

**WAIRARAPA AGRICULTURAL SEMINAR**

**A VISION FOR AGRICULTURE**

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## **A VISION FOR AGRICULTURE**

The topic I have been assigned is 'A vision for agriculture'. I have to confess that I'm cautious about visions. Great visionaries of the twentieth century included Lenin, Mao, Pol Pot and Fidel Castro. The results of their visions were devastating. On a recent radio programme I heard a Russian saying that Russian politicians should stop having visions. The failure of every past vision had left the population feeling more disillusioned and hopeless than ever.

Of course I don't want to knock the idea of visions in a general way. Much depends on who is having the vision and how the vision is expressed.

It's fine for individuals to have visions – indeed I wish many New Zealanders had higher aspirations. It's also fine for corporate entities such as a company, a school, a government agency or a voluntary organisation to have visions. They can set goals and devise strategies for achieving them. Visionary leaders can motivate teams and inspire them to achieve great things.

Where we get into trouble with vision-talk is with other kinds of entities, in particular when we talk of national visions. A country is not a company. The citizens making up a country do not have a single vision – people are not clones. They have diverse and sometimes conflicting preferences, values and visions. A society is a civil association not a corporate association. Nor can an industrial sector like agriculture have a single corporate vision. The world would starve if countries adopted a Soviet vision for agriculture.

Treating a country as though it were a company (New Zealand Incorporated, so to speak) quickly leads to a grandiose view of the role of government and central planning visions. A perennial favourite is a target for economic growth. In New Zealand we have had so many visions of this type that we must be close to being visioned out.

In my working life this national sport began with the National Development Conference of the late 1960s. In response to concerns about New Zealand's faltering

economic performance, it set a national growth target of 4 percent per annum (plus specific targets for sectors like agriculture). They weren't achieved, and the 1976 report *New Zealand at the Turning Point* commented that:

... those responsible did not heed the glaring discrepancies which emerged between targets and actual performance, and failed to modify policy accordingly.

Not deterred, however, the Planning Council in 1978 set a 5-year target of 3 percent annual growth, which again wasn't met. For a while during the 1980s the third Labour government concentrated on actions not growth targets, but play resumed in 1990 with the Trade Development Board wanting New Zealand to become '10 by 2010' – the tenth wealthiest country in the Organisation for Economic Cooperation and Development (OECD) area. A bit later, at about the time it gave up on economic reform, the Bolger government came out with a 3.5-5 percent annual growth target for the period to 2010. Winston Peters trumped that with a 6 percent target. In the budget this year the minister of finance set a target of 4 percent or more. The prime minister has spoken of New Zealand getting into the top half of the OECD by 2010. The ACT Party has adopted the '10 by 2010' goal. The leader of the opposition has talked about doubling New Zealand's growth rate. There can't be many other options left on the menu.

The problem remains the same as that identified in the 1976 report. The Bolger-Birch government did not show the slightest concern about the discrepancies between its goals and its performance, despite endless attempts to point them out. The goal of getting back into the top half of the OECD by 2010 would require real per capita income to grow at an annual rate of somewhere between 4.6 and 7.4 percent, depending on the assumptions made. There are currently no signs that the government is contemplating the radical policy changes that could move the country towards such a goal. On present policies it is more likely that New Zealand's ranking among the OECD countries will continue to fall. Unrealistic goals which governments have no intention of pursuing are diversions and a recipe for disillusionment. We might as well dream of inventing a grass-eating pig that lays eggs.

In any event, a goal of achieving a particular growth rate is a central planner's vision, not a vision for a free and democratic society. We would no doubt get a lot more growth if the government legislated for a 60-hour working week, but is that what most New Zealanders want? Supporters of the Green Party might not want any growth at all. Should their preferences simply be overridden? A vision for a democratic society needs to be expressed in quite different terms – such as maximising opportunities for people to achieve their own goals, provided they do not interfere with the rights and freedoms of others.

Besides these outbreaks of 1970s 'growthmanship', several other visions and pseudo-economic ideas have featured in recent public debate.

For a start, there has been much talk about a 'new economy'. One implication is that 'old economy' industries like agriculture are losers; our river flats should be converted into Silicon Valleys. Proponents of the 'new economy' have looked foolish as the hi-tech boom turned into a hi-tech bust. The best performing sector on the Australian stock exchange in the past year has been building materials – an old economy sector if ever there was one. The collapse of many of the dotcom companies simply showed that the old laws of economics still apply.

Talk of a 'knowledge economy' is not much more helpful. Knowledge has mattered for economic progress ever since hunters and gatherers left their caves. The shift from manpower to brainpower has been going on at least since the industrial revolution. Innovations in information technology are just one of many waves of innovation since that time.

This is obvious in agriculture. Turning ultraviolet light and soil nutrients into casein, a lamb rack or an award winning wine that competes on world markets is enormously intensive in knowledge. In fact it has only been through constantly expanding the base of knowledge in farming that we have been able to maintain a vibrant agricultural sector. If all farms were to revert tomorrow to using the technologies and knowledge that were around in, say, 1950, they would be out of business by the end of the year.

Moreover, knowledge and wealth creation should not be equated with higher education, important as education is. The celebrated speech by Larry Ellison, chief executive of Oracle, that was circulated widely on the internet last year was apparently apocryphal but it contained an element of truth. It had him telling a class of graduates at Yale University that he, the second richest man on the planet, was a college dropout and they were not. So were Bill Gates and Paul Allen, the first and third richest men respectively. Among various other heresies the audience was told:

Leave. Pack your things and your ideas and don't come back. Drop out. Start up ... A cap and gown will keep you down just as surely as these security guards dragging me off this stage are keeping me down.

The point is that wealth creation is primarily due to entrepreneurs, not people in white coats. And the most important stimulus to entrepreneurship is open markets with relatively light taxation and regulation. We need to put as few obstacles as possible in the way of entrepreneurs and ensure they get rewarded when they succeed.

There has also been a lot of loose and often self-interested talk about New Zealand's dependence on primary industries and the need to move away from 'commodity production' and into 'value added' activities and 'further processing'.

All this is more pseudo-economics. There is nothing wrong with producing commodities if that is what we do best. Commodities have to be produced and some countries will have a comparative advantage in producing them. Commodities comprise about 55 percent of Australia's goods and services exports, which rose by 23 percent last year. Far from being impoverished hewers of wood and drawers of water, Australians enjoy per capita incomes that are now around 40 percent higher than ours. Australia was one of the best-performing countries in the OECD in the past decade.

In any case, what is a commodity? McDonald's hamburgers and Starbucks coffee are surely commodities, yet they have made great wealth for investors. So too are international toll calls, standard banking services and air travel, in the sense that

competition for these largely undifferentiated products is mainly on price. Some people seem to think that commodities are the wrong business to be in because they fall in price – that agricultural terms of trade are poor. In fact New Zealand's agricultural terms of trade have risen slightly in the past 10 years whereas the prices of many so-called 'new economy' products have fallen like a stone – Microsoft's Windows prices by 50 percent, telecommunications toll charges by much more.

'Value added' talk is even more confused. Value added is just production or gross domestic product (GDP). At the level of the economy or the firm it is simply the value of production less the cost of inputs. Of course we want more value added in the sense that we want increasing production and higher national income by using scarce economic resources better. But there is no more to it than that. There may be as much added value in a seedling growing into a tree as in the most sophisticated microprocessor.

By value added some people mean further processing of so-called raw materials (like a log). But this may or may not make sense for firms or the economy. Further processing involves costs which may exceed the additional revenues. The important issue for wealth creation is the return on investment. This may be higher at the margin for logs than for processed wood products.

Furthermore, just because an activity adds value doesn't mean we should be pursuing it. We might well be able to add value using thermal steam to heat glasshouses to grow bananas in – but the capital and labour involved would very likely generate better returns in some other activity.

All this is elementary economics, but elementary economics does not seem to feature in some of our current debates. Whenever New Zealanders get anxious about the country's economic performance, new and old nostrums get hawked around. The list is familiar: promote hi-tech industries, subsidise R & D, cut the company tax rate, join Australia, double the population, adopt the US dollar. Some of them may have merit; others are as foolish as the late 1960s idea of closing down the dairy industry. But they do not add up to a coherent economic strategy. Talk of 'kick

starting' the economy or finding a 'circuit breaker' has no basis in any serious analysis of economic growth.

At a precursor to the forthcoming Knowledge Wave conference, the former Canadian prime minister Brian Mulroney made some basic points about economic policy. He observed that there was little new or revolutionary about the lessons of economic success. There was no single panacea – a country had to get a lot of things right. Key requirements included low inflation, free trade, openness to foreign investment, deregulation, privatisation, low taxation and good education. Relatively unrestricted labour markets generating high levels of employment, the avoidance of welfare dependency, and good institutions – such as secure property rights and a sound legal system – could be added to this list. Mulroney went on to say that such a programme had to be durable and applied consistently, not overturned with every change of government. I am not sure that his audience got the message. But as the *National Business Review* said in a recent editorial:

Unless the Knowledge Wave conference addresses the key drivers of wealth creation – greater direct foreign investment, low tax, smaller government and a climate that fosters innovation – it will be an expensive failure.<sup>1</sup>

The general answer to questions about the future of agriculture in New Zealand is also fairly elementary. Broadly speaking, agriculture will do well in an economy that is performing well and it will do badly in an economy that is performing badly. Over the last 15 years agriculture (including off-farm processing) has more than maintained its share of GDP – it has gone from 14.2 percent of GDP in 1986/87 to 16.6 percent in 1999/00. So much for farming being a sunset industry. The key to this performance has been productivity growth – an annual increase of 3.9 percent in total factor productivity compared with 1.1 percent for the whole economy. The Employment Contracts Act 1991 was a pivotal factor in this productivity improvement.

Right now farming overall is on a roll – farmers are enjoying their best year for 20 years according to some accounts. Yet average sheep and beef farm profit this year is estimated to be around \$90,000 and dairy farm profit around \$120,000. These are

modest sums for what are large enterprises. Even at current levels the returns hardly stand out relative to long-term returns from investment on the stock exchange.

Around 1993-94 farm incomes also rose when the economy's international competitiveness lifted and economic growth took off after the years of economic reform. Farmers became far too complacent about the future. They generally turned a blind eye to the spending sprees and policy drift of the Bolger-Birch governments. A few years later the sector and the economy were back in the doldrums. The current recovery in farming has happened on the back of favourable international conditions and a weak dollar, itself largely a result of several years of economic mismanagement. These conditions won't persist: the economy as a whole is not in good shape; export volumes are not growing strongly; investment is relatively weak; and the medium-term prospects are for growth of only 2-3 percent a year. Agriculture will not be doing well until its performance this year is routine (barring adverse weather conditions), not a 1 in 20 year event.

In particular, farmers should be mindful that currency depreciations only improve profitability temporarily. Currently the economy's real exchange rate (ie the nominal exchange rate adjusted for differences in relative inflation rates or unit labour costs) is currently well below its long-term average. It will drift back to the average or above at some point in time. The only issue is whether the path upwards is part of a benign scenario based on a higher nominal exchange rate underpinned by a good relative inflation performance and cost reductions in the non-traded sector, or whether competitiveness is lost due to higher inflation and wage increases not backed by productivity improvements. In the interests of achieving the former scenario, farmers should be among those calling loudest for lower government spending and taxation and for microeconomic policy reforms to promote cost reductions and innovation.

In respect of innovation, the main barrier to change within the farming sector has undoubtedly been the archaic producer board structures. These are now in their death throes, but it has been an agonising process. My main reflections on a 10-year

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<sup>1</sup> *National Business Review*, 6 July 2001.

debate would be the slowness of farmers to get to grips with the basic economic arguments; the debilitating politics within the sector; the time that has been lost before change has occurred – and then sometimes only in the face of crises (as in the wool and apple industries); and the low quality of some final outcomes, in particular in the dairy industry. This industry will still be highly regulated rather than put on the same basis as most other industries. More change will be needed in the period ahead, including within its cooperative structure where the bundling of on-farm and off-farm returns remains a huge distortion.

In my view it is these issues of broad national economic policy, including policies specific to agriculture, that farmers should keep their eyes firmly focused on through their representative and commercial organisations. The vision they should embrace is one of an open, competitive, dynamic economic environment in which entrepreneurs in all sectors can make the most of the opportunities it offers.

By contrast, we should recognise that in the so-called knowledge age we are probably more ignorant than ever about the concrete form those opportunities might take, even in the next 10 years. Ten years ago the internet barely existed. Who could have foreseen its impact on households, businesses and our general way of life today? In the next 10 years it is easy to speculate that the impact of developments in biotechnology will be just as profound. But none of us has any overall idea about their scale or form. It would be a conceit to pretend otherwise.

Nor should that worry us from a national policy perspective. If we allow sensible applications of biotechnology rather than stifle them with a misplaced 'precautionary principle' approach, entrepreneurs will soon discover them – New Zealanders are not slow to adopt new technology. A strong R & D industry drawing on international advances in genetic engineering – while monitoring any risks – would create an environment in which entrepreneurial farmers can choose the type of technology that best fits their circumstances and markets. I expect other entrepreneurs will find new opportunities for growing and selling organic products, to the extent that consumers demand them. Both genetic modification and organic approaches to farming should co-exist, and farmers should be free to put their money on the line and test the market opportunities. It is plausible to argue that

New Zealand's future very likely lies in the same place as our past: as a wealthy exporter of primary and resource-based products. But none of us really knows what the agricultural sector will look like in 10 years' time, or how it will fare in the competition for resources with profitable opportunities elsewhere in the economy.

What we do know is that governments will maximise the opportunities for New Zealanders if they refrain from making these kind of judgments about industry winners and losers, and concentrate on lowering the barriers to entrepreneurship and wealth creation. The agricultural sector has every reason to cast a jaundiced eye on government-sponsored visions. A vision to industrialise New Zealand and reduce our dependency on agriculture brought us high import barriers, a cost-plus economy, a farm sector that had to be propped up by subsidies, the madness of Think Big, and ultimately the need for a wrenching, economic restructuring. The record of disasters associated with governments that have had visions of that kind is long and well documented.

I suggest that it would be folly for New Zealand to go down the road of 'hands on' state intervention again. In today's complex society governments should strive for simple, general rules to guide business life and allow entrepreneurs to realise their own visions. They should not attempt to impose a corporate vision, growth targets or national plans on the economy or any sector of it. With the collapse of the centrally planned economies, we should have worked out by now that, as an Australian economist once put it, governments should emphasise:

... dynamic efficiency, flexibility and the capacity to sail ... on the shifting socio-economic winds rather than trudging relentlessly on with fixed structures to inevitable defeat in the snows of Moscow.<sup>2</sup>

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<sup>2</sup> Richard Blandy in Israel Kirzner (1984), *The Role of the Entrepreneur in the Economic System*, Centre for Independent Studies, Sydney.