

# The Meat Board "carve-up"

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# Foreword

The purpose of FMF *Monographs* is to use the analytic method of political economy to shed light on how best the promotion of free markets will improve the workings of the South African economy. In particular, authors are urged to apply the microeconomic approach of studying how individuals, firms and households behave in response to either naturally occurring or regulatory induced incentives. This requires they display a sound institutional knowledge and understanding of their theme. It also implies that authors pursue their analysis in a logical fashion to policy proposals unencumbered by preoccupation as to what is or is not politically acceptable at any given time.

The author of this *Monograph* has stuck to that remit à l'outrance, not only in the pages following, but in his activities as a successful commercial farmer opposed to the Agricultural Control Boards which had distorted the industry's commercial activities for decades. Agricultural support policies of various sorts have been common throughout the world since the Depression years. They have been maintained allegedly to keep farm incomes above what they would be in the presence of exposure to free markets, including imports. Subsidies, price guarantees and restrictions on imports are all variations on the theme.

France and Germany in Europe, the USA in the Americas, and South Africa are all countries typified by long standing government intervention in agricultural markets. The front runner in deregulation has been South Africa. This *Monograph* investigates one agricultural market – red meat – and suggests, in a careful, scholarly but practical way, why regulation here is not necessary and how some recently proposed regulatory changes are retrogressive.

The prime motives for agricultural support are often thought to be political. The dependency of South Africa's governing party on farm votes is now negligible. Nonetheless, South African agricultural deregulation began before the 1994 Elections. Clearly even the pre-1994 government had begun to realise that the supposed advantages of agricultural support were either less substantial than previously believed, or that the price paid to achieve them was too great.

Critics of agricultural policy are generally academic economists with a special interest in either regulation or in agriculture. Alternatively, farmers themselves can be critics, but, like most managers, they are too busy with their primary tasks of day-to-day management fully to analyse the wider implications of the policies which confine their working lives and which, at first sight, may appear beneficial. Mr Dittmer's boots are dirtier than those of either the ivory-tower academic or the secluded bureaucrat. But his understanding of economic principles has enabled him to appraise agricultural regulation in a manner which only a few well-informed scholars have done with similar competence.

Mr Dittmer is out to convince us that while the Meat Board has gone, its disappearance is more apparent than real. Many of its functions will simply continue under a new guise. Marketing boards may be defined as "producer controlled, compulsory, horizontal organisations sanctioned by government authority to perform specific marketing operations in the interests of the producers of the commodity concerned". The objectives may be masked by such phrases as "orderly marketing", "fair and reasonable pricing", "quality assurance" and "social responsibility".

But, as with any cartel organisation, long run survival, without government backing or consumer support would be a chimera. Dittmer is concerned that statutory cartel powers remain in red meat marketing, and that without these powers, consumers would not support any proposed cartel (however diluted its authority might be relative to the old Meat Board).

To support this view he provides a detailed economic analysis of the industry and of the previous regulatory framework. He illustrates how (p.7) "the floor-price scheme was ... a net destroyer of wealth" but (p.8) how bureaucracy nonetheless could argue as a consequence for further rather than fewer controls. In Chapter 3 and onwards Mr Dittmer questions the rationale for intervention from first principles and on an item by item basis.

He denies that research and marketing are "public goods" which must be funded by a compulsory levy on producers or they will not take place at all. He explains how the voluntary principle can and does work for such activities, and how and why the activities are better performed

if decentralised – information is dispersed by definition and is impossible to locate in one central place. Worse, once a centralising policy has been adopted, not only is it probably wrong, vested interests will tend to perpetuate or magnify any error. Grading and quality control can have similar arguments applied.

Dittmer argues for competition – including import competition – as the optimum control measure for agriculture, and in particular red meat. Market control, he argues best serves farmers, consumers and the economy at large.

Mr Dittmer's arguments will not be acceptable to all in either farming or in politics. The views he expresses are his own and are not necessarily shared by the members of the Foundation.

However, the FMF offers this *Monograph* as a contribution to the current debate. Deregulation of the agricultural marketing process has been one of the successful features on the South African politico-economic landscape in the 1990s. The debate now is whether further to improve on that process or – as Dittmer fears – perhaps to put it into reverse.

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## The author

Nils Dittmer grew up on a farm in the Kalahari and studied biochemistry at the University of Pretoria. He is a successful farmer and businessman with a special interest in the development and management of extensive pastures. He became Chairman of the Organisation of Livestock Producers (OLP) in 1990 and there championed the cause of agricultural deregulation and spearheaded the campaign against Agricultural Control Boards. In the process he guided the construction of the joint OLP / Sunnyside Group Red Meat Deregulation Proposal.

Dittmer travelled the length and breadth of the country gathering support for the proposal – and countering opposition – with all of the players affected. His efforts and their success led to his being awarded the 1992 Free Market Award for his exceptional contribution to economic freedom in South Africa.

## Acknowledgement

I would like to thank Roger Kerr for providing me with – and permitting me to use – invaluable information on the deregulatory initiatives affecting Agricultural Board marketing in New Zealand.

**Nils Dittmer**

# 1

## Introduction

The National Agricultural Marketing Council (NAMC) was established in terms of the Marketing of Agricultural Products Act, 1996. The NAMC immediately commenced a review of all statutory measures imposed in terms of previous legislation, which had been repealed by the new Act, and called for proposals to bring the existing statutory bodies into line with the requirements of the new Act and with changes that had occurred in government policy.

In responding to the NAMC request, The Meat Industry Forum (MIF), which is a coalition of interest groups in the red meat industry, made a submission to the NAMC in which it proposed that the assets and functions of the Meat Board should be transferred to a Section 21 company (i.e. a registered non-profit company). An implicit understanding then developed that the company should also take over the disbanding Meat Board's remaining statutory powers, thus becoming a Statutory Marketing Authority (SMA), which is an institution or body appointed by the Minister in terms of the 1996 Act to implement or administer statutory measures.

The MIF envisages that the Section 21 company will take over and continue the following statutory regulatory powers and services from the Meat Board:

- research and promotion;
- mandatory grading and quality standards;
- statistical and information services; and
- political and social responsibilities.

Although in the past the Board had the right to authorise even more drastic intervention measures such as minimum prices, supply control and pooling, these schemes were abandoned in 1993. However, measures such as mandatory grading and quality standards are still imposed. It is often argued that these activities are in the interests of the whole industry, that they constitute a public good<sup>1</sup>, and that enforcing compliance is consequently justifiable. This argument is invalid because meat producers and consumers have gained considerably from the liberalisation of meat marketing during the past few years and will gain even more from the removal of these last few interventions.

There would be no objection whatsoever to a Section 21 company that operated purely as a voluntary association of members with common interests. However, granting statutory powers to such a company, including the power to use compulsion and force, would lead to manifest injustice. Any organisation that is granted statutory powers should be accountable directly to Parliament so that the supreme law-making body in the country can have proper control over its activities. The creation of the Section 21 company is merely an attempt, and an obvious one, to keep the Meat Board alive in another guise. This ploy should not be allowed to succeed. Consumers and producers paid the costs of the errors of the Meat Board in the past and would once again be called upon to pay for the futile interventions of any body attempting to replace it.

This *Monograph* will attempt to analyse:

- the probable consequences of continuing the defunct Meat Board's remaining activities as mandatory measures; and
- the likelihood of consumers and the meat industry benefiting in any way from maintaining any of the Meat Board's former activities.

In recent years there has been a growing shift in thinking regarding the institutional and regulatory arrangements that are considered appropriate for the primary producing sectors. There has also been wider recognition of the extent to which the pervasive role and power of the control boards has cast

a shadow over the meat and wool industries. The sea-change in perceptions about the role of Boards or SMAs in competitive and open markets has overtaken the 1993 Kassier Commission<sup>2</sup> recommendations. The Commission was appointed to investigate the Marketing Act (Act No. 59 of 1968) and in its report it recommended sweeping deregulation. Whilst there was considerable opposition to the Kassier proposals when they were published, the need for SMAs is now being questioned, even by people who are close to them.

Chapter 2 examines the various components of the meat industry, the effects of regulation on the industry, changes that resulted from deregulation and the benefits of the changes. Chapter 3 analyses statutory intervention in the meat industry and evaluates the various arguments for intervention. In Chapter 4 we examine whether regulations are required to ensure adequate levels of research and promotion. In Chapter 5 we discuss the issue of maintaining quality and providing grading standards to minimise transaction costs. In Chapter 6 the issue of accountability is addressed, while in Chapter 7 we look at anti-dumping measures. Chapter 8 concludes the arguments.

<sup>1</sup> For a definition of a “public good” see p. 11.

<sup>2</sup> Kassier Commission, *Report of the Committee of Inquiry into the Marketing Act*, Pretoria. December 1992.



# 2

## The meat industry

The meat industry is the largest sub-sector of the agricultural industry. It has myriad intermediaries, and has links with the leather, pharmaceutical, abattoir, processing and other industries. Primary proceeds from slaughter stock exceed R4 billion per annum and total retail sales realised from these products, after processing, probably exceed R20 billion. Stakeholders in the industry include:

- Primary producers of red meat:
  - extensive farmers (i.e. those who produce meat off natural grass and other vegetation); and
  - semi-intensive farmers (i.e. those who produce meat off established pastures).
- Secondary producers of red meat:
  - intensive producers or feedlots (i.e. those who produce meat entirely from pre-mixed rations which include high-energy grains).
- Intermediaries and firms involved in the trade:
  - agents and brokers;
  - abattoirs (including Abacor, the government corporation that is currently not financially viable);
  - processors (hides and skins);
  - facilitators (transporters and offal handlers); and
  - distributors (wholesalers and retailers).
- Government regulatory bodies with duties including:
  - grading;
  - health;
  - hygiene;
  - veterinary health; and
  - the NAMC (which makes recommendations on agricultural policy to the Minister of Agriculture).
- Group interests:
  - more than ten organisations representing group interests such as primary producers, intermediaries etc; and finally
- Consumers.

Prior to 1993, almost 80% of the meat industry was controlled by three large vertically integrated firms namely Vleissentraal, Kanhyam/Karoo and ICS. This concentration came about mainly through planned integration and protectionism. The most important regulatory restrictions prior to 1993 which played a role in the structure of the industry were:

- the designation of controlled (mostly high-consumption and densely populated) and uncontrolled (mostly rural and production) areas and restrictions on the movement of meat between these areas;
- supply control by means of quotas and permits;
- compulsory auctioning of carcasses;
- compulsory use of accredited agency services (i.e. firms registered with the Meat Board and complying with restrictive and prescribed requirements);
- trade licensing and registration of butcheries, meat wholesalers etc;
- the establishment of floor prices for different grades of meat;
- restrictions concerning the sale of hides, skins and offal; and

- restrictions on the establishment of abattoirs.

Removal of these restrictions as a consequence of the 1993 deregulation (Amendments to the Marketing Act of 1968) brought about a major restructuring of the meat industry, just as the protagonists of deregulation had predicted. The following were the most important changes:

- significant rationalisation occurred in the three largest firms in the industry (known as the “Big Three”) to the extent that they are no longer a major factor in the industry. In fact, one of these former dominant firms has virtually collapsed;
- Abakor started experiencing financial problems. Rebuilding the group abattoirs it is estimated will cost R3 billion whilst their market value is estimated to be no more than R110 million. R200 million has been lost over the past five years and R55 million is owing to the Meat Board;
- smaller abattoirs mushroomed all over the country and especially in the production areas;
- hundreds of small wholesaling and retailing outlets developed;
- a much more efficient flow of livestock to the abattoirs developed, responding to supply and demand in the market; and
- the net price to producers for offal and hides increased by 500%.

The former surplus-removal-floor-price scheme (based on the 1968 Act) turned out to be nothing more than a pretentious (and effectively fraudulent) attempt to defy economic law and market forces. According to the floor-price-scheme propaganda, the floor price would prevent the price of meat from falling to “nothing” in times of so-called “oversupply”. However, the fact was conveniently disguised that the price of all the stock of a particular commodity on offer cannot be raised to a level above the market-clearing price – at least not if the market is indeed to be cleared. In reality, such a scheme can only offer some producers higher prices at the expense of others, and all parties then still have to bear the cost of administering the scheme.

In times of drought the floor-price scheme induced producers to hang on to stock too long, waiting for the promised preferential market access. This promised market access often never materialised, or came too late because the abattoirs handling the stock administered under the scheme did not have sufficient slaughtering capacity. The end results of keeping animals on the limited grazing for too long were damage to the veld and far greater de-stocking of herds than would have resulted if herd reductions had been carried out earlier. The floor-price scheme was therefore a net destroyer of wealth and also a disincentive to and destroyer of the self-respect of the producers. The only beneficiaries were the Meat Board bureaucrats who were paid to implement the scheme but had no or little direct financial stake in its success or failure. The price has never dropped to “nothing” and no “chaos” has ensued since the floor-price scheme was abandoned in 1993.<sup>1</sup> Thus, conclusively disproving the dire predictions that persuaded producers to support the introduction of the scheme in the first place.

Deregulation of meat marketing has been of benefit to the whole country. However, the process is incomplete and certain restrictive regulations still need to be removed. One of the prime factors in the maintenance and growth of regulatory intervention is the existence of statutory levies on the marketing of agricultural products. Initially, the levies were introduced at relatively small and painless levels and for feel-good purposes such as “research for the benefit of the industry as a whole” or “industry-wide generic product promotion”, which producers vaguely believe will bring them a benefit that is greater than the cost.

However, once the levies and the bureaucracy that feed off them are in place, there is and inevitably will be lobbying for more intervention, more bureaucrats to implement and police the interventions, and ever-higher statutory levies. The only way to stop this statutory-levy/increased-regulation upward ratchet spiral is to tackle the problem at its root. There must be *no* statutory levies at all.

This does not, in theory, stop producers from getting together to contribute levies voluntarily for some collective purpose. Of course, in practice this never happens, or never functions for very

long or very successfully. The reason is purely economic. If there is a real demand for the services, they will be supplied by an entrepreneur intent on making a profit, and what is more, the services will be provided more efficiently and at lower cost. Only those producers who buy the services will have to pay.

The following chapters will examine whether there are functions and services that:

- can be considered to be essential “public goods”;
- warrant the use of force in the form of statutory compulsory levies to provide funds to institute them; and
- will not be adequately and efficiently supplied by the market in the absence of the levies and the bureaucracy that accompany them.

<sup>1</sup> These terms were used by Meat Board officials and propagandists.

# 3

## Grounds for statutory intervention

Market transactions for human interaction predominate in our economy and those of most of the developed world. No one enters into voluntary transactions without expecting to benefit him/herself *and* his/her trading partner. Market transactions provide a means of co-ordination among a myriad of producers, intermediaries and consumers. Initiation and control of the market process in the meat industry rests with the marketers and processors, with contracts being formed with the producers in order to achieve the required level of quality and supply.

Statutory intervention very often has unintended consequences. For instance, if the government decided that all motor cars should comply with Rolls Royce quality and safety features, most of us would be riding bicycles. The intention behind the requirements would be better and safer cars, but the consequence would be that few people would be able to afford them. The whole system is interdependent and co-operative. It is not, and should not be viewed as a confrontational process. Government should, therefore, be fully aware of the economic consequences of its interventions.

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

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

- reducing the cost of transactions between individuals and firms (minimising market imperfections);
- funding the provision of public goods which will be inadequately provided by the market (the public good argument);
- providing that firms earn sufficient rewards from goods and services that yield wider community benefits to ensure that they are adequately supplied (the externality argument);
- promoting competition (the anti-monopoly argument);
- promoting the provision of goods and services which are likely to be under-supplied because of difficulties in obtaining information.

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

- because of different regulatory requirements, one of the grounds listed above applies to the production and exporting of meat;
- if those grounds do not apply, there are unique aspects of meat products that distinguish them from other products and justify statutory or other regulatory interventions;
- any intervention produces benefits that are greater than any costs;
- the proposed intervention is the most appropriate.

In the remainder of this *Monograph*, the foregoing criteria are applied to assess whether a positive case can be made for the intervention.

# 4

## Research and promotion

The proposed functions of the Section 21 company referred to in the introduction include increasing the demand for the product (through marketing and research) and undertaking research. Research would be done either to improve the quality of the product or to increase the efficiency of production. Promotion would be carried out to introduce to or remind consumers about a product and to increase the demand for that product. Expenditures on research and promotion are the most commonly cited examples of services which have some of the elements of a “public good”. To define, public goods or services exhibit both of the following features:

- it is difficult to exclude non-payers from the enjoyment of the benefits of the goods and services, i.e. “free-riding” by non-payers is easy and is difficult to prevent; and
- the extra cost (and price) of providing such goods or services to an additional user is very low or zero. In a narrow sense, the cost of providing street lighting for the extra passer-by is zero. The extra cost of providing meat promotion to one more producer would likewise be close to zero. Or, alternatively, once one extra unit of the so-called “public good” is consumed, no supply reduction has occurred so that later consumers need not make do with less.

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

Against this, however, market mechanisms do exist, for example, to exclude non-payers from the benefits of promotional expenditure where it is economical for funders of promotion to use them. Examples include the development of brands and trade or quality marks such as *Dairybelle* cream or *Eskort* bacon. These represent property rights which are given statutory protection through trademarks and patents. Rules protecting brands or trademarks enable the person who invests in promotion or quality standards to capture most (if not all) of the benefits of the expenditure. Non-payers do not derive any direct benefit since they are denied use of the brand or quality mark. The implications of the development of stronger licensing and copyright arrangements make it easier for companies to capture and protect the benefits of research. Stronger property rights are a contributing factor to a climate that provides for research by individual companies.

Alternatively, interventions could prevent the development of such mechanisms, and the outcome may be less effective in the longer term. Generic promotion, for example, implies that all products of a specific commodity are of the same quality. The imposition of levies to fund generic promotion and research may displace research or promotion that would otherwise be undertaken directly by stakeholders. Since processors and other intermediaries have stronger incentives and better information than producer Boards, Forums or SMAs optimally to tailor promotion to market needs (including incentives to decide whether to fund promotion at all), producer-funded generic promotion is likely to be a poor driver of success. The dismal failure of such generic advertising in the meat industry in South Africa speaks for itself. The per capita consumption of red meat has decreased from 68 kg in 1930 to under 20 kg in 1995. The onus is now on the MIF to show beyond any reasonable doubt why their efforts will amount to a better allocation of resources.

Third, even if non-payers cannot be excluded, it may still be worthwhile to invest since the pay-off may be high enough to make it worthwhile. The onus again is on the MIF to show that the benefits to producers will be greater than their contributions.

It may also be argued that expenditure on research gives rise to externalities that are not captured by the funder of the research. This is similar to the public good problem. Supposed

externalities are widespread and do not necessarily imply the need for intervention. As observed by Nobel Laureate Ronald Coase<sup>1</sup>:

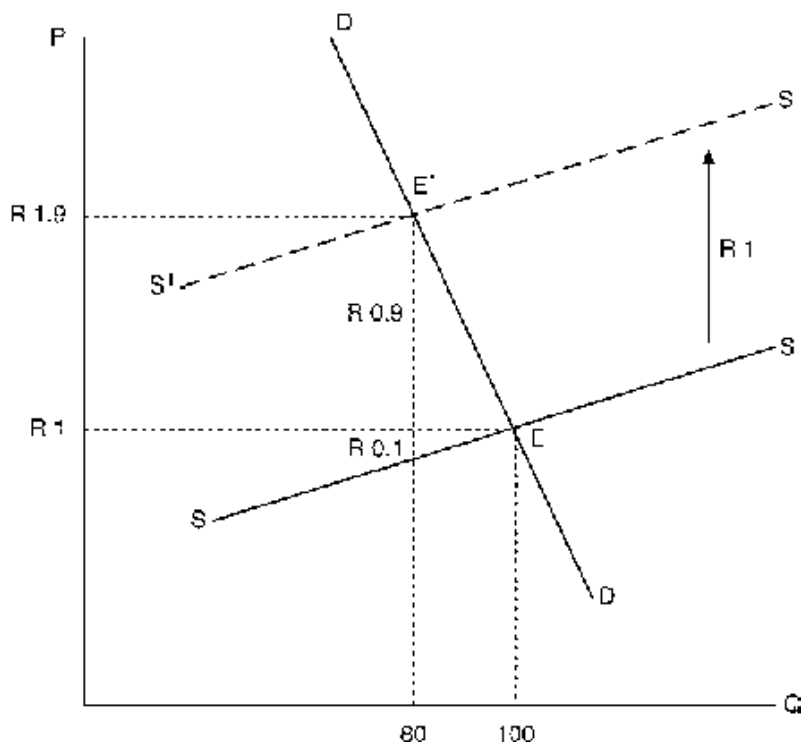
The ubiquitous nature of externalities suggests to me that there is a *prima facie* case against intervention, and the studies on the effects of regulation that have been made in recent years in the USA, ranging from agriculture to zoning, which indicate that regulation has commonly made matters worse,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

Even in markets where externalities might exist, such as the provision of computer communications networks, competing firms often co-operate. They may do so by standardising technologies or protocols without government intervention in order to reduce unit costs or to become more user-friendly. Externalities might also be ignored by consumers and producers because of inadequately defined property rights (such as patent rights). In these cases, better defined property rights are likely to be a preferable alternative to centrally determined subsidies or taxes. It is notable that property rights in respect of Board-funded activities are often quite weak. There is also some doubt about the strength of property rights in respect of the Meat Board's carcass grading system (e.g. it disallows any kind of quality mark, differentiation or origin-mark).<sup>2</sup>

Finally, funding of favoured research and promotion projects through compulsory levies increases the costs to producers as well as their risks. The levies that fund the Meat Board represent a significant proportion of producers' before-tax net income (probably in excess of 10% plus the indirect cost of intervention). It is doubtful whether many producers would voluntarily choose to fund these activities. The benefits and costs of levies paid by producers are, in reality, shared by consumers and processors of the commodity (see figure and explanation below). The producer's share is determined by the relative responsiveness (elasticity) of quantity supplied and demanded to changes in price. It is ludicrous to suggest that consumers ultimately pay these levies because producers simply add the cost of levies to their prices. The only reason the levy is deducted from producers is convenience to the collectors of these levies.

The following figure from Samuelson and Nordhaus<sup>3</sup> shows that a tax falls on both the consumer and the producer.

## Effect of unit of tax on competitive price and output



A R1-00 tax shifts  $ss$  up R1-00 everywhere to give parallel  $s^1s^1$ . This intersects  $dd$  in new equilibrium at  $E^1$ , where the price to the consumer has risen 90 cents above the old  $E$  equilibrium and where the price to the producer has fallen by 10 cents. There is a change in both the traded price and quantity. Had  $dd$  been very elastic and flat relative to  $ss$ , most of the R1-00 tax would have fallen on the producer. Had  $ss$  been completely horizontal, the whole R1-00 tax would have been shifted forward onto the consumer.

There is no reason for the demand curve of consumers to have changed at all. At R1-00, consumers will still be willing to buy only 100 units; they neither know nor care that the producers must pay a tax. But the whole supply curve is shifted upward and leftward: leftward because at each market price the producers will now supply less as a result of the tax; upward because to get producers to bring any given quantity to the market, say, 80 units, we must give them a higher market price than before – R1-90 rather than R0-90, which is higher by the exact amount of R1-00 tax the producer must pay.

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

A recent study on the impacts of brand and generic advertising on meat demand in the USA concluded that, relative to increases in advertising expenditures, considerably smaller percentage reductions in beef prices are needed to induce equivalent increases in consumption<sup>4</sup>. This implies that funding of promotion may provide much lower yields to producers than expenditure (including research) aimed at reducing on-farm production costs. Another commentator has argued that “...producers should prefer a research-induced decrease in production costs”<sup>5</sup>.

There is a difference between advertising that is observed to be successful because it induces increased demand, and profitable advertising. For example, an expansion in domestic demand may



merely divert production from the export to the domestic market. If export and domestic prices are similar, then average prices (and hence revenues to producers) do not increase<sup>6</sup>.

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

Commercial judgements about the allocation of resources among promotion, research and other activities are made by businesses every day. However, a compulsory levy to fund a variety of research, promotion and other interventionist activities is a cumbersome mechanism to address the trade-offs involved. Accountability arrangements provide little protection against the risk that, as in the past, the resources of producers will be devoted to a narrow range of risky schemes. Resources may be over-committed to currently fashionable marketing or other strategies which, without a market test, will prove to be ineffective.

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

In short, grounds for intervention are weak, and any benefits are unlikely to exceed associated costs. Promotion and research should be the responsibility of those who directly benefit and who are best placed to make the trade-offs involved.

The case for compulsory funding of research and promotion amounts to rent-seeking<sup>7</sup> and serves to disguise the superfluous and biased nature of research conducted by state-controlled institutions.

<sup>1</sup> Coase, RH (1988), *The Firm, the Market and the Law*. Chicago, The University of Chicago Press.

<sup>2</sup> Any mark other than the official grading marks brought on to the carcass is described by law as a misrepresentation and consequently fraud.

<sup>3</sup> Samuelson, PA and Nordhaus, WD, *Economics* (12<sup>th</sup> ed), 1985, Chapter 18, p 387.

<sup>4</sup> Brester, Gary and Schroeder, Ted (1995). "The Impacts of Brand and Generic Advertising on Meat Demand". *American Journal of Agricultural Economics* 77, pp 969 - 979.

<sup>5</sup> Wohlgenant, MK (1993). "Distribution of Gains from Research and Promotion in Multi-stage Production Systems: The Case for the US Beef and Pork Industries". *American Journal of Agricultural Economics* 75, pp 642 - 651.

<sup>6</sup> Piggott, RR, Piggott, NE, and Wright, VE, (1995), "Approximating Farm-Level Returns to Incremental Advertising Expenditure: Methods and an Application to the Australian Meat Industry". *American Journal of Agricultural Economics* 77, pp 497 - 511.

<sup>7</sup> Rent-seeking is an economic term meaning the use of government power by interest groups and individuals to obtain special privileges for themselves. Successful rent-seekers gain above-market returns by deliberate contrivance, by successfully lobbying government for favours. Consumers, and society at large, are inevitably the losers in such lobbying processes.

# 5

## Mandatory grading and quality standards

The current meat classification/grading system is based on the number of permanent incisors cut by the animal, which in turn is a reasonable reflection of the age of the animal, as well as the degree of fatness of the carcass. An animal with no permanent incisors is an A-grade, one with one to seven permanent incisors is a B-grade, and one with eight is a C-grade. It is a well-known fact that older-carcass meat is less tender, but more tasty than younger carcasses. Consumers seem to prefer more tender meat. A-grade animals are usually younger than 22 months and B-grade animals vary in age from two to six years. However, the problem is that there is more variation in tenderness within the B-grade than between the A and B grades.

The current meat classification/grading system does not reflect consumer preference and taste. The system was devised to facilitate the old meat scheme<sup>1</sup> with compulsory auctioning of carcasses and possibly also to benefit feedlotters over extensive producers. The major feedlots in the Meat Board era were owned by the “Big Three”. The research done by the Agricultural Research Centre that gives credibility to this grading system has been done with a pre-determined conclusion and therefore lacks scientific credibility.

The current meat classification system discriminates unjustly against primary producers, since it is extremely difficult to reach market-maturity off grass before the cut-off age for A-grade classification. It has not been proven that an additional six months, which may be needed to reach market-readiness off the veld, would significantly reduce meat quality. Genetic variation, according to most animal scientists, is far more significant than age.

It is sometimes argued that statutory intervention is necessary because product characteristics are frequently difficult for consumers to observe due to high information costs. Consumers may, for example, be unsure about the properties of meat by-products. If consumers are less informed than suppliers about product quality, bad suppliers can end up driving good ones out. (This is often referred to as the “market for lemons” problem.)<sup>2</sup>

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

Mandatory grading systems and quality standards cut across these normal market responses. Provided valid hygiene and sanitary concerns are addressed in accordance with market demands, any other mandatory quality standards are an attempt to impose a particular market differentiation strategy. Judgements about the viability and nature of such strategies should be left to market participants, who have the strongest incentives and best information to get them right. Removal of mandatory requirements would mean that:

- certification costs would be targeted more effectively on products for which the demand is most responsive to the setting of standard grades or quality marks;
- each marketer would have an incentive to ensure that the grades or quality standards met the needs of consumers while enhancing the marketer’s reputation;

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

Despite the protection we enjoy under the constitution, the powers and financial muscle of SMAs represent a risk to stakeholders and make the agricultural sector less attractive to investors. The high cost of fighting legal battles against the state and others wishing to impose costs on the meat industry is also a deterrent. In the event, for instance, of export restrictions being imposed, an individual company could be adversely affected by majority decisions, which means that commercial risk in the industry is unnecessarily increased.

Moreover, to the extent that market restrictions or requirements do not relate to valid hygiene or sanitary concerns, they amount to non-tariff barriers in respect of which remedies are being developed under the rules of the World Trade Organisation.

The Organisation of Livestock Producers (OLP) has suggested that SMAs should not have exclusive powers to grade meat. The current grading/classification system can be retained for those who wish to use it, but owners of slaughter stock should have the choice of using any other system, which is not presently the case. Freedom of choice for the producers will ensure that statutory interventions do not cut across normal market information that suppliers convey to consumers and that they will also not impede the independent enhancement of brands.

<sup>1</sup> As empowered by the Marketing Act, 1968 (Act No. 59 of 1968).

<sup>2</sup> Akerlof, G, 1970, "The Market for 'Lemons': Qualitative Uncertainty and the Market Mechanism", *Quarterly Journal of Economics*.

# 6

## Accountability arrangements

A review of the grounds for statutory intervention shows that valid grounds for intervention (taking account of associated costs) potentially exist in respect of markets only where access or other restrictions apply. This does not justify maintaining the infrastructure of SMAs.

Boards and SMAs are poorly suited to be bulk-funded from levies to undertake a wide range of activities (market access, promotion, research etc.). This arises from the following incentive problems:

- capital market constraints on the performance of the Boards are relatively weak. For example, management is not exposed (as it is in a corporate environment) to the threat or reality of takeovers and information generated by the share market reflecting management performance. While this applies particularly to Boards as a holding entity, producers have found to their cost that incentive problems also arise from subsidiaries owned or controlled by SMAs;
- accountability to producers is primarily through political processes and pressures which lead to the use of political, rather than commercial, decision criteria. A continuing and substantial role for the SMAs in funding research and promotion makes it easier for special interest groups to lobby to invest funds in low-yielding activities. Lobbying to maintain or increase spending on favoured, but low-yielding, activities can be successful since decision-making is intermediated through industry politicians rather than through the far stronger accountability mechanisms applying to commercial activities;
- the Boards and SMAs have confused and overlapping objectives. The in-general mission attempts to strike a balance between the Board's accountability to its levy payers, its responsibilities to the wider industry, and the national interest. These objectives must conflict, which means that any shortcoming in meeting an objective can be attributed by the Board to a requirement to pursue another;
- as ultimate owners of Board-owned assets, producers have relatively weak incentives to monitor the performance of SMAs and their managements. This is because producers are not able to act directly on information they receive about SMA performance, for example by buying and selling shares.

The above incentive problems are heightened because the objectives of producers may conflict with those of the SMA. The interests of producers may be better served if the Board distributed its reserves or liquidated assets and returned the proceeds. The interests of the management of the Board may lie in retaining earnings and investing in politically popular ventures that, due to poor returns or risk, would not be undertaken by an entity subject to normal commercial disciplines.

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

The willingness of producers to take risks differs. The sale of the Board's remaining assets and the discontinuance of levies would reduce the risk producers face, or would enable them to manage their own risk according to choice. Many producers have limited opportunity to influence

the decisions of the Boards and have few options to offset the effect on them of adverse decisions. It is very costly, for example, to convert land uses to other, less encumbered activities.

Performance measures for Boards and SMAs, while probably superior to none at all, are a pale reflection of the disciplines that apply in the private sector. More elaborate procedures for political accountability, such as approving annual plans, three yearly votes or scrutinising spending on major initiatives, are merely palliatives. Such approaches confuse the role of stakeholders and management, and do not address the fundamental weaknesses that arise from a reliance on political rather than commercial accountability.

These differences between Boards and an investment vehicle in which stakeholders directly hold ownership interest mean that, on average and over time, resources invested through Boards are likely to achieve lower returns than if those resources were invested directly by producers. History to date supports this conclusion. The fate of the entire sector could be determined by who controls the majority vote.

The existence of Boards and SMAs and their statutory powers also keeps alive the fallacy of “producer control” that has bedevilled primary industries for decades. The endless appointment of Committees of Enquiry over the last thirty years underscores this. Wool, meat and pork processors and exporters, politicians and unions can all fall into the trap of believing that if they could only lay their hands on the resources and powers of the Boards to achieve the right interventions and strategies, the forces of economic gravity would somehow be defied and downturns in markets that are beyond anyone’s control would be reversed.

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

The false sense of “producer control” induced by umbrella organisations like SMAs also diverts the attention of producers and others from the development of more conventional and successful forms co-operation and co-ordination that are typical in other sectors (such as sophisticated purchase contracts where there is seasonal supply and demand). In the past, producers have been misled into believing that some paternalistic figure would do that for them. Rather than trying to tamper yet again with the architecture of the Boards, they should be dispensed with once and for all.

# 7

## Anti-dumping measures

Prior to 1992, quantitative import controls were imposed by the Boards as anti-dumping measures. This led to favouritism and market-signal distortions. Quantitative import controls have since been replaced by import tariffs under the jurisdiction of the Department of Trade and Industry. This leaves the Board of Tariffs and Trade with the impossible task of deciding what the fair price of a commodity should be and of imposing an “appropriate” import tariff.

### **Growth in share prices versus inflation (1990 to March 1997)**

| <b>Type of prices</b>           | <b>% increase</b> |
|---------------------------------|-------------------|
| Inflation                       | 95                |
| <b>Agricultural prices</b>      | <b>85</b>         |
| <b>Agricultural land prices</b> | <b>23</b>         |
| All shares                      | 132               |
| Mining shares                   | 32                |
| - Gold                          | -7                |
| - Coal                          | 164               |
| - Other                         | 61                |
| Financial shares                | 166               |
| - Industrial/general            | 100               |
| - Fixed property                | -13               |
| - Banks and insurers            | 567               |
| Industrial and trade shares     | 191               |
| - Industrial                    | 188               |
| - Trade                         | 217               |

**Source:** South African Reserve Bank

From the table above it is clear that the agricultural sector has suffered relative injury compared to most other sectors of the economy. One of the contributing factors could be inadequate protection against foreign export subsidies. Another factor could be an over-emphasis on food security incentives. The real decrease in land values for production purposes indicates that investment in agro-commodity production has become less attractive.

The only way dumping can be economically harmful to the country as a whole, is if it allows for so-called predatory pricing. Predatory pricing occurs when a firm drives out competition by artificially lowering prices, and then subsequently raises prices sufficiently to recoup losses. However, in practice the conditions which would permit predatory pricing in a free market are actually inconceivable. The example of the Nigerian meat industry, where EU export subsidies are said to have destroyed the local beef industry, is often used by the protagonists of dumping protection as an example of predatory pricing. It remains highly questionable whether a country in such political turmoil, with equally poor performances in other industries, can be used as an example of harmful dumping.

Predatory pricing can be dealt with in terms of existing competition statutes or investigated by the Harmful Business Practice Committee, if and when it occurs. No additional legislation is necessary. Affected parties in industry will be very quick to report such cases to the authorities. It is argued that if and when predatory pricing occurs, the government would be unable to act against it. The most important safeguard against predatory pricing would be for firms to secure long-term contracts and prices with foreign suppliers in order to secure their own business viability.

The most direct beneficiary of import tariffs is the government in respect of revenue. Other very likely beneficiaries of import tariffs are corrupt customs officials as well as the firms doing the

importing. The big money involved in tariffication is therefore diverting the original intention of protecting producers. The state wants to maximise its revenue and importing firms seek to minimise the price of imported goods. The whole process is completely out of the hands of producers. Consequently, it is estimated that more than 60% of imported meat escapes tariffication.

In the worst case meat-dumping scenario, only part of the local industry is likely to be affected because imported meat can enter the market only in frozen form. This does little harm to the sophisticated fresh-meat market. Importation of live animals on a large scale is unlikely because humane transport of the animals over long distances is difficult. Total destruction of local meat production due to imports is therefore extremely unlikely.

Even if the EU were to practise predatory pricing against one particular country, it is very unlikely that all other meat-producing countries such as Argentina, the USA, Australia and New Zealand would all conspire to raise prices of frozen meat to South Africa to levels above the international market price. This negates any possibility that excessive prices will be charged after the deliberate destruction of the meat industry in a developing country.

Importation of red meat should therefore be allowed to occur freely without any impediment, provided that the necessary safeguards against the spread of disease are in place. The current protection measures are probably not influencing prices significantly, and abolition of the existing import controls would raise South Africa's status as a trade-friendly country.

# 8

## Conclusion

The factors that make the meat industry in any sense special are minimal. The very limited grounds for intervention that may exist do not warrant the retention of the full paraphernalia of the Meat Board. Moreover, its retention would guarantee a continuation of the Byzantine manoeuvring, pressure and industry politics which divert commercial effort in a way that few other sectors have to suffer.

The right to associate voluntarily is a fundamental right which would, if undermined in a free and open economy, stunt economic growth, prosperity and initiative.

The meat industry has been plagued by regular crises for the past seventy years. Its development has been affected by government and producer Board interference that has been grossly distorting. The Meat Board was criticised in both the Sunnyside Group Report (1991)<sup>1</sup> and the Kassier Report (1993)<sup>2</sup>. Since then there has been a substantial shift in thinking, and a wider recognition of the extent to which the pervasive powers of the Board have cast a shadow over the sector.

In order to secure a viable future, these industries must match the rates of improvement in innovation and productivity of other sectors in the economy. Otherwise, the meat sector will lack profitability and be unable to compete for resources. The industry must therefore be freed of all unnecessary limitations on choice.

<sup>1</sup> *The Red Meat Industry: Assessment and Recommendations*, Sunnyside Group (September 1991).

<sup>2</sup> Kassier Commission, *op. cit.*