

NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION TO THE MINISTRY OF AGRICULTURE AND FORESTRY

REVIEW OF THE REGULATORY FRAMEWORK FOR PIPFRUIT EXPORTING

JANUARY 2001

1.0 Introduction

- 1.1 This submission to the Ministry of Agriculture and Forestry is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.
- 1.2 The NZBR commends the government for undertaking this review of the regulatory framework for pipfruit exporting. The pipfruit exporting sector is one of the most heavily regulated commercial activities in New Zealand and a fundamental overhaul of the regulatory environment is required.
- 1.3 This submission examines the problems with the current regulatory environment, outlines the reasons why we consider deregulation is inevitable and then addresses the transition path to a normal commercial environment for the pipfruit industry. Finally, we consider the relative merits of a Horticultural Export Authority (HEA)-type regime for the pipfruit sector before drawing overall conclusions.

2.0 Background

- 2.1 The pipfruit sector is a significant industry in New Zealand, especially in the Hawke's Bay and Nelson regions. The efficiency with which the industry uses its resources impacts on the economy as a whole.
- 2.2 While New Zealand is recognised by the World Apple Report 2000 as being the most efficient apple producing country in the world, the industry is not profiting from this productivity.¹ ENZA's performance is poor² and the typical apple grower has made losses in most of the last five years.³

¹ It should be noted that this measure is based on on-orchard production efficiency, industry infrastructure and inputs and such macroeconomic factors as inflation and interest rates. Contrary to some interpretations, the measure is not based on marketing performance.

² A key indicator of ENZA's performance is its payout ratio (ie the percentage of its revenue that accrues to growers as suppliers and shareholders). ENZA's payout ratio of 33 percent compares with payout ratios for Chilean fruit exporters of around 58 percent and Sunkist of 72 percent (see 'Costs and Benefits of Producer Board Deregulation', Geoff Sinclair, Treasury Working Paper 99/4).

³ As estimated on the basis of MAF's model orchards for the Nelson and Hawke's Bay regions.

3.0 The problems with the current regulatory environment

- 3.1 The Apple and Pear Industry Restructuring Act 1999 and the associated regulations are an improvement on the regime that previously governed the pipfruit sector. The advantages of the 1999 legislation are it separated the commercial functions of ENZA from its non-commercial activities, established ENZA as a company with clear, tradable property rights and set up an independent export licensing regime.
- 3.2 However, as we stated in our submission to the select committee at the time, the 1999 legislation was a compromise package that failed to address adequately the fundamental problems in the statutory framework governing the industry.⁴
- 3.3 The current regime imposes unnecessary costs on growers and the economy as a whole. In particular, under the regime:
- exports that are in the national interest (ie where the exporter can offer a lower cost or better service to the grower than ENZA) but that are not "complementary" to ENZA are unlawful. As a result, ENZA is protected but growers and the New Zealand economy as a whole lose;
 - exporters are subject to regulatory uncertainty as to whether they will be allowed to export, how much they will be able to export, to which markets and for how long;
 - ENZA is subject to extensive restrictions, including rules on non-diversification, non-discrimination, information disclosure, and arms-length rules so it does not unduly favour its on-shore logistics business. While such constraints are required given ENZA's privileged position under the current regulations, they impede ENZA's ability to compete in the international marketplace; and
 - the industry is burdened by the extra costs of seeking a permit and additional layers of bureaucracy with an Apple and Pear Board required to oversee the regulations and an Export Permits Committee charged with authorising exports.
- 3.4 All the above costs are unnecessary and would be removed by establishing a normal regulatory environment for the industry.

⁴ Submission on the Apple and Pear Industry Restructuring Bill, August 1999.

4.0 Deregulation is inevitable

4.1 Deregulation of the pipfruit industry is, in our view, inevitable. Reasons for this view are:

- there is no economic rationale for New Zealand restricting exports of pipfruit. It does not make sense to claim that New Zealand can achieve sustained market power for apples. New Zealand accounts for only around 5 percent of international trade in apples and less than 1 percent of world apple production. Further, New Zealand's apples must compete with other fruits and other foodstuffs;
- the current system is not in the interests of growers. While the establishment of an independent export permits committee has reduced ENZA's control over growers, most growers still have little choice over whom they supply their fruit to;
- no other country in the world has a single desk system for pipfruit. Those few countries that had such a regime (eg South Africa, Israel (for citrus), British Columbia) have all abolished their single desk regimes and there is little sign that they would go back to the regulated industry of the past; and
- the largest remaining statutory monopsony in New Zealand, the Dairy Board, has now acknowledged that the single desk is not in the interests of the industry or farmers, and the industry leaders are asking the government to remove the statutory protections of the Board and move to a normal commercial environment.

4.2 The international market, however, will not wait for New Zealand to sort out its pipfruit regime. New Zealand's pipfruit industry must become open and more commercially focused if it is to meet the challenges of increasingly competitive international markets, consolidation of buyer groups, and competitors innovating in such areas as packaging, logistics, category management and customer relations.

5.0 Transition to a normal commercial environment

5.1 The move from a regulated to a deregulated export marketing system is likely to involve some transition costs. The experiences of South Africa and Israel, for example, suggest that deregulation can be followed by an initial fragmentation of the export sector before consolidation of exporters occurs.

5.2 There is probably no way to avoid some adjustment costs in the move from a regulated to a deregulated environment. The government can, however, help reduce these costs by establishing a clear timetable for deregulation and by

avoiding an excessively long transition period (ie no more than one season at the most).

- 5.3 Further, there are reasons to expect New Zealand will avoid some of the transitional costs that were experienced in other countries as deregulation here has been anticipated for some time. Entities have already moved to prepare themselves for an open exporting environment through the consolidation of packhouses. In addition, a significant transitional issue for the pipfruit industry has been resolved with the establishment of ENZA as a standard corporate entity and the resolution of the ownership rights of ENZA.

6.0 Horticultural Export Authority system

- 6.1 Despite its superficial appeal as a 'compromise solution', we do not believe an HEA-type system for the pipfruit sector would be in growers' or New Zealand's interests. Reasons for not favouring the HEA model for the pipfruit industry are:

- it would give a ministerially appointed body the power to decide what entities can and cannot export pipfruit. As a result it would risk continuing the politicisation of the pipfruit sector in New Zealand;
- it risks stifling innovation as individual exporters that disagreed with the approved product group strategy would still be required to comply with it; and
- given the size of ENZA, the governance structure of the apple and pear product group would most likely become dominated by ENZA, both in representation and in decision-making. This would be a step backwards from the current system, in which at least ENZA does not control the Apple and Pear Board or the Export Permits Committee.

- 6.2 While these risks may be small for some other horticultural products, the long history of politicisation of the pipfruit industry in New Zealand, the initial dominant position of ENZA and the size of the pipfruit sector mean that the costs of imposing an HEA-type regime for pipfruit may be considerable. If the transition to a normal commercial environment is to be achieved at least cost, every effort should be made to permit a clean start and to minimise the risks of a return to the politicised and ENZA-dominated industry of the past.

7.0 Conclusions

The apple sector is not performing well, with many growers in serious financial trouble. The current regulatory regime is unsustainable and further deregulation of pipfruit exporting is inevitable. An HEA-type model is not suitable for the pipfruit industry. The export industry should move to a normal

commercial operating environment, with a transition of time of no more than 6 to 12 months.