements (which are the province of MAF). Part IV provides for the board to impose export requirements in response to restrictions imposed by authorities in export markets.

6.2. It is sometimes argued that statutory intervention along the lines embodied in the Bill is necessary because product characteristics are frequently difficult for consumers to observe due to high information costs. Consumers may, for example, be unsure about the properties of meat byproducts, or the quality of wool offered for sale. If consumers are less informed than suppliers about product quality, bad suppliers can end up driving out good ones.[17]

6.3. However, situations where consumers know less than suppliers about the quality and other characteristics of a product are not uncommon. In these situations consumers are prepared to pay for a good product if they have assurance about its quality. Suppliers can respond by certifying the quality of a product and thereby enhance their returns. The supplier's incentive to report accurately the quality of the goods offered arises from the returns to building a good reputation. These returns can be greater for intermediaries (such as meat processing companies or wool brokers) since they carry out more transactions than individual suppliers.[18] Accordingly, an intermediary can offer many different products (of differing dimensions and qualities) for sale, and consumers can rely on the reputation of the intermediary without the need to investigate the many product suppliers. In particular, the intermediaries can serve as guarantors of product quality through warranties and contract terms.

6.4. Mandatory grading systems and quality standards cut across these normal market responses. Provided valid hygiene and sanitary concerns are addressed in accordance with international obligations, any other mandatory quality standards are an attempt to impose a particular market differentiation strategy. Judgments about the viability and nature of such strategies should be left to

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17 This is often referred to as the 'market for lemons' problem.

18 Spulber, Daniel (1996), 'Market Microstructure and Intermediation', *Journal of Economic Perspectives*, 10(3), p.135-152.

market participants, who have the strongest incentives and best information to get them right. Removal of mandatory requirements would mean that:

- certification costs would be targeted more effectively on products for which the demand is most responsive to the setting of standard grades or quality marks;

- each marketer would have an incentive to ensure that the grades or quality standards met the needs of importers and consumers while enhancing the marketer's reputation; and

- incentives faced by producers and processors would more fully correspond with those dictated by the marketplace. Since marketers would directly bear the cost of certifying their products, they would face the strongest incentives to ensure certification is cost effective.

6.5. Accordingly, there seems little justification for retaining the existing structure of the boards in order to manage:

- licensing requirements for meat exporters as provided for in Part IV of the Bill, except where that is necessary to allocate and manage access to country-specific tariff quota markets;

- meat export requirements provided for in Part V;

- quality requirements for meat provided for in Part VI;

- carcass descriptions provided for in Part VII; and

- quality requirements in respect of wool in Part XVIII.

6.6. Despite the protections in the Bill, the powers of the boards in respect of the above requirements also represent a risk to stakeholders and make the sector less attractive to investors. Some powers, like those relating to the imposition of export requirements for meat in Part IV, are broad and would be exercised only in response to restrictions imposed by authorities in overseas markets. However, in the event of such restrictions being imposed, an individual company could be adversely affected by majority decisions, which means that commercial risk in the industry is unnecessarily increased.

6.7. Moreover, to the extent that market restrictions or requirements do not relate to valid hygiene or sanitary concerns, they amount to non-tariff barriers in respect of which remedies are being developed under the rules of the World Trade Organisation. It is therefore doubtful whether the full range of restrictive powers set out in Part IV is either required or appropriate, since it is conceivable that their existence might invite the imposition of non-tariff restrictions.

6.8. In summary, the NZBR concurs with the minister of agriculture that grading powers should be removed from the Bill. Likewise, the ability of the boards to set quality standards in Parts VI and XVIII should be removed. This will ensure that statutory interventions do not cut across normal market signals that suppliers convey to consumers, nor impede the independent enhancement of brands and reputation.

7. Access to Tariff Quota Markets

7.1. As part of its powers to impose export requirements, the Meat Board will be responsible for establishing and administering mechanisms for the allocation of access to tariff quota markets (provided under Part V of the Bill).

7.2. Quota restrictions are a diminishing problem for New Zealand's meat and wool markets. As a result of the Uruguay Round, quotas have been liberalised and the trend is for them to be replaced over time with tariffs. Quota access applies in respect of the European Union and (in the case of beef) the United States and Canada. However, it is now only in respect of exports to the European Union that volume limits are reached.[19] In the specific case of that market, there is a role for statutory arrangements for the time being to ensure that rents (net of any costs of setting up and administering a quota system) created by restricted access are not dissipated. The Bill does not address the issue of how the quota should be allocated. Instead, the job of establishing a mechanism is left to the Meat Board. However:

- the administrative requirements to operate and manage an allocation mechanism are not extensive; and

- there is no particular reason why the board should be retained solely for this purpose. For example, if allocations to the EU and the US were established as property rights and, once allocated, were valued and traded according to their commercial merits, the ongoing involvement of any external agency would be minimal. Other allocation mechanisms would also be possible without board involvement.

7.3. The issue of access to tariff quota markets is now a relatively minor one. The administration of export licences and other valid export restrictions is more appropriately a government function (as was the case with import licences) than an industry function. The job of devising and allocating quota access could be given to a small, special purpose agency with a limited life set up for the purpose. Alternatively the job could be given to MAF (which, prior to the advent of the Ministry of Fisheries, had responsibility for allocating quotas for fish stocks).

8. Accountability arrangements

8.1. A review of the grounds for statutory intervention shows that valid grounds for intervention (taking account of associated costs) potentially exist only in respect of markets where access or other restrictions apply, and this justification is likely to apply to just one market (the EU), and for a limited period. This ground for intervention does not justify maintaining the infrastructure of the boards as envisaged by the Bill.

8.2. The boards are also poorly suited to be bulk funded from levies to undertake a wide range of activities (market access, promotion, research etc.). This arises from the following incentive problems:

- capital market constraints on the performance of the boards are relatively weak. For example, management is not exposed to the threat or reality of takeovers and information generated by the sharemarket reflecting management performance is absent. While this applies particularly to boards as a holding entity, producers have found to their cost over the last decade that incentive problems also arise for subsidiaries owned or controlled by the boards;

- accountability to producers is primarily through political processes and pressures which leads to the use of political, rather than commercial, decision criteria. A continuing and substantial role for the boards in funding research and promotion makes it easier for special interest groups to lobby to invest funds in low-yielding activities. There are still calls by some in the sector for the boards to invest in "a string of commercial companies", ignoring costly lessons of the past.[20] The chief executive of the Meat Board

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[19] New Zealand's beef exports to the United States over recent years have fallen well below the permitted quota level.

[20] *NZ Herald*, 21 March 1997, p.C4. The Bill provides few impediments to the boards in

is reported as being keen to see the board's $70 million in reserves used to fund a range of partnerships with local and overseas companies.[21] Private investment will be deterred where the powers and resources of the boards can be used in a selective and arbitrary fashion. Lobbying to maintain or increase spending on favoured, but low-yielding, activities can be successful since decision making is intermediated through industry politicians rather than through the far stronger accountability mechanisms applying to commercial activities;

- the boards have confused and overlapping objectives. The general policy statement notes that the objects which spell out what each board is to achieve "…are intended to strike a balance between the boards' accountability to their levy payers, their responsibilities to the wider industry, and the national interest". These objectives will often conflict, which means that any shortcoming in meeting an objective can be attributed by the boards to a requirement to pursue another;

- as ultimate owners of board-owned assets, producers have relatively weak incentives to monitor the performance of the boards and their management. This is because producers are not able to act directly on information they receive about board performance, for example by buying and selling shares; and

- the activities of the boards can overlap with those of the government, resulting in waste and a confusion of roles. The minister of agriculture has questioned spending by the boards on market access.[22] He pointed out that this is properly a role of the government, assisted where appropriate by organisations that represent direct stakeholders, such as the Meat Industry Association and Federated Farmers (with these organisations having an incentive to work jointly where their interests coincide).

8.3. The above incentive problems are heightened because the objectives of producers may conflict with those of the boards. The interests of producers may be better served by the boards distributing their reserves or liquidating assets and returning the proceeds. The interests of management or of the boards may lie in retaining earnings and investing in politically popular ventures that, due to poor returns or risk, would not be undertaken by an entity subject to normal commercial disciplines.

8.4. A further point is that, because of the conflicting objectives of producers and the boards, spending on favoured marketing or research strategies may not accord with producers' spending and investment preferences. The preferences of producers are unlikely to be uniform because they face vastly different circumstances. Many are currently hard pressed to pay for necessities such as food, housing and basic farm maintenance. They could be expected to put a low priority on promotion or the retention of non-core assets by the boards compared to retaining the levies they pay and receiving cash distributions from board reserves, both of which would increase their disposable incomes (in the order of 12 percent for the average sheep and beef farm). Producers who wish to invest in commercial assets could do so independently of the boards. Boards cannot reflect the preferences of each producer since their decisions affect all producers.

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the future deciding to expand their role in commercial subsidiaries. In this context, Wool Services International is a recent salutary illustration of why boards are poor vehicles for commercial decision making. The Wool Board's decision to acquire the venture followed its decision to terminate its involvement with minimum pricing arrangements, and reflected its desire to find another role for itself. The poor performance of the company cost producers dearly.

[21] *Rural News*, March 10, 1997.

[22] *NZ Herald*, 21 March 1997, p.C4.

8.5. A similar point arises in respect of risk-taking. The willingness of producers to take financial risks differs. The sale of the boards' remaining assets and the discontinuance of levies would reduce the risk producers face, or would enable them to manage their own risk according to their preferences. Many producers have limited opportunity to influence the decisions of the boards and have few options to offset the effect on them of adverse decisions. It is very costly, for example, to convert land uses to other, less encumbered activities.

8.6. As entities in which investors are captive, performance measures for the boards stipulated by the Bill such as five yearly reviews, while probably superior to none at all, are a pale reflection of the disciplines that apply in the private sector. The 1992 collapse of the kiwifruit industry occurred immediately after a statutory review which did not identify the serious weaknesses in the Kiwifruit Marketing Board's operations. Most importantly, it is simply impossible to establish the counter-factual through such reviews - what return could producers achieve if they had the ability to make alternative investments? Likewise, attempts to require more elaborate procedures for political accountability, for example by approving annual plans, requiring three-yearly votes or scrutinising spending by the boards on major initiatives, are merely a palliative. Such approaches confuse the role of stakeholders and management, and do not address the fundamental weaknesses that arise from a reliance on political rather than commercial accountability.

8.7. These differences between boards and an investment vehicle in which stakeholders directly hold ownership interests mean that, on average and over time, resources invested through the boards are likely to achieve lower returns than if those resources were invested directly by producers. History to date underscores this conclusion.

8.8. The existence of the boards and their statutory powers also keeps alive the fallacy of 'producer control' that has bedevilled primary industries for decades. This fallacy is still manifested in movements like Farmers for Change and Meat and Wool Levy Payers, and has led to endless inquiries like the Weir Committee, the Cullwick Committee and the review that preceeded the present Bill. Wool, meat and pork processors and exporters, politicians and unions can all fall into the trap of believing that if only they could use the resources and powers of the boards to achieve the right interventions or industry strategies, the forces of economic gravity would somehow be defied and downturns in markets that are beyond anyone's control would be reversed.

8.9. However, all the meetings, reviews and movements reflect a failure to understand the disciplines of competitive markets and sustain naïve ideas about collective ownership that are little different from those espoused in the former Eastern bloc. They divert a great deal of time and energy of industry participants which would be better directed to business activities, whether on or off the farm.

8.10. The false sense of 'producer control' induced by umbrella organisations like the boards also diverts the attention of producers and others from the development of more conventional and successful forms of cooperation and coordination that are typical in other sectors (such as sophisticated purchase contracts where there is seasonal demand or supply). Rather than trying to tamper yet again with the architecture of the boards, they should be dispensed with once and for all.

9. Conclusion

9.1. The meat and wool industries have been prone to regular crises for the past 20 years. Their development has been plagued by government and producer board interference that has been grossly distorting. They are also continuing to suffer from the effects of inappropriate controls in the dairy sector.

9.2. Existing structures in the meat and wool industries were criticised in the NZBR report *Agricultural Marketing Regulation: Reality Versus Doctrine.* Since that time there has been a significant shift in thinking, and a wider recognition of the extent to which the pervasive role and powers of the boards have cast a shadow over the sector. Even the review of institutional arrangements in the meat and wool industries undertaken by Federated Farmers in 1994 and the introduction of the

Bill have been overtaken by events. There is now a great deal of questioning about whether the boards are needed at all, including by people who are close to them.

9.3. The meat and wool industries are slowly recovering from the adverse effects of past interventions. There is no reason to believe that both industries, and the pork industry, should not have a good future. However, to secure a viable future, these industries must match the rates of improvements in innovation and productivity of other sectors in a better performing economy. Otherwise, they will lack profiability and be unable to compete successfully for resources. The sectors must therefore be freed from all unnecessary handicaps and distractions.

9.4. This submission has established that any special factors that make the industries covered by the Bill stand out from others are minimal. The very limited grounds for intervention that exist do not warrant retention of the full paraphernalia of the boards. The only significant one which remains valid for the time being is access to quota markets with significant rents and could be handled by giving licensing powers to a government agency. Moreover, retention of the boards leaves open the likelihood that the sectors will continue to be plagued by political manoeuvering and pressures which divert commercial effort in a way that few other industries have to suffer from.

9.5. Accordingly, we submit that the Committee should step back from the detail of the Bill and consider how the industries it covers should be put on a more certain and durable long-term footing. In particular, it should recommend either:

- that the boards be wound up with the proceeds from the sale of their assets sold and distributed to levy payers; or

- that the boards to be reconstituted as companies with shares allocated to producers.

9.6. In either case, the proceeds or shares could be distributed on the basis of previous levy payments. Reconstituting a board as a conventional company subject to normal commercial disciplines would be appropriate if it is desirable to retain the assets of the boards, including ownership of brands that have a positive market value. Once reconstituted, the new entities would be as free as any other company to engage in joint ventures, purchase commercial operations, or charge royalties for the use of brands they own. Likewise, producers would be free to retain or sell their interests in the new entities.

9.7. If producers wish to continue to fund promotion or research through a compulsory levy, they could use the provisions of the Commodity Levies Act 1990. While this Act might be improved,[23] it has a number of advantages over bulk funding boards to undertake a variety of tasks:

- more flexibility is provided for levies to be targeted for particular purposes, for example research as distinct from promotion;

- unlike the case with the meat and wool boards, levies cannot be spent on any commercial or trading activity unless either specific approval is given by the minister of agriculture or commodities are bought and sold for certain other limited purposes (such as those associated with promotion, research, education or product development); and

- levies to fund particular activities have a limited life, whereupon a fresh mandate is required from levy payers.

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[23] Some of the problems with the Act are referred to in MAF (1996), 'Post Election Brief: Policy Issues and Current Status of the Agriculture Sector', Wellington, p.50-51.