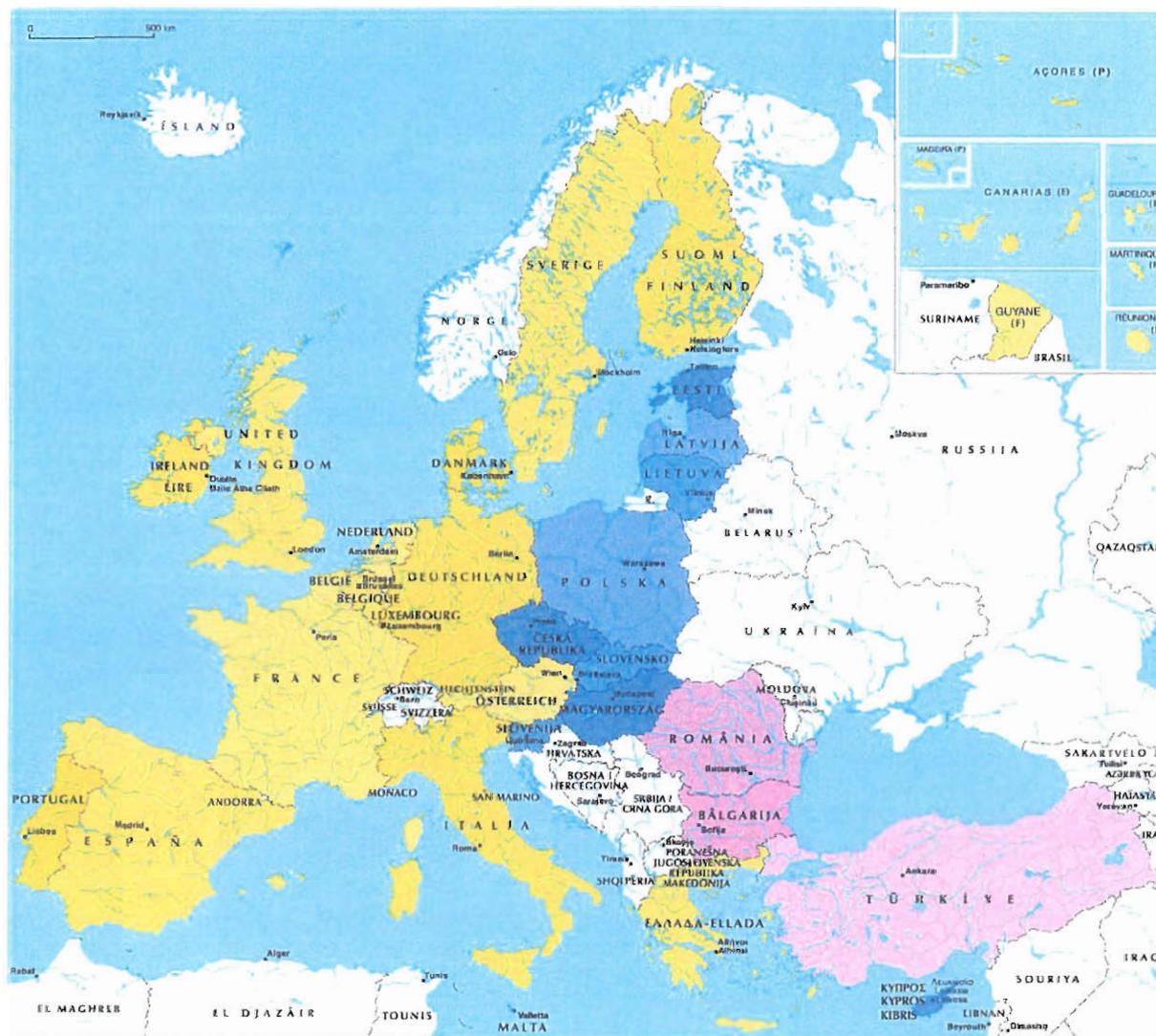


The Allocation of Sheep and Goat Meat Quota Into the European Union.



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Allocation of the Sheep Meat Quota into the European Union (EU).

Introduction:

As a passionate producer of sheep meat for the export industry for thirty years, I have always taken a keen interest in all aspects of the industry that would impact on the profitability of my business.

I have always held the view that if I concentrated my energies on what I had direct control of, and have influence on, then the rest would be looked after by the other sectors (farmer co-ops, processors, marketers, meat and fibre Federated Farmers), who, I thought are more qualified than myself, to ensure an acceptable return was passed back to me, the producer.

My energies have tended to focus heavily on farm management to optimise production and ultimately my returns.

I am proud to be constantly improving productivity on properties I have farmed, using all sorts of technology to lift the total volume of meat I have available to sell

To be part of an industry that has made production gains in excess of 4% per annum has been of immense satisfaction and I have enjoyed being part of it.

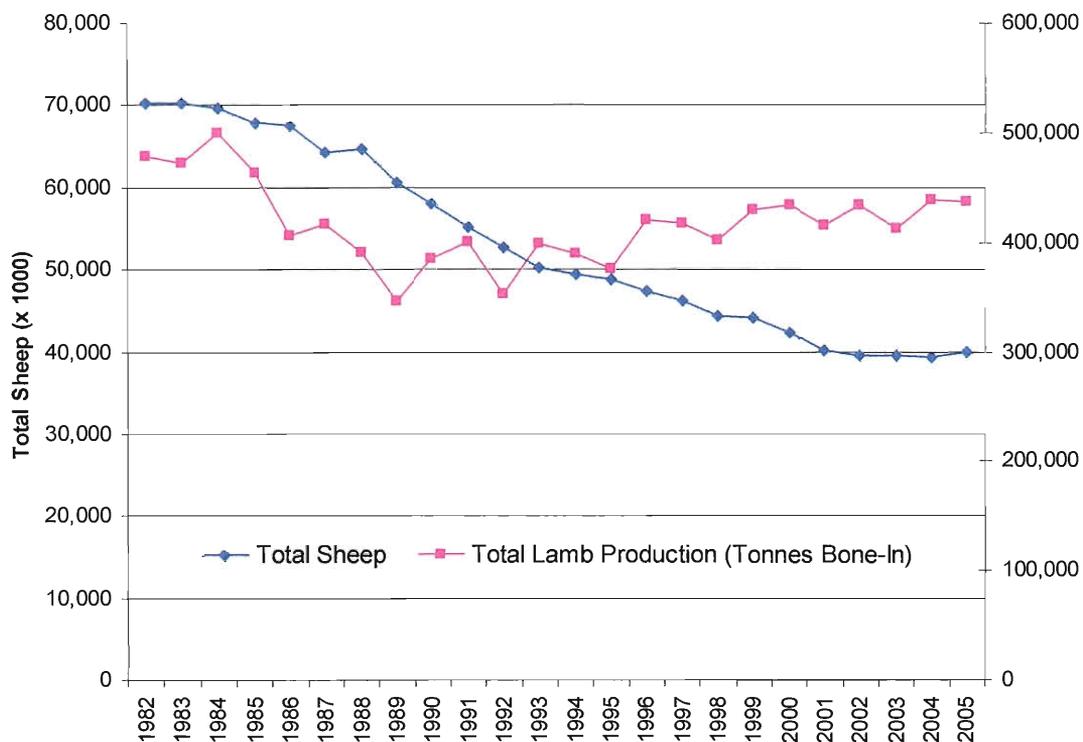


Figure 1. Total Lamb Production (Tonnes Bone-In)

Sheep numbers drop 30 million, or 41% Total Lamb Production (tonnes) drop 10% since 1995, 4% production gains per annum.

Profitability of the industry though has always been low when expressed as a return on capital.

A measure used to express profitability in most businesses.

Table 1: Sensitivity Analysis. (Clarke, 2007).

Assumptions: 4000 S.U. at \$700/S.U. = \$2,800,000

Stock and plant = \$656,450

Lamb Price	\$50	\$60	\$75	\$85	\$154
Capital	3,456,450	3,456,450	3,456,450	3,456,450	3,456,450
Cash Surplus	-52,356	-20,856	18,477	40,527	192,672
Return on Capital	17,645	49,145	96,395	127,895	345,245
Return on Capital as %	0.5	1.4	2.8	3.7	10.0

This compares with an intensive cropping farm generating 2% return on capital and dairy (factory supply) generating 2.5% return on capital (Preston, 2007). Both these sectors will receive huge income increases in the 2007-2008 year.

When we look at the very credible productivity gains over the last ten to fifteen years, in the sheep industry, we must also take account of the cost of achieving that productivity.

Sheep meat producers have now become locked into higher production costs at the expense of that greater productivity. They are now very sensitive to smaller fluctuations of the price they receive for their sheep meat.

Table 2 clearly illustrates what return is needed to sustain a sheep farming business when you look at the cost of production.

Table 2: Cost of lamb production net of direct costs incl. interest (leased land).

	3200 ewes @ 800 hoggets @ 3840 su	1 su/ewe 0.8su/hogget =17% of total su 340 ha	11.3su/ha
Expenses	Total	17% replacements 188 hgts su/ha 0.8 su/hogget 2.35 hgts/ha Ewes 9.41 ewes/ha 140% lambing 13.18 lambs/ha 2.35 hoggets/ha 10.82 sale lambs/ha	
Fert	\$36,000		
Vehicle	\$16,500		
Animal Health	\$12,000		
Ram	\$4000		
Contracting	\$10,000		
Shearing	\$26,000		
Feed pasture	\$40,000		
R&M	\$5000		
Standard expenses	\$159,500	\$469/ha	
Dep	\$10,000		
Management	\$50,000		
	\$219,500	\$646/ha	

Cost of capital (stock interest@8.5%)	\$22,780	\$67/ha	(ewes@ \$70, hoggets@ \$55,
Cost of land lease	\$66,280	\$192/ha	(\$17 /su)
Total expenses	\$307,560	\$905/ha	
Income			
Wool	\$62,100		
Cull ewes	\$28,000		
	\$90,100	\$265/ha	
Cost to produce lambs	\$640/ha		
Lambs/ha	10.82/ha		
Cost to produce lambs	\$59.09		
Net of charges	\$60.49/lamb		

This is further illustrated by Figure 2.

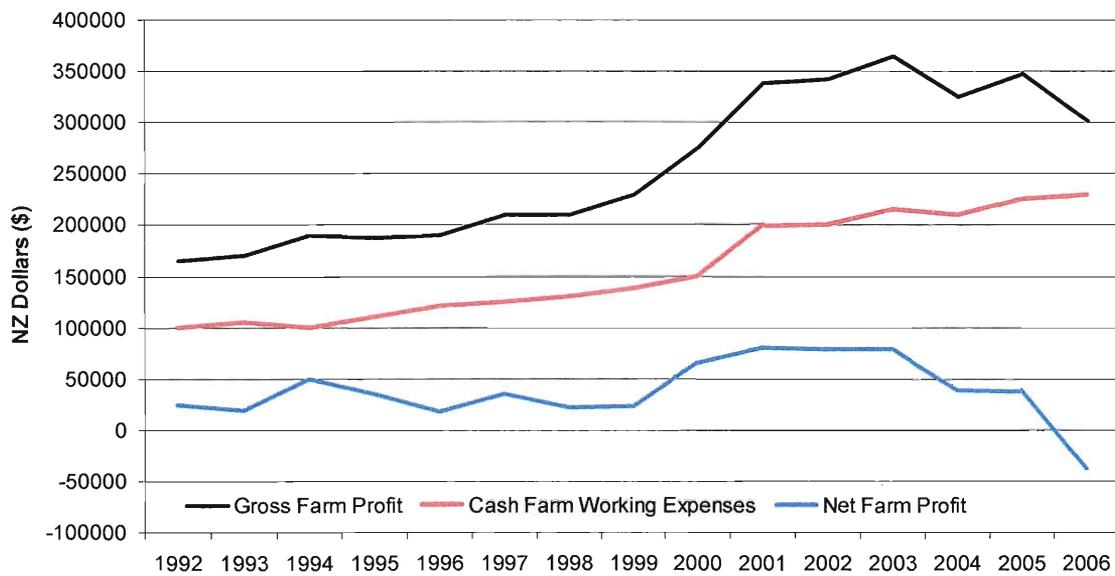


Figure 2: Trend in gross farm profit, working expenses and net farm profit for down-land sheep farms. (Preston, 2007).

No business can sustain losses in succession for any length of time and remain viable. The seriousness of lack of profitability has been masked somewhat by the ever increasing value of land. Land has steadily increased in value beyond its earning potential for a variety of reasons.

- 1) The demand for land suitable for dairying
- 2) Demand for land subdivision, urban spread.
- 3) New Zealand farm land has been cheap by world standards.

To make the issue worse, processors/exporters are not operating profitably either. New Zealand's largest meat processor PPCS has announced a \$40 million loss in it's 2006-2007 season, its second loss in succession.

Other companies are not returning results to maintain a sustainable business long term.

Lack of profitability is not new to the New Zealand meat industry. Any research into the history of the industry soon reveals a roller coaster ride. Sustainable profitability for both producer and processor has been difficult to achieve to both parties in succession.

Quote

"Looking back at past annual reports, the comments have frequently begun with some crisis or circumstance which has made for a difficult year. You could be forgiven for wondering if there will ever be a year free of outside influence which affects our business. The answer is probably not."

J.F.Turner, Chairman, Alliance Group Annual report.

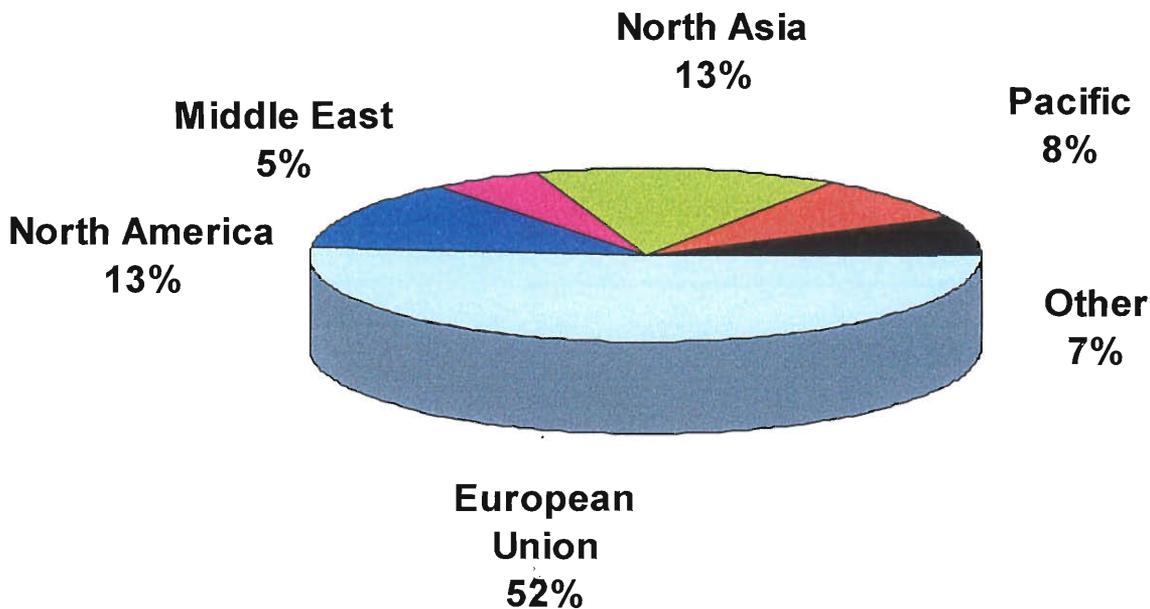
What is different with this downward cycle is the challenge from other land use. A Tsunami of milk engulfs the country, taking with it large tracts of the most productive sheep producing land. This land is the most reliable on the best soils or irrigated, so gives certainty of production, often on the shoulders of the processing season, ensuring year round supply, so vital now that chilled lamb on year round supply is such a profitable component of the export market. The full impact if this land use change is yet to be felt by the industry.

The returns achieved for the industry (producer, processor ,exporter) in the 2002-2005 years were hailed as the return of the sheep meat industry. It had turned itself around, repositioned itself to now exporting high value cuts away from the commodity cycle of supplying whole carcasses in mutton cloth as has previously been the case for the last 120 years.

This was the boom I had been farming twenty five years for, my patience for staying in the production of sheep meats was to be rewarded. It was to be short lived, returns retracted just as quickly as they had risen. The New Zealand dollar strengthened from 0.42cents US to mid-high .70 cents. Sheep by products, pelts, tallow, and offal all depreciated in value. Drought conditions in Australia put extra product into the market place. Food safety issues in Europe faded from consumers minds.

A resultant proliferation of comment from rural media and industry leaders has resulted over the last two years, a lot of this has been incorrect information. Everyone has their view on what is needed to correct this, our once most valuable export industry, to sustainable returns for producer and processor.

New Zealand sheep meats and their by-products are exported to over 100 different countries. One market stands as the single most critical to the sheep meat industry. The European Union (EU) This market takes 52% of New Zealand sheep meat by volume, but returns 63% by value of our total sheep meat exports.



Entry to the EU market is restricted.

New Zealand has such a privileged position in a large market where competition from other competing countries is restricted and yet producers are not able to meet their cost of production.

As this market is New Zealand's largest and most profitable, access to it by New Zealand lamb exporters/processors is rationed, so all companies have an opportunity to have a share of this higher returning market. This market share is referred to as "Quota".

All meat quota into the EU is administered by the New Zealand Meat Board. Another significant quota market administered by the Meat Board is the US Beef Market.

My objective at the beginning of this study was to not only fulfil my obligations of the Kellogs course, but to maybe make some useful observations and recommendations to the industry. However as my research progressed, I began to appreciate the vast complexities of quota administration.

I have enjoyed immensely the research into this subject and if I don't conclude with strong recommendations then I hope this study serves to educate fellow producers, as it has me.

History

In order to get an understanding of the quota system, we must look back at the history of the New Zealand meat industry.

You can only imagine the misbelief at the prospect of meat being transported by sailing ship some 22,000 miles around the world to our then, mother country of England.

For the colony of New Zealand, this would be a milestone of significance, which for many years would be the foundation of our export economy.

Prior to this first frozen meat shipment only non perishable produce could be exported, the main item being wool.

With a small local population the consumption of meat was limited. Sheep too old to economically produce wool became worthless.

The Evolution of the New Zealand Sheep Meat Industry

2007, marks 125 years since the first shipment of frozen meat left New Zealand shores. Sailing from Port Chalmers the 'Dunedin' was loaded with freshly killed sheep from the Totara Estate, near Oamaru.

During loading there were problems with the refrigeration and the first 641 carcasses were unloaded and consumed by New Zealanders, not Britons .

The 98 day voyage was uneventful except for a problem with the sparks from the boiler (which ran the refrigeration unit) setting the sails on fire. The crew enjoyed the luxury of fresh meat instead of bully beef or salted meat.

Off the coast of the Isle of Wight directors of the shipping company now Shaw, Savill and Albion boarded to taste some of the fare from that far off land New Zealand.

The shipment on arrival was duly sent to London's Smithfield market and all was sold within a fortnight. The mutton and lamb received the price of 6 ½ pence per pound, a profit of 3 ½ pence per pound.

The scene was set; the voyage by that sailing ship the 'Dunedin' was to forever change the economy of that young colony New Zealand.

Within 9 years of that first voyage 17 freezing works were established. Names like NZ Refrigeration, Canterbury Frozen Meat and Dairy Produce Ltd, Gear Meat and Preserving etched their names into the history of the New Zealand meat industry.

1882 to 1990, the exports were mutton, (the meat of sheep over 24 months of age). An interesting secondary by- product from the freezing industry was the establishment of 19 soap and candle works.

When the meat trade was established there was some debate as to the sustainability of the trade. Could New Zealand supply one million sheep a year without depleting the breeding stock? The doubters were proved infinitely wrong. Within 10 years 1,607,754

carcasses were exported annually, national sheep flock numbers had increased to 19.38 million. Sheep farming accounted for 59% of the countries exports

By 1894 just over two years after that first shipment, 43 establishments were committed to freezing or preserving of meat.

In 1915 a flourishing industry is given further security when the First World War breaks out, troops needed feeding.

The end of the war saw the first disruption to what seemed an insatiable market. It is worth noting that due to the rapid expansion in the numbers of processing facilities that they were of British ownership or subsidiaries of British Companies.

With 180,000 tonnes of meat in storage the equivalent of one years production the inevitable happened, prices collapsed!, this collapse was made worse by the knowledge of a new seasons production imminent and the exporters of the day dumping large stocks into Smithfield market and undercutting each other so they weren't left holding large stocks.

Prime minister of the day Mr William Massey was not about to stand back and see the economy collapse. He proposed a Meat Pool Scheme where by all meat for export should go through a common pool and sold through one channel. This met with not unexpected debate. However Prime Minister Massey was determined we could do better. Many called for the establishment of a Board of Control representing the various interests in the meat industry.

Mr Massey was firmly convinced that a board operating a meat pool or a similar proposal, which would also control shipping and trading and negotiate freight contracts, would have an immediate effect on London meat prices. Without some system of control the new season's meat would go forward to add to the existing congestion.

As the Prime Minister talked to farmers all over the country, he pointed out some of the results which were already apparent as a result of the discussion going on within New Zealand, although the country and government were still in the talking stage.

While the controversy raged, several companies had announced a reduction in freezing charges at New Zealand works. There was also a noticeable and unexpected improvement in prices offered for New Zealand meat. Reviewing the season, a few months later, one of New Zealand's largest stock agents commented, "Prices for lamb, although disastrous before Christmas (1921), improved considerably from the beginning of the New Year, and mutton prices were higher than anticipated". (Taken from the book 'Golden Jubilee')

The table of lamb prices paid to farmers by meat exporters in Canterbury that year shows that in four months these climbed from 5d to 8 1/4 d per pound.

William Massey was convinced that this improvement was at least, in part, due to the moves within New Zealand to exercise more control over meat marketing and when he met opposition he frequently pointed to this compelling argument.

Among those who were strongly opposed to any pool arrangement, or creation of a Board to control various aspects of the meat industry, were the stock and station agents, meat exporters, freezing companies and some business organisations

A 1922 Quote “Farmers today are suffering from shock caused by the rapid fall in meat prices. We are like drowning men grasping at straws. We should try to remedy some of the fault at our end”. (Golden Jubilee)

Those comments made in 1922 still have a familiar ring 85 years later.

There were however the suggestions that the scheme, to have a single marketing pool was socialistic; these were scornfully rejected by the Prime Minister.

February 1922 saw the implementation by Parliament of the Meat Export Control Act. The Bill gave the Board extremely wide powers - indeed the title clause said “it was to appoint a Meat Producers Board with power to control the meat export trade”.

Under the original Act the Board could assume control over all export meat, prohibit or limit exports, impose a levy, negotiate all shipping contracts, lay down conditions on grading, handling, storage and insurance, arrange promotion, or make any arrangements it considered necessary for the sale and disposal of New Zealand meat.

These powers were further extended under the meat act of 1939 and 1964, which gives the Board considerable influence over the granting of licences for new Meat Works, or permission to extend or alter existing works. The Board also has the power to advise the Minister of Agriculture on a wide range of matters affecting the meat industry, including the granting of licences to meat exporters. The extent of the board’s power can be assessed by Clause 58 of the Meat Act which says that even the Minister of Agriculture may not be granted permission for an exporter to have stock killed or handled in an export slaughterhouse without the consent of the Board. Clause 28 states that the Minister has to obtain the Boards approval before licensing a new export meat works. The above body quickly became known as the New Zealand Meat Producers Board (NZMPB).

In layman’s terms the NZMPB was established to oversee the meat export industry and to insure its orderly development. In order to do so the NZMPB was endowed with statutory powers. These powers included the right to prohibit or limit the amount of exports or exporters to various markets, to negotiate shipping contracts, to impose levies on producers and to specify conditions for the exporting of any or all meat industry products as and when it saw fit, although it was to take nearly 50 years before they were to use this right.

The NZMPB, with the tacit approval of government, immediately made its presence felt by declaring a moratorium on the building of new processing plants, wanting the processing industry to consolidate. If companies wished to increase throughput and market share they had to do so through better technologies, productivity, and improved economies of scale.

Any company that wished to build a new processing plant had to prove that in doing so they would not force another company to go out of business, and that producers receive net benefits from the new plants participation in the industry. Therefore in the 46 years between 1922 and 1968 only 3 new abattoirs were established, two of which subsequently closed, leaving one new plant built in this country in nearly 50 years (although 5 more were built before 1980). The first major intervention in the workings of

the meat industry- except the two World Wars- laid the foundations for the restructuring problems experienced by the meat processing industry in the late 1980s and early 1990s.

Whether or not the NZMPB was instrumental in consolidating the meat industry, the fact remains that meat exports maintained a steady, if unspectacular, upward growth path after the First World War (the industry had to wait until the impact of aerial topdressing hit before it saw a big increase). This was a result of more land being utilised for the production of meat, better farm management practices, and higher productivity in the farming sector. However, exporters remained commodity dealers, with virtually no efforts being made to develop specialised markets.

Exporters were content to merely supply the Smithfield markets in the United Kingdom. Right up until 1954, all New Zealand's meat exports, both beef and sheep meat, went to this market, and all of it was in the frozen form- carcasses in the case of sheep meat, quarters in the case of beef.

New Zealand was prospering as industrialised Britain's off shore farm. Demand for our products remained stable and New Zealand's currency was pegged to the British pound, with no resulting exchange rate fluctuations, creating a situation where there was no need to market these products as such. Product was aimed squarely at the British market and its needs. This focus on production led the industry to become inward looking towards the resource base and the efficiency of production, rather than outward looking to markets, simply because there was no need to do otherwise, a problem that to a certain extent remains with the industry today. This was further exacerbated by the fact that as most freezing/processing companies were partially or wholly British owned the flow of information from the market and market requirements was limited.

In 1922 the UK was the only market for New Zealand sheep meat exports, however even though it was 1922 there was competition from South America and Australia. Australia had supplied the first shipment of frozen meat two years earlier than New Zealand in 1890, and like New Zealand was a member of the British Empire.

The impact of the formation of the NZMPB was immediate and Massey was able to justify his urgency in getting the Board established.

By 1931 sheep numbers in New Zealand hit 30 million. In 1931 The Ottawa Conference was held, negotiations took place with Common Wealth members to protect the UK market from over supply of meat and further develop Empire trade. Common Wealth preferences in trade are reconfirmed. There were no access restrictions on the import of frozen meat from New Zealand for an initial two year period to 1934, then to 1938. Severe quota restrictions were imposed on non Common Wealth suppliers.

Another issue the Board was to move on was the removal of the opportunity to market small consignments of lamb on owners account.

One ship had 150,000 carcasses on board

- 217 separate bills of lading
- 915 different marks and numbers
- 381 lots of 100 carcasses or less
- 33 lots of a single carcass
- 24 lots of two carcasses

It would not be hard to imagine the huge amount of extra time and labour involved during loading or unloading to keep track of all these lots.

This situation was remedied by standardising all grade marks throughout the country and setting a minimum number of carcasses in one parcel to 250.

It is ironical when we now consider the effort put in to be able to trace every cut of meat back from supermarket shelf to farm of origin.

The restriction on the building of new freezing works was frustrating in some parts of the country, none more so than Otago and Southland. Between 1936 and 1938 there were no fewer than 10 applications for meat export licences in Southland. These applications were all held in abeyance until a report commissioned by the Meat Board and the Department of Agriculture and the Government, known as the Scott- Matheson Report was completed.

The content of this report was damning, schedule buying, the committee found, was a misnomer as far as expressing the prices paid for fat stock. Where schedule was strictly adhered to producers suffered. Otago and Southland lamb was equal to any other district, having regard to both meat and skin value but the producers in these two areas received less than elsewhere between 1933 and 1936.

Published freezing charges were also a misnomer because of rebates to large clients. Its final conclusion was that the freezing works combination in the South Island was not operating in the best interests of producers.

Southland farmers believed all that to be true, However the report was marked top secret and was not publicly released for several decades. The wheels of progress were however very slow as it was to be 1959/60 before the Alliance Meat Company was able to commission its new works at Lorneville just out of Invercargill

1939 saw the outbreak of World War Two and the New Zealand Government signed a bulk purchase agreement with the UK Ministry of Food. This agreement finished up lasting until 1954.

The high Attrition rate of ships during the war put pressure on all available shipping so beef was boned out and mutton carcasses were telescoped to gain greater efficiencies in shipping.

1942 New Zealand's Economic stabilisation Scheme was introduced and the Meat Industry Stabilisation Account was established to complement the Meat Pool Account.

1954 The Meat Industry Reserve Account was established based on funds accumulated during the period of bulk purchase agreement.

One can only take from the above that they must have been relatively prosperous times for producers as there was the ability to build numerous reserve accounts.

It is worth while to record how a significant portion of these funds were accumulated. The Economic Stabilisation Regulations came into force on December 15, 1942 and any price increases granted by Britain after this time were paid into the Meat Industry Stabilisation Account. Producers received higher prices for their meat only when they could prove that they had increased production costs.

At the out break of war New Zealand told the British Government that it would not increase the cost of New Zealand foods, provided there was no rise in the costs of goods New Zealand had to buy from Britain.

The British Government was not as successful as New Zealand's war time Government in holding prices, so the cost of New Zealand's imports from Britain increased.

The Ministry of Food recognised this and periodically agreed to pay higher prices or provide a lump sum payment of several million pounds for New Zealand meat and other foods.

New Zealand was not slow to point out to Britain how the Dominion was affected by rising costs, but the real bargaining started at the end of 1943 and early 1944 when it was obvious that the Allies were winning the war.

New Zealand wanted some lump sum payment for her meat and other food stuffs to compensate for the higher price of British goods. Much of the bargaining was done on New Zealand's behalf by Mr. (later Sir Bernard) Ashwin, secretary to the Treasury.

1950 saw the establishment of the Meat and Wool Boards Economic Service. The basis being that price increases could be justified to UK importers if cost of production increases could be justified.

The end of the war saw the return of New Zealand servicemen, many of them now experienced pilots. This heralded the era of aerial top dressing in New Zealand, probably the single most significant development in agriculture since the success of that first shipment of frozen meat.

The Meat Board was quick to recognise the impact this would have on production for the industry. so by way of loans from Réserve accounts was able to provide 'venture finance' to the agricultural aviation industry. Such was its success that these loans were all honoured and duly repaid.

1951	35 million	Total sheep numbers) Aerial Top dressing
1961	48 million) Aerial Top dressing
1971	59 million) Subsidies
1981	70 million) Subsidies

1958 saw the first hint of change, The treaty of Rome was signed by France, Germany Belgium, Netherlands, Luxemburg and Italy, to establish the European Economic Community, or EEC. The Treaty defines the general principals of a common agricultural policy. Briefly the idea behind the Common Agricultural Policy or CAP was for member countries to become self sufficient in food stuffs an attitude that had much to do with how they were affected during the two World Wars.

To this end the Common Agricultural Policy had a two fold policy. Internally producers were encouraged by way of production subsidies to increase their output. Externally quota limits were placed on the amount of exports that countries could send to EEC member countries.

The UK agreed to join the EEC in 1973 so with the stroke of a pen NZ lost its unrestricted guaranteed access to the British market for all agricultural commodities. For the first time lamb exporters would be exposed to international competition with serious

ramifications. The most important of course was that other markets had to be found for the meat that could no longer be exported to the British market.

To soften the impact of the UK entering the EEC the Meat Board was proactive in setting up the Meat Export Development Company, which soon became known as DEVCO, it was to control the marketing of all lamb and establish lamb in the North American market. It was to be 9 years before DEVCO operations in the United States showed an annual profit and over that period the accumulated costs of developing that market amounted to 11 million dollars, large expenditure in any bodies terms, let alone in 1960 \$ terms. However the equivalent of 7 million lambs had been sold in North America and had these lambs been sold on the British market it is reasonable to assume they would have met with lower all round prices for New Zealand meat. What can be taken and what hasn't changed is the expense of developing new markets especially where lamb or mutton isn't the first meat of choice. We start to realise how lucky we have been for all those years to have had the UK market where they knew how to prepare and wanted to eat lamb or sheep meats.

The 70's can only be described as a period of extreme turmoil. Lamb priced slumped and the NZ Meat producers Board successfully initially intervenes in the market, buying lamb during the peak kill period to put on the market as a steady supply throughout the rest of the year.

The Government of the day introduced supplementary payments to help retain sheep numbers on farms.

1978 the Government introduces further price support in addition to the price smoothing arrangements operated by the Producer Boards. Unemployment was at exceptionally high levels in New Zealand and it was seen appropriate by the Government to aid industry and thus maintain employment. What it didn't address though was the efficiency within those industries.

The early 70's saw another major advancement in technology for the meat industry, a process known as AC and A. This process, Accelerating, Conditioning and Ageing is now used in all meat export works. Research work quickly identified there was a huge variation in the tenderness of meat, this variation was traced back to the amount of time meat was left to hang at a controlled temperature before freezing and also the amount of stress the animal was under before slaughter. The AC and A process involves electrical stimulation immediately after slaughter and then the carcass is left to undergo aging in a controlled chiller for 24 hours. This gave a very consistent level of tenderness, after 24 hours the meat can then go towards its end use. This alleviated the colossal storage problems of hanging large volumes of carcasses for long periods during peak kill. But more importantly delivered a consistently tender product to the consumer. Up take of this technology was slow but with a strong push from an independent body like the Meat Board it was able to be implemented across the industry further raising the quality and reputation of New Zealand meat.

1981 saw a repeal of a section of the Meat Act 1922, that was designed to prevent the sort of problems experienced by the export industry and producers that came about as a consequence of the high turn over of meat plants and companies in that period immediately prior to 1922. It was felt that by preventing others from entering the industry stability would be gained leaving both farmers and processors better off and this certainly

proved to be the case up until the late 1950's. However the Act had a major weakness in that it protected existing processors from the benefits of competition. Just a handful of new plants opened between the period 1934 and 1980, despite a 350% increase in the amount of stock presented for slaughter.

This had two major draw-backs, firstly companies had little incentive to worry about the costs incurred in processing as these were easily passed on. Secondly in the 60's and 70s huge sums were wasted in patching up and trying to modernise old plants many of which had depreciated. Consequently the processing industry as it entered the 80's was characterised by large, costly and inefficient plants. The lack of competition amongst processors caused inefficiencies to develop.

Export slaughtering for processing costs were estimated to be 50 to 100% higher than the cost in other countries. The Government in conjunction with the Meat Board decided to act in 1981 to induce competition and increase efficiency and competitiveness in the processing sector and to allow the increasing stock numbers bought about by Government policies access to slaughter houses. They lifted the restricted licensing requirements for entry into the export processing sector. The response from both existing operators and new industry players was immediate.

Between 1980 and 1986, 11 new plants were established throughout the country, these were small specialist single chain plants so different from multi chain multi species plants that have dominated the industry.

Construction of these new plants into the processing sector following industry deregulation was fast. Exit of the older less efficient plants from the industry took much longer. The basic reason for this occurrence was two fold. The meat processing industry is easier to enter than exit. With the labour market structured the way it is, being a labour intensive industry, there is a high exit cost with redundancies in those plants especially when those employees have been long term employees. "Plant closure can be anything from two to twenty million dollars to shut a plant depending on scale."

(Grant Cuff, CEO, Alliance Group)

The ramification of the end of all industry subsidies in 1985 was immediate. Between 1986 and 1989 more than 30 killing chains were stopped. On average the time these chains had been operating was 84 years, which shows some of the issues facing the processing sector at that time.

As we headed into the 80's New Zealand as a nation was heading toward bankruptcy. Slipping from being the third richest country in the OECD in the 1950's to one of the poorer members of the 'rich man's club'. When the Labour Government took office in 1982 it started a period of massive restructuring of the economy. First to go were the wage and price freezes and then all meat industry equalisation and price movement schemes were to be removed overnight. This brought home to New Zealand meat producer's full realisation that world markets for lamb could not match that of the EU for returns, something that had been masked by the above price support and equalisation scheme. Freezing processing companies went in to receivership and some sheep producers literally walked off their farms, for the first time in 100 years there was a massive swing out of sheep production.

1981 70 million sheep

1991 55 million sheep

2001 40 million sheep

The period of the 1980's to 1990's there was enough happening in the industry to justify a study on its own, however I will just outline some of the highlights so we can then appreciate where we are today.

1981 Lamb prices are very low. The New Zealand Meat Producers Board stores lamb in the UK. New Zealand freezers are full and for processors to continue killing they have to wait for ships to arrive to create storage space

1983 A Meat Industry Task Force recommends a national pool for the marketing of sheep meats. This is rejected by the industry.

1985 New Zealand dollar is floated. The New Zealand Meat Producers Board withdraws from ownership of all meat

1986 -1989 Market returns to farmers are masked by procurement wars for livestock by processors stalling of the inevitable plant closures. It also sees the complete withdrawal of foreign ownership of all New Zealand processing companies.

1987 DEVCO now North American Lamb Co loses its exclusive licence to the US

1991 The Employment Contracts Act is passed. Employers are able to negotiate to link wages to productivity and negotiate on an individual Plant basis.

1993 The EEC becomes the EU a single Market

1994 GATT, General Agreement Trade and Tariffs. Gatt Uruguay round of trade negotiations concludes successfully for New Zealand. New Zealand achieves certainty of access to key markets that have been absent since the UK entered into the Common Market. It provides confidence to the industry to undertake substantial new investment and long term planning. Specific benefits include the guaranteed entry of 225,000 tonnes of New Zealand sheep meat to the EU with a tariff bound at zero and the absence of restriction on chilled lamb export.

2004 The Meat Board Act 2004 is passed to restructure the NZMB established under the Meat Board Act 1997, enabling the NZMB to establish and operate meat export quota management. The Act also makes provision for the transfer of ownership and use of the NZMB's assets to an "industry-good organisation"-(Meat and Wool New Zealand Ltd)

The EU continues to see substantial growth in member countries now having 27 member countries.

15 February 2007, 125th anniversary of the first shipment of New Zealand frozen meat.

The European Union\Why It is Important

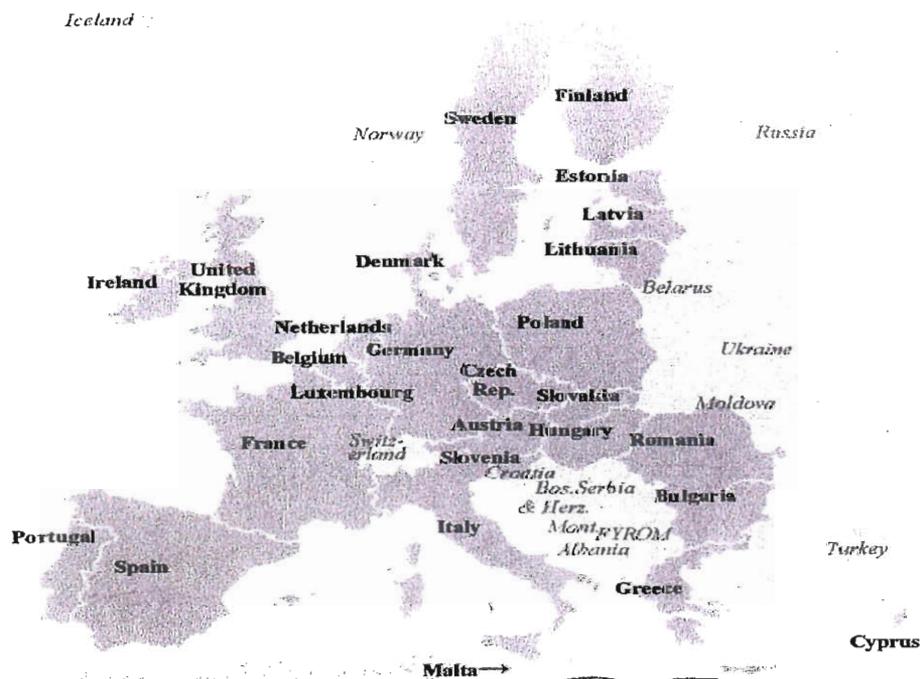
The European Union, formally known as the EEC European Economic Community, or EC European Community became known as the EU in November 1993. It was made up of 27 independent states joined to enhance political economic and social co-operation.

The EU created a single market which seeks to guarantee the freedom of people, goods and services and capital between its member states. In 1999 the EU introduced a common currency known as the Euro which has now been adopted by 13 member states.

With 500 million citizens the EU generates an estimated 31% of the worlds nominal GDP.

It represents its members at the WTO World Trade Organisation also at the UN and G8 summit.

One function carried out by the EU is the enforcement of the Common Agricultural policy aiming for self sufficiency, in food supply, as seen as desirable politically, economically and from a physiological point of view.



The European Union has 27 member states. Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden, and the United Kingdom. There are 3 official candidate countries, Croatia, the Republic of Macedonia and Turkey. To Join the EU, a country must meet the Copenhagen criteria, defined at the 1993 Copenhagen European Council.

The New Zealand Meat Board.

The New Zealand Meat Board is a statutory body governed by the Meat Board Act 2004. The 2004 legislation replaced the Meat Board Act 1997, removing ‘the ‘industry good’ activities previously undertaken by the Meat Board.

The Meat Boards function is governed by Section 8 of the Meat Board Act 2004, that states the functions of the Board are:

- a) to establish and operate quota management systems;
- b) to collect, process and maintain information as required to support the Boards function under paragraph (a);
- c) to manage, in the interests of livestock farmers, the Boards reserves and other assets, including-
 - a. providing funding to assist in the meat industry’s response to any major industry crisis; and
 - b. maintaining a prudent level of net assets to avoid jeopardising quota markets and the integrity of quota management systems; and
 - c. providing funding for industry good activities.
 - d. To account to livestock farmers regarding the Board’s activities.

The Boards objects are to facilitate the capture, for New Zealand and in the interests of the meat industry, the best possible ongoing returns available from quota markets and to manage the Board’s reserves and other assets in the interests of livestock farmers.

All the Boards activities must be conducted in a manner that will ensure that the board’s objects are not compromised. (www.meatboard.org)

The Board consists of:

- 10 Directors – elected on a ward basis on rotation, 2 elected annually.
- 2 Meat Industry Representatives, elected from members of the Meat Industry Association.
- 2 Government Appointees, appointed by Government.

The original board in 1922 consisted of,

- 5 Producer Representatives
- 1 Representative from the Stock and Station Industry
- 2 Government Appointees

While the role of the Board has gone the full circle, where the 1970-80’s were dominated by market intervention by the NZMPB, to its present day role as outlined in the above act of quota management, the objectives have always remained the same.

“The object of the Board is to control the whole of the exported meat of the Dominion so it may yield the highest net return to the producer”. (1922 Golden Jubilee.)

Quota Administration.

Initial administration of Quota after the UK joined the EU was simple as the number of meat companies operating was controlled by the New Zealand Meat Producers Board. Quota was allocated on the basis on your percentage of your kill in the current year. This simplicity was to be lost with the subsequent deregulation of the meat processing industry in New Zealand. As new players entered the field they wanted their share of this premium market. The industry was also struggling to maintain bankable business, needing more certainty of quota access to remain viable. Further necessitating change was the fact that the EU market was giving substantially better returns. It was becoming obvious however those better returns were likely to be lost, as companies compete to get increasing volume earlier into the EU market, thus gaining a greater percentage of the quota. This system had another flaw in that it forced companies to be procurement and throughput orientated with little emphasis on the marketing.

Various options were floated, but gaining an industry wide agreement between all parties was proven very difficult, this wasn't surprising given the impact any change in quota could have on respective companies. New Zealand wanted to retain the administration as opposed to the EU so what ever format quota administration took it had to be acceptable to the EU and in turn the World Trade Organisation.

The industry bankers were increasing their pressure for an agreement. Government really increased intensity and put a cat among the pigeons by recommending that all quotas be put up for tender. This option raised fears within the industry that the EU may take back control of the quota if they thought Government or some other agency was gaining a value from the allocation process.

1994 A window of opportunity arose with the successful GATT round. These talks resulted in giving New Zealand an increased tonnage available for allocation into the EU, thus giving the New Zealand meat industry a one off opportunity on negating any one off impact to any individual company which may suffer by the reallocation of quota.

Agreement was finally reached on a system where quota was allocated annually on the basis of:

- 1) The average of your last 3 years throughput, for all plants up to EU hygiene standards on export graded product.
- 2) 5% of the total allocation was initially withheld for new entrants.
- 3) Quotas could be traded.
- 4) Quotas could be earned on 5% of qualifying product going to the domestic market.
- 5) Administration was to be carried out by the New Zealand Meat Board.

This agreement was introduced in time for the 1994 season and is still the basis of quota administration today. This agreement seemed to satisfy all parties, producers, industry and EU authorities.

Two significant amendments have since been introduced, these have been as to a 5% new entrant which wasn't being used 'legitimately', in spite of initial fears that it wasn't enough, subsequently 2% of the total quota is now withheld for new entrants.

EU Allocations

Company	2001	2002	2003	2004	2005	2006	2007	Allocation changes	Rolling 3 year average	Rolling 5 year average
PCS Limited	91475.4	88943.4	85,101.5	80,827.9	76,676.6	73,191.9	69,352.7	-24%	73,000	76,600
Alliance Group Ltd	59628.8	59162.2	58,642.7	59,496.6	60,553.0	62,299.1	61,753.3	3.50%		
Affco NZ Ltd	25190.8	25053.4	25,322.5	24,715.8	24,265.7	25,090.8	25,754.3	2.20%		
Canterbury Meat Packers Limited	8659.1	8585.2	8,993.8	9,298.8	9,928.0	10,114.9	11,435.7	32%	10,492	9,900
Caylor Preston Limited	9428.8	9180.3	8,987.5	8,553.5	8,956.5	10,458.3	10,569.5	12%		
Horizon Meats New Zealand Limited	87.3	85.8	94.0	6,361.6	6,344.9	6,592.3	6,822.7	740%	6,600	5,200
Progressive Gisborne Limited	1395	2205.7	2,893.2	3,520.0	4,471.7					
Stamb Packers Feilding Limited	3711.0	3508.8	3,977.1	4,393.3	6,283.9					
Bernard Matthews New Zealand Limited		6145.8	1,371.3	1,294.1	1,310.7	12,099.8	12,139.9	97%		
Hilson Hellaby Limited	2639.0	2103.8	2,817.8	3,276.7	3,891.9	4,285.3	4,369.0	66%		
Crusader Meats NZ Ltd	1789.9	2536.2	2,763.1	2,496.0	2,828.7	3,666.6	4,395.7	146%		
The Kuiti Meat Processors Limited	3235.7	3017	3,094.7	3,100.1	3,097.4	3,093.8	3,017.8	-6.70%		
Levin Meats Limited				1,317.1	2,685.0	3,045.2	3,344.9	153%		
MR Grace Limited	1406.5	1203	1,514.7	1,583.2	1,417.5					
Abco Meats Limited (in receivership)			1,054.9	1,142.8	1,237.5	1,520.1	1,149.7			
Albion NZ Limited			293.4	183.3	212.4	235.3	263.0			
Canterbury Fresh Limited				259.1	189.9	172.3	100.2			
Davmet NZ Limited	2117.5	2105.3	2,202.0	2,325.7	2,377.9	2,351.8	2,221.3			
Eastertown Meat Co Limited	1583.9	1564.7	1,614.9	1,574.1	1,602.7	1,623.2	1,629.9			
Fresh Meats NZ Limited					1,437.4	912.8				
Integrated Foods Consortium					461.2	342.5	1,430.1			
ANZ Company Limited	1275.0	1074.1	1,244.7	1,450.3	1,212.2	817.7	174.4			
Lean Meats Limited	982.4	997.2	1,039.8	1,099.7	1,308.0	1,436.8	1,705.8			
Milot (NZ) Limited				830.5	1,133.1	1,635.0	1,865.5			
Prime Range Meats Limited		834	1,425.9	1,092.1	1,189.4	1,372.8	1,506.4			
Wallace Trust Meats Limited			1,408.6	1,260.8	1,611.0	1,490.7	1,463.9			
Wrightson		583.6	822.7	1,132.7						
Alpine	101.9	99.7	50.7	27.0						
Barrett			112.2	23.1						
Heartland	2303.1	2450.9	2,510.2	2,403.9						
Hellaby Meat				1,069.3						
IZ Standard				15.6						
Venex			205.6	221.4						
Blue Sky		6145.8	6,478.8							
Takeview		1858.4	603.2							
Southern Organic		82.1	53.5							
Total	217,011.10	229,526.40	226,695.0	226,346.1	226,684.2	227,849.0	226,465.7			
Total companies supplying the E.U.	18	24	29	31	26	23	22			
Average price per head (NZ\$)	63.72	70.82	64.29	65.56	68.28	55.95	53.36			

The other major change was that all product of export quality going to local trade now qualifies for quota. The next page shows a history of the companies and the volume of product supplied over the last seven years.

Issues perceived by farmers and media commentators

- A) Too many sellers in the EU market.
- B) Weak selling by one or a combination of companies

A) Too many sellers in the EU Market

22 companies currently supply the EU market, that number over the last 7 years has fluctuated from 18 to as many as 31. The season just completed had the least number since 2001 when it was 18. In 2007 the six largest suppliers by volume supplied 85 % of the quota or 191,000 tonnes. In 2001, 6 supplied 91% of the quota or 198,091 tonnes.

Tesco, a major buyer of NZ lamb; as a company has turnover of US \$51b
P.P.C.S NZ's biggest quota holder, has total turnover of US\$1.3b
(Source Rabobank).

What negotiating strength do multiple sellers of NZ lamb have with the likes of TESCO?

Therefore you would have to say the majority of the product entering the EU is controlled by just 6 companies. The fluctuating number of quota holders below that hold very insignificant volumes of quota; you would almost say they are niche sellers, a percentage are.

If you look at the bottom line on the previous page, the correlation between the number of sellers and the prices received is very low, in fact it seems more quota holders appear in the market after a period of better returns.

B) Weak Sellers in the market.

Rumours abound the industry with accusations of weak selling, some companies appear more often in the rumours than others.

Reasons for weak selling:

- 1) Product nearing the end of its shelf life (chilled)
- 2) The market returns are perceived to be in a downward spiral
- 3) Companies in need of cash flow.

In reality the same company could not be guilty of weak selling. As they all purchase stock on a similar market, to then process and ship by similar methods some may gain some short term advantage/ disadvantage of exchange rate, but the reality of a competitive industry is that the same company could not be continually weak selling, they would not survive. That is how a competitive market works i.e if a company sells weak in the EU, they then have a reduced margin to buy, process and freight. In turn they reduce the one cost they can directly control-the original purchase price of lamb. Farmers then supply less stock to that company. It is a downward spiral, less lambs equals higher fixed overheads and also reduced quota.

Issues perceived by the industry that need addressing.

These issues have arisen from my discussions from within the industry.

- 1) Existing Quota Holders Entitlement.
- 2) The Allocation of Quota to non-exported product.
- 3) 2% of quota withheld as of right to new entrants.

Existing Quota Holders Entitlement.

Length of Period that the quota is allocated for.

Currently quota is allocated on the basis of your last three seasons total production of export quality meat.

Looking page 18, the extreme right hand column shows the

- 1) Increases or decreases in quota over the last 7 years of the 11 largest suppliers to the EU in percentage terms.
- 2) I have looked at PPCS and CMP and Horizon Meats as examples (because they have all had major increases/decreases in quota.) and seen how their quota would be affected by altering the averaging period.

	Current Model	
	3 years average	5 years average
PPCS	73,000	76,600
CMP	10,500	10,000
Horizon Meats	66,000	52,000 Tonnes

Obviously if you are trying to increase your quota entitlement the shorter the average period is, is in your favour. If your share of total production is dropping, the longer the averaging period the better.

We must ask what will enhance market returns the best?

- 1) Is the current model above adversely affecting longer term returns by lack of investment in the market, development, promotion etc.
- 2) If a company is underperforming in the market is it advantageous they hold bigger volumes of quota for longer periods.
You are only going to lose quota if your company's share of the total NZ production drops.
Lamb producers are not slow to support companies that offer advantages and premiums, so it is not a competitive market working at its best. A three year average takes out short term seasonal hiccups of supply.
- 3) Alternative suggestions like allocating access on market returns gained i.e. the more you sell for per kg the more quota you are entitled to. Sounds ideal but looked at realistically, it must be:
 - i) administered with checks in place.
 - ii) Be acceptable to the EU (which is governed by WTO) fair trading rules.

The Allocation of Quota to Non Exported product.

Against:

Entitlement of quota goes to some who have made no investment in the export market.

The cost and risk in export marketing are far in excess of supplying local trade, so any benefit of the above should fall to those who participate in risks.

If there is trading in quota by non exporters (and there is), this is a subsidy by those who do export and the suppliers who supply exporters.

Quota markets need long term planning and investment in the market place to capture the full economic value of quota, so those only supplying domestic markets are free riding on the investment of the exporters.

Quota was negotiated originally only for export meat.

With excess processing capacity in the industry only those who have established that investment, should benefit.

Producers near large population centres i.e. Auckland are receiving the benefit of having that market on their doorstep as well as the quota benefit.

One could argue that Otago, Southland producers with a limited local trade are cross subsidising the local consumers and or producers close to these markets.

Those who invest in quota markets get the full reward.

The purpose of the Act is to maximise returns from quota markets.

By including local trade product there is another tier of administration to administer the act

The Allocation of Quota going to Non exported Product

In Favour.

Local trade suppliers must compete with exporters for product, (raw material) in the same market.

The crown owns the rights to secure the economic benefits deriving from quota markets and those benefits are to be assigned to the benefit of all the meat industry, not just the exporters and their suppliers. (The meat board enforces and regulates the act on behalf of the crown).

When non exporters receive quota benefits there is less temptation for them to export. Currently 22 companies supply the European Union with lamb, there is the risk of further fragmentation of that market if they were denied this quota benefit locally. Not all of New Zealand's sheep meat production can enter quota markets (53% EU), this enables the best possible returns from all markets, not just quota markets, thus assisting returns to all producers.

The average weight of local trade lambs over the last six years was 12.91kgs as opposed to 17.12kgs for export lambs over the same period. All export companies discount this lighter weight of lamb through their weekly procurement schedules to producers.

Is the local trade providing a valuable service removing these lambs from possible export at values not obtainable if exported?

If local trade supply is an 'easy catch' of EU quota benefit, why are the larger exporters not capturing this market as well?

3) 2% of quota with held as of right for new entrants.

Refer Page 18.

There is a high attrition rate of new entrants in the last 6 years, 8 new entrants have entered the market. But also in that period 8 new entrants have entered and then withdrawn from that same market.

- 1) Competition to supply the EU market is seen by most as healthy, however between 18 and 31 companies supplying that market over the last 6 years, How many is healthy ?
How many is detrimental?
- 2) The 2% available to new entrants is taken from the total amount of quota available , so it is at the expense of those already supplying the EU, those that have invested significantly in developing that market, that this quota comes from.
- 3) There is justifiably an argument that new entrants should have to demonstrate having something better to offer before access is granted as of right i.e. innovation in another market initially, other wise they are entering at the expense of existing processors and exporters.

With the ability to enter now as of right, it could be argued that new entrants are free loading on previous market development of existing suppliers to the EU. Entry as of right also encourages fragmentation of the market.

How many of the new entrants are genuine 'new entrants'?

When looking at various company profiles there are some major share holders that appear under one or more company structures.

Have these companies been created to solely benefit from new entrant qualification?

Some companies are known to have opted out of marketing in the EU to concentrate on processing, e.g., Blue Skies production is now marketed by Horizon Meats, explaining some of Horizons rapid increase in quota.

An Overview

There is little doubt of the immense value of the EU sheep meat trade to the New Zealand sheep farming industry. NZ has an enviable volume of access to that market. New Zealand has 40 million sheep and 226,000 tonne so quota. Australia has 101 million sheep and 10.5 thousand tonnes of quota.

For this volume of access we have the negotiation skills of our predecessors before us to thank. Not only is the volume secured critical but the fact that is administered here in New Zealand by the industry. It should always remain close to any of our thoughts for change of quota allocation.

Let's now have an overview of the issues raised. The detrimental effect of the number of sellers in the market place has been over hyped. With 85% of the quota held by just six companies 58 % by 2 companies then it is the ability of these six to perform strongly while more importantly the top 2 quota holders that will have far more effect on the stability of the market than what the sixteen smaller quota holders are doing. The weak selling accusations will be taken care of by market forces. Declining stock numbers will force processors and exporters to always extract the best from the market to remain competitive, any weak seller cannot remain competitive for long.

The issue of increasing the certainty of your quota for a longer period of time - at the most it should be lengthened to five years. If some one is under performing they should not be closeted from the effects of their actions. A five year average would not give instant changes to allocation by large amounts, so does allow for some more seasonal fluctuations in production.

Also on the next issue of local consumption gaining quota should remain as it is. Only 53% of New Zealand's sheep meat production can enter the EU, where the rest goes does it really matter, just because it doesn't leave our shores and incur the same cost to export. New Zealand is after all another market just like any other market outside the EU? All other overseas markets outside the EU attract the quota benefit, We are after all only talking about 2-3% of our quota allocation that is sold locally it is also a different class of product that is consumed locally. As mentioned earlier it is a class of product that is heavily discounted by the exporting companies so you could actually argue that the local market is doing a service by taking these light weight lambs for local consumption.

With declining sheep production and the need for rationalisation of the industry there is certainly an argument for new entrants to have proven their ability in other markets and shown that they have something more to offer - expertise to extract more from a market before entry is granted to the EU. A comment which holds some truth is that the processing industry costs more to exit than to enter. So while the industry needs rationalisation why leave the door wide open for new entrants.

In summary, the administration of quota, is not having the negative effect on returns I had previously believed. What has changed is the dynamics of the EU markets, with a

few large supermarkets dominating the supply chain and the increased percentage of higher valued chilled product with a shelf life needing a disciplined entry to the market.

While farmers continue to demand competition at the farm gate and show a lack of loyalty the industry will not alter. The industry has proven it cannot work together collectively, since deregulation in the early 1980's. I can see more of the 'last man standing game', with a number of niche marketers picking up the pieces. The ball for the future of the sheep meat industry is in the farmers hands as much as the processing and exporting industry.

“Only through the adoption of a new global marketing strategy can the industry hope to achieve a balance market risk. This will involve new dynamism, a strong spirit of co-operation and a total commitment by every sector of the industry. Anything else will jeopardize the future prosperity and indeed the future survival of the industry on its present scale”

Graeme Harrison. 1982.
Ask yourself, why sheep farmers are disillusioned.

People interviewed

Grant Cuff	Alliance CEO
Graeme Harrison	ANZCO –CMP Managing Director 1984-2004 1973-1975 Economic Research Officer NZMPB Wellington 1976-1979 Economist and Commercial Manager NZMPB London Director Sealords Director Westland Dairy Co-Op
Reece Hart	PPCS Chairman
Steve MaCaluey	Retail Meat NZ Secretary
Owen Poole	Meat Industry Rep NZ Meat Board
Cros Spooner	NZ Meat Board General Manager Operations (Quota)
Neil Taylor	NZ Meat Board CEO 1997-2003

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Alliance was approached for support as it was the one company that I did most of my business with. I was also aware of several of their present Directors being past participants of the Kellogg programme, therefore I was confident they would be aware of the benefits of attending. Alliance Group gave me no guidance as to what topic to study.

The views in this study are my own and are not those of other groups that I may belong to i.e. Federated Farmers, Meat industry action Group.