CHAPTER TEN

INDUSTRY REVIEWS IN THE LAND USE AREA

A number of industries in the land use area have been, or are currently being, reviewed. The tobacco industry was reviewed in the early 1980s and is currently following a restructuring programme resulting from that review. Both the wheat and flour and the egg industries are currently subject to reviews, which are at different stages of completion. Officials are working on a number of problems in the inshore fisheries area. The town milk industry is not currently being reviewed; however, there are good reasons to believe that a review is warranted. Details of the reviews of these industries are given below.

The Tobacco Industry

For many years the tobacco industry was heavily protected and regulated. Regulations included the licensing of producers, the use of production quotas to control production, specified domestic leaf content in domestically manufactured cigarettes, and price setting and protection, by way of import licensing, on cigarettes and manufactured tobacco. Reserve Bank funding of tobacco stocks was introduced in 1976. As a result of an industry study undertaken by officials, in December 1980 the Government initiated a restructuring of the tobacco growing industry. Following a report by the Industries Development Commission, further measures relating to tariffs and import licensing were announced in June 1981.

The overall effect of the tobacco restructuring plan is to gradually phase-out special legislative protection and other forms of assistance so that by 31 August 1986 the industry receives no more assistance than other horticultural industries. This involves the removal of licences for growers and the substitution of tariffs for import licensing. Reserve Bank financing is also to be phased-out by the 1988/89 season. The major objective is to ensure that land use changes are responsive to changes in the international market by subjecting the domestic tobacco growing industry to more competitive pressure.

The need for a restructuring of the industry became particularly apparent in the late 1970s as a result of the production of the tobacco leaf in excess of domestic manufacturers' requirements. This problem was overcome in the short term by a number of measures including adjustment assistance grants of $7,000 per hectare to growers who wished to leave the industry or to reduce their licensed tobacco growing area.

The restructuring programme for the industry is continuing. At present, as agreed with the industry, all elements of the restructuring plan are being reviewed by officials to ensure the initial objectives of the plan are being achieved. No major changes seem called for.

It should be noted that CER will have an effect on the domestic tobacco industry and is making restructuring inevitable.

The Wheat and Flour Industry

In May 1983, the Government agreed that the wheat and flour industry should be reviewed by officials. Officials presented their report to the Government in February 1984. This report was released and at present the Wheat Board is, at the Government's request, collecting the industry's views on it. The Board will report on the industry reaction, and its report is to be evaluated by officials.

The review was prompted by the considerable extent of regulation within the industry and by the advent of CER. At present, the Wheat Board controls virtually all aspects of wheat growing, wheat flour and feed wheat milling, and the sale of wheat and flour. This structure of regulatory controls has remained essentially unchanged since the 1930s. The original consideration of domestic self-sufficiency is no longer considered relevant and the CER agreement with Australia will in any case make change inevitable. Under the agreement there is to be free access of flour into New Zealand from 1995 or possibly from an earlier date.

Officials consider that the present system of regulatory control is contrary to the attainment of a neutral assistance framework involving, among other things, equal levels of assistance, in which producers compete for resources on the basis of their underlying efficiency. The rigidities in the system are inimical to efficient development and costly to the final consumer. In the national interest controls on wheat marketing and flour milling should be removed.

A major problem identified within the industry is the locational rigidity of flour production. This is caused by national pricing of wheat and flour which removes transport costs as a consideration in location decisions. Also flour production quotas are based on historical production patterns and have not taken account of population shifts. Transport deregulation is leading to a change in the relative costs of transporting wheat compared to flour. If efficiencies are to be gained, the industry must be responsive to transport costs and to changes in the relative pricing of different transport modes. There is evidence of appreciable over-capacity in the milling industry and this is probably, in large measure, the result of a cost-plus price control system.

Officials have recommended reductions in controls affecting the industry to make it more responsive to market forces, and more efficient in terms of the allocation and utilisation of resources. These recommmendations include the abolition of the flour quota in 1987 and the removal of controls on flour prices in 1987. Officials have recommended that the role of the Wheat Board in the marketing of wheat for flour milling be reviewed in 1990 and that, in the meantime, its pricing policy for wheat should reflect, to a greater extent, quality and freight costs of individual consignments. Officials recommended that the Board's control over the marketing of feed wheat be removed in 1987.

The Egg Industry

In May 1984, the Government agreed that a review of the egg industry should be undertaken by the Industries Development Commission. The Commission is to consult with the industry, consumers and officials before submitting its report on the egg industry to the Government by 28 February 1985.

The current industry structure involves extensive control by the New Zealand Poultry Board over the production, distribution, and marketing of eggs and egg products. There is much to suggest that these controls have led to a very inefficient industry structure and use of resources. For example there is considerable overproduction and the surplus is sold at a loss which is mostly passed on to consumers. The regional imbalances in egg production suggest poor locational decisions and excess costs which, again, are mainly borne by consumers.

The objectives of the review are, therefore, to examine the present structure of the egg industry with regard to the efficient use of resources in the industry, and to suggest areas where the public interest can be enhanced by promoting competition and efficiency in the production, distribution and marketing of eggs. Areas that the Commission is to specifically examine, and make recommendations on, are:

- the pricing and marketing system;
- the entitlement scheme—this discourages new entrants to the industry and protects those already there;
- the location and level of egg production, noting current imbalances and surpluses;
- the administrative structure of the industry—whether an administrative body is needed and if so, what is its role and how should it be funded; and
- the current controls over the exporting and importing of eggs and egg products.

Inshore Fishery

The inshore fishery is normally defined in terms of the fisheries' principal commercial species—i.e. Snapper, Trevally, Tarakihi, Red Cod, Red Gurnard, Rig, School Shark, Monkfish, John Dory, Barracouta and Jack Mackerel. The current problem of the inshore fishery is one of overfishing—i.e. too many fishermen and fishing boats chasing too few fish.

Overfishing is a common problem in fisheries around the world. Indeed, the economics of fishing are such that with relatively high fish stocks a given catch is always worth much more than the total costs (including returns to capital and labour) of the minimum required harvesting effort. There is thus an incentive for fishermen to take as much of the available catch as they can and for additional resources (including additional fishermen) to enter the fishery. However, those additional resources ultimately reduce fish stocks and consequently also reduce the previous efficiency in harvesting a given catch. The consequence is that the net economic surplus that could have been derived from rational exploitation of the stocks is dissipated in excess capacity.

Overseas attempts to prevent over-fishing have often ended in failure. For instance, attempts made in Canada to reduce excess capacity by buying out boats and restricting the number of boats allowed to fish have resulted in fishermen simply increasing the power and the size of those fishing boats remaining in the fishery. In other words the excess capacity has remained in the fishery, albeit in another form.

Following a review last year by the National Fisheries Management Advisory Committee (NAFMAC)—a joint officials/industry grouping—officials have been reviewing the policy options available to sensibly restructure the New Zealand inshore fishery. Considerable work has already been undertaken but still further work is required before officials will be in a position to put recommendations before Ministers.

In the long-term one of three scenarios may prevail in the inshore fishery: it produces an economic surplus, it produces neither an economic surplus nor an economic loss, or it produces an economic loss. An economic surplus means a net national benefit in that the value of the fish being caught exceeds the value of the resources put into the fishery by the industry and the Government. With no government intervention, market forces as described previously will ensure that in the long run there is neither a surplus nor a loss. However, inappropriate government intervention could lead to the third scenario where the industry is putting in resources equal in value to the fish being caught and in addition the Government is also putting in resources through administration, enforcement, etc.; the government input would represent economic waste. The first scenario would be best; the second would be second best; and the third would be worst.

Our view is that the regime with the greatest chance of producing an economic surplus, is one of creating individual property rights via individual transferable quotas (ITQs) within a total allowable catch (TAC). An ITQ is the right to catch a certain amount of fish from a certain species and fish stock within a given period; this right may be bought and sold like any other commodity. The setting of the TACs, which are the sum of the ITQs and hence also related to particular species and stocks, determines the speed at which the various fish stocks will be built up again and future economic surpluses secured.

However, it is not completely clear as yet whether the costs of implementing ITQs would outweigh the benefits in the New Zealand inshore fishery. Indications are that the costs of enforcing and administering ITQs could be kept down by, for instance, a system of random checks, but only if there was reasonable cooperation from the industry. There could also be costs associated with making some capital and expertise redundant in the short-term through necessarily lowering the amount of fish allowed to be caught. Work is continuing to assess the benefits of implementing an ITQ system against the associated costs.

Assuming the benefits of an ITQ system do in fact outweigh the costs, there still remains the question of how the various costs and benefits should be distributed amongst the community. It is Treasury's view that the community as a whole should ultimately appropriate any excess profits arising from an ITQ system, both because most of the costs are borne by the community as a whole and because the profits would be essentially unearned. On the other hand, fishermen will be made worse off in the short term and to gain their cooperation for an ITQ system there may be a case for short-term adjustment measures. There are two basic ways of achieving the above income re-distribution objectives.

Firstly, a limited quantity of ITQs could simply be allocated to existing fishermen. The sum of all ITQs would be set at the desired TAC, which would be less than previous catch levels. Any expected excess profits as a result of ITQs over the following years in the relocation period would be capitalised into the value of the ITQs. The gift of the property rights inherent in the ITQs would therefore have some value, reflecting the right to share in future economic surpluses and would therefore represent assistance to existing fishermen. The balance of the economic surplus could be appropriated to the community by levies on fish caught and/or the tendering of quota. A second approach would be to more directly compensate fishermen for restricting their short-term catch. An attractive method of achieving this would be to allocate ITQs up to historical catch levels and then to offer to buy quota by tender in order to reduce catching levels back to the desired TACs. This would ensure full compensation and no more. A less attractive means would be to offer to buy back existing fishing boats. Such an approach would probably be administratively more difficult and could create inefficiencies. For instance it would discourage some fishermen from keeping their boats and fishing part-time only. In whatever way assistance is delivered, the economic surpluses arising during the period of the initial quota should be appropriated to the community by a levy on catch which would be increased over time as the economic surplus increased.

In conclusion, it is clear that a problem of over fishing does exist in the inshore fishery. A solution is desirable but it must be one in which the economic benefits from intervention outweigh the economic costs. Although work on the issues is proceeding well, further work is still required. Officials are unlikely to be in a position to be able to put recommendations before Ministers in the near future.

Town Milk

The town milk supply industry is regulated at all stages of production and in its sales to consumers. Town milk producers' seasonal production is determined by individual farmer quotas. Similarly, the throughput volume of milk stations is the area aggregate of town milk producer quotas. Town milk vendors are licensed, the licences being purchased from the New Zealand Milk Board. Although the returns to town milk producers are linked with export returns, the margins for milk stations, shop sales and town milk vendors are all determined by the Secretary of Trade and Industry, largely on a cost-plus basis. The costs of the regulatory structure, (i.e., the administrative costs of the New Zealand Milk Board and milk producer association), are also met in the price of town milk; these costs amount to about 2 percent of total town milk supply costs. Finally, the price of milk is subject to control, being set by the Minister of Agriculture.

There can be little doubt that under such a rigid system of market regulation the industry's cost structure is protected from any significant competitive pressure. It is somewhat ironic that while on one hand government regulation almost certainly increases costs, on the other hand, the Government subsidises the price of bottled milk. In 1983/84 this subsidy was about $9 million or about 1.5 cents per bottle of milk. However, present policy is that the milk subsidy can rise to $30 million before the price of milk is increased—this would represent a subsidy of about 5 cents per bottle.

In Treasury's view the high level of regulation in the town milk industry needs to be reviewed in order to determine whether a greater degree of competition should be introduced into the town milk market. In the past, a predominant theme in support of a regulated town milk industry has been the stability of supply to consumers. It seems very doubtful if the benefits to the consumer of these extensive interventions exceed the costs to the consumer. It seems clear that efficiency gains are possible because premiums are paid in a number of areas for the right to supply town milk. A number of alternative arrangements could be considered including a greater use of reconstitution and use of manufacturing milk supply.

It would be appropriate to review separately the case for a milk price subsidy. Some recent economic analysis of milk consumption in New Zealand has indicated that changes in milk prices have very little effect on the medium term consumption of milk (AERU Research Report No.147 refers). Treasury considers that the subsidy has probably had little effect in promoting milk consumption in New Zealand and that the expenditure on this subsidy could probably be better targetted if it is to remain as part of social welfare assistance.

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