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MEMO

TO: Dr Ross Patterson

DATE: 5 July 2022

FROM: James Mellsop

SUBJECT: **Response to new material in 15 June 2022 Link Economics report**

NZTGA-only version

1. You have asked me to review any new material contained in the 15 June 2022 Link Economics report prepared for the New Zealand Tegel Growers Association.
2. There are a number of statements in the Link Economics report that I disagree with. However, I understand that I should limit my comments to any new material.
3. I adopt the same confidentiality key as the Link Economics report:
   A. Confidential to NZTGA and Tegel.
   B. Confidential to NZTGA.
   C. Confidential to Other Submitter.
   D. Confidential to Tegel.
4. For the sake of brevity, I have set out my comments in tabular form, below.

Para	Link Economics statement	NERA response
11	[ ] [ ] [ ] [ ]	This is a subjective judgment. It is quite possible that both Tegel and the relevant individuals are better off with the individually negotiated agreements. Indeed, I also note: ▪ The Link Economics report's statement that [ ] ([10]), [ ]; and ▪ The NZCC's statement at [141] of the Draft Determination that [ ].
12	"NERA (para 6) states that NZCC does not refer to any evidence that less shed investment would have occurred under individual bargaining. [ ]	[ ]
14	"Moreover the fact that the FMA does not have higher rates for farms with higher land prices or a smaller scale would seem likely to encourage efficiency – if a grower knew that if its costs were higher, then it would be paid more, it would have less incentive to keep costs down."	It is difficult to see how a grower could control the price of land.

15	"NERA (para 12) further discusses the issue of homogeneity by referring to a paragraph from the Australian Competition Tribunal's decision on Port of Newcastle. I note that the Tribunal's reasons for not finding any material transactions cost savings did not include a lack of homogeneity between coal producers (see paras 347 to 350 of the Tribunal decision) and found that the coal producers did have a common interest."	We did not refer to the Tribunal decision because of its facts, but because of the economic framework it adopted, which was similar to that set out by King (2013).
18(c)	"On the topic of elasticities, NERA expresses the view that the price elasticity would be lower over a 10-year period."	Actually, we said the opposite. It is uncontroversial that demand generally becomes more elastic the longer the timeframe of analysis. See, for example, pages 83-84 of Katz and Rosen (1994).[1]
18(d)	"Given Tegel's financial position and its announcement that wholesale prices would increase (as noted in the Commission's Draft Determination), it seems unlikely that Tegel would passthrough any reduction in grower fees in the form of lower wholesale prices."	The NZTGA is trying to get collective bargaining authorised, which would *increase* Tegel's costs, not decrease them. For the reasons given in section 3.1 of our 20 May 2022 report, these increased costs would be passed through and would be borne by consumers (whether in the form of higher prices or lower quality). To be clear, end consumers of chicken will pay for any higher grower fees or other increased costs that occur due to collective negotiations.
19(b)	"Dynamic efficiency benefits of the authorisation include the ability for the growers to collaborate through the NZTGA on innovative growing techniques."	It is not clear why collaboration on innovative growing techniques requires collective bargaining with Tegel or authorisation. And more generally, it is not explained why the more general economic principle that competition leads to more innovation is not the case here.
23	"NERA takes the view that the relationship between Tegel growers is one of mutual independence with precise bargaining power varying over time as the demand for chicken meat varies. NERA suggests that because the future is uncertain, and the relative bargaining power of the parties may change, 10 years is too long for an authorisation. However, NERA's reasoning does not recognise that individual growers are ***entirely*** dependent on Tegel for recovering the significant shedding investments that are specific to raising broiler chickens, but Tegel is not entirely dependent on any individual	We said the relationship is one of mutual *dependence*, not independence. It is correct that Tegel is not "entirely" dependent on any individual grower, in the sense that there are multiple growers supplying Tegel. However, as our 20 May 2022 report noted, when there is not excess growing capacity Tegel would be dependent on each of the growers it has, providing the growers with bargaining power (particularly, of course, if they are permitted to act collectively). The situation will be particularly stark for Tegel **[ ]**[2] **[ ]** (as noted at [75(a)] of the 15 June 2022 NZTGA cross-submission). At

[1] Michael L Katz and Harvey S Rosen (1994) *Microeconomics* (2ed) Irwin.

[2] **[ ]**

	grower. This leads to a fundamental imbalance in bargaining power that would persist over the 10-year period of the proposed authorisation.”	this time, **[ ]** whose contract terminates **[ ]**. We note that [26] of the NZTGA’s cross-submission lists the options it considers Tegel has, including the options to obtain new growers. We understand that Tegel’s response will address these other posited options.
36	“Given that the Commission found in its determination on the Waikato-Bay of Plenty Chicken Growers Association’s authorisation that wealth transfers may represent a positive public benefit, it is unclear as to why that conclusion would not equally apply to NZTGA’s authorisation application. In the case of the NZTGA authorisation application, the Commission finds (para 141.1 of the Draft Determination) that Tegel is likely to have more bargaining power in the counterfactual. Therefore, it stands to reason that under usual trading conditions an authorisation would result in a public benefit from a wealth transfer.”	The Link Economics report does not engage with the NZCC’s analysis (in the present case) regarding the treatment of wealth transfers. In particular, the Link Economics report does not: ▪ Point to any evidence of Tegel earning (whether now or in the future) “functionless monopoly rents”; or ▪ Dispute the NZCC’s characterisation (at [152]) of Tegel as being *“a business in New Zealand which employs New Zealanders, adds value to New Zealand primary production and produces goods sold to New Zealand consumers in competition with other domestic companies, appears to be the kind of “trade and investment which, from a long-run perspective, benefits the New Zealand public””*. Finally, even if it was correct that Tegel would have more bargaining power under the counterfactual than the factual, it does not automatically follow that Tegel would earn functionless monopoly rents. It seems more likely that any bargaining power would be competed away in Tegel’s output markets.