



Meat Industry Association of New Zealand (Inc)

Background Paper

Meat Inspection and Competition

November 2006

MEAT INSPECTION AND COMPETITION

1. The Animal Products Act 1999 removed the previous government monopoly position with regard to meat inspection services. As was the case with previously dismantled government monopolies – such as those in the telecommunications and electricity sectors – the government service delivery arm was established as a State-owned enterprise ('SOE'), Asure New Zealand Limited ('Asure').

Basic Principles of State-owned Enterprises

2. The SOE model came about as a means of addressing troubling inefficiencies in the way in which government trading operations were delivered up to the mid-1980's. The model as initially envisaged had three basic principles:
 - a) The delivery of services through state-owned companies, registered under the Companies Act and operating on a commercial basis.
 - b) De-regulation of the markets in which those services are provided, to allow for SOEs and private entities to compete on equal footing wherever possible.
 - c) Privatisation of state-owned companies (where practicable).¹
3. Over time, the commitment of successive governments to the last of these principles – privatisation – has been inconsistent. However, the first two principles have been consistently applied (e.g., with regard to telecommunications and postal services).
4. This was certainly the case with the 1999 formation of Asure and the contemporaneous passage into law of the Animal Products Act. The government surrendered its monopoly on meat inspection services and transferred its meat inspection delivery arm to an SOE. In doing so, meat inspection became a commercial service provided in a de-regulated market. As such, it comes under the general jurisdiction of the Commerce Act 1993.
5. The Commerce Act aims to ensure that consumers receive the benefits of the quality incentives, cost-efficiencies, and pricing behaviour that arise from having efficient markets for the sale and purchase of goods and services. It does so in a number of ways, and the discussion below looks at the two most relevant broad approaches under the Act, and how they apply to a 'market' that for the purposes of this paper we have as a 'market for the supply of ovine, bovine and caprine ante- and post- mortem meat inspection services in New Zealand'².

Competitive Approach

6. As a general rule, the Commerce Act 'prefers' to promote the efficiency of markets through real and actual competition and the prohibition of anti-competitive behaviours among actual or prospective competitors. This is apparent in Part 2 of the Commerce Act, which identifies and prohibits a range of activities that are collectively termed 'restrictive trade practices'. These prohibited activities are clustered into four broad groups:

¹ State Services Commission, *New Zealand's State Sector Reform: A Decade of Change* (www.ssc.govt.nz/decade-of-change)

² Note that the way in which markets are defined is crucial to the application of the Commerce Act. The 'market' definition used in this paper may be argued to capture more than one market, but for present purposes it is considered that the wider definition is appropriate as it reflects the entirety of Asure's current monopoly services as are relevant to MIA Members.

- i) Practices substantially lessening competition (i.e., where two or more parties enter into arrangements that have the effect and/or intent of lessening competition in a market)
 - ii) Price fixing (which is really a subset of the grouping above)
 - iii) Taking advantage of market power
 - iv) Resale price maintenance (i.e., where a supplier seeks to control the price at which its products are on-sold)
7. In the case of meat inspection, only two of these broad groups could conceivably have any real relevance this point in time. Price fixing is not an issue as Asure has no competitors at present with whom it may collude on prices. Resale price maintenance is also not an issue given that the services Asure delivers are not on-sold.
8. As the holder of a present monopoly on the delivery of meat inspection services, however, Asure would be well-placed to take advantage of market power to deter competition should it choose to do so. It is important to stress that there is no suggestion that Asure has sought to do so, or that it holds any intention of doing so. On the contrary, almost since its inception Asure has embraced the expectation that competition in the delivery of meat inspection services was an inevitability.
9. With regard to the remaining grouping, 'substantial lessening of competition', section 27(1) of the Commerce Act 1993 imposes a prohibition on agreements and arrangements with certain implications in terms of lessening of competition:

27. Contracts, arrangements, or understandings substantially lessening competition prohibited –

- (1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.*
10. This is a very broad provision and captures a diverse range of conduct from the formal (contracts) through to the decidedly informal (arrangements or understandings). Most commonly, the section would target agreements between competitors, such as a division of areas into respective 'patches'. Given the present lack of a competitor for meat inspection services, however, arguably this provision is only likely to be triggered in the event that Asure or another interested party were to secure an agreement or undertaking from a potential competitor to abandon plans to enter the market for delivery of meat inspection services.

Control Approach

11. As discussed above, Asure theoretically operates within a competitive market. In practice, however, there is no competition – in large part because the overseas markets to which Asure's customers export products do not yet recognise that meat inspection services can be delivered by a truly private company (as opposed to a State-owned one).
12. Although the Commerce Act favours and encourages effective competition as a means for delivering the benefits of efficiency to purchasers, it also recognises that in some situations there may be a 'natural monopoly' in the provision of certain services or products.

13. Frequently, services or products that require a large investment in capital infrastructure are held up as examples of a natural monopoly in a New Zealand context. Transpower, for example, uses a national grid to transmit electricity around New Zealand. The sheer cost involved in replicating the national grid effectively precludes any realistic prospect of a competitor to Transpower emerging.
14. Where such situations exist, the Commerce Act provides mechanisms for preventing a monopoly service provider from using its position to extract excessive profits to the detriment of consumers. In the Transpower example, Part 4A of the Commerce Act contains specific provisions giving the Commerce Commission specific powers with regard to the electricity industry. The specific provisions are designed to allow the Commerce Commission to implement a control regime to promote market efficiency and prevent excessive profiteering.
15. More generically, however, the mechanism through which the Commerce Commission can regulate aspects of the conduct of a monopoly supplier is through Part 4 of the Commerce Act. Under Part 4, an Order in Council may be made at the recommendation of the Minister of Commerce specifying that the goods or services specified in the Order are 'controlled'. In making such a recommendation, the Minister may act unilaterally or on the advice of the Commerce Commission.
16. Before making a recommendation, the Minister must be satisfied that that criteria for control set out in section 52 of the Commerce Act have been satisfied. These are set out below:

52. When control may be imposed –
Good or services may be controlled if –

 - (a) *the goods or services are, or will be, supplied or acquired in a market in which competition is limited or is likely to be lessened; and*
 - (b) *it is necessary or desirable for those goods or services to be controlled either –*
 - (i) *in the interests of the persons acquiring the goods or services (whether directly or indirectly), if the goods or services are acquired from a person who faces limited or lessened competition for the supply of those goods or services; or*
 - (ii) *in the interests of suppliers, if the goods or services are supplied to a person who faces limited or lessened competition for the acquisition of those goods or services.*
17. Under section 54 of the Commerce Act, the Minister may also seek advice from the Commerce Commission as to the thresholds at which it would be appropriate to impose control on the supply of a particular good or service. These may be quantitative thresholds (e.g., when prices reach a certain level, or where the return on capital exceeds a certain amount) or qualitative thresholds (e.g., where reliability of supply of goods or services falls below a particular level).
18. Where control is imposed over a product or services, it may only be provided pursuant to an authorisation issued by the Commerce Commission – which may specify matters such as pricing or revenue formula and quality standards – or a written undertaking by the supplier accepted by the Commission as an alternative.
19. If the status quo with regard to meat inspection services continues, there is certainly a case for consideration of, if not the imposition of control, at the very least of the thresholds at which imposition of control would become appropriate.

20. Looking at the criteria in section 52, meat inspection services are indisputably provided in a market in which there is 'limited' (and in fact, no) competition. The only question is whether it is necessary or desirable to control the provision of meat inspection services in the interests of those that purchase them.
21. In our view the very fact that export of meat products to New Zealand's major export markets can at present only take place if Asure's meat inspection services are purchased clearly points towards an answer to this question. Under the status quo, export meat processors simply cannot conduct their usual business without purchasing Asure's monopoly services. Ensuring this monopoly cannot be exploited is clearly desirable to the purchasers of those services.
22. At present, the expectation of future competition has had an effect in promoting cost-efficiencies in the delivery of meat inspection services. However, should this expectation ultimately prove unfounded the incentives for pursuing such efficiencies will decrease, to the potential detriment of the purchasers of those services.
23. For these reasons, if it is apparent that the status quo with regard to meat inspection services will continue into the medium term, we would advocate that the Minister of Commerce should seek the advice of the Commerce Commission as to the appropriate thresholds at which consideration should be given to imposing control over the provision of those services.