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**Protection or Competition
in Agricultural Marketing?**

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PROTECTION OR COMPETITION IN AGRICULTURAL MARKETING?

In their own interest, it is high time farmers took a long hard look at the organisations which handle and sell their produce after it leaves the farm gate. They have no more reason to assume that statutory marketing monopolies efficiently prosecute farmers' interests than we all have to assume that Telecom, Australia Post, the railways and the main road departments give us the best possible service at least cost. Since in each case there is no legal opportunity for alternative services to develop, we have no sure way of knowing whether the service we get is the best possible... More legislated accountability... won't make the marketing authorities efficient - only competition will do that."

John Hyde, former Australian farmer-politician.

The topic of agricultural marketing regulation is a large one, and I can do no more than scratch the surface of it in this talk. I believe it is a subject which requires much more fundamental analysis and debate among farmers, the business sector and the general public.

All are stakeholders in the performance of the agricultural sector. Whether we use resources in agriculture well or poorly is of interest to everyone in the community. It is no more appropriate to regard the subject of controls on agricultural marketing as the exclusive business of producers in the sector than it would be to regard manufacturing industry protection as the exclusive business of manufacturers or restrictions on trans-Tasman shipping as the exclusive business of shipping companies. Farming organisations, quite rightly, have had a good deal to say about each of the latter issues, and what they have said has often made a lot more sense than the utterances of some of those within the manufacturing or shipping sectors.

Controls on agricultural marketing are important to the functioning of the economy because they affect, to a greater or lesser degree, some 50 percent of New Zealand's exports. Our trading performance has been poor, for a variety of reasons both domestic and international. There are grounds for hope that reforms in both areas will enable us to exploit more successfully the natural comparative advantages we enjoy in agriculture. On the domestic reform agenda must be the issue of whether changes to agricultural marketing systems and structures would help us to do a better job.

In my remarks I shall be focusing on agricultural marketing regulation in general rather than the narrower topic of producer boards for several reasons. There are significant differences between the five main boards, with those responsible for dairy products, apples and pears and kiwifruit having a much more important selling role than the meat and wool boards. All share, however, some mix of regulatory, commercial and industry servicing activities. The general issue as I see it is whether any or all of these activities should be conducted within a framework which differs

from that applying to most other commercial activities. If changes are justified, they are likely to take the form of changes to that framework rather than to the existence of producer boards themselves.

Those who defend today's structures and systems tend to overlook the point that there have already been significant changes in recent years to the legislation under which the boards operate, mostly of a deregulatory nature. Access to concessional Reserve Bank financing for stabilisation purposes was removed, statutory price setting authorities were abolished and the boards were given more responsibility for their affairs by removing many requirements for ministerial consent. Future policy reviews are more likely to focus on a range of similar questions which may be asked with respect to each of the boards' functions rather than on whether producer boards should be retained or abolished.

Partly because I do not have any simple reform blueprint, and partly because analysis comes before prescriptions, I will concentrate on examining the arguments that are advanced in support of existing arrangements. I do feel there is a need for a cool analytical look at whether they stand up to scrutiny.

There is of course a strong 'If it ain't broke, don't fix it' body of opinion that does not take kindly to any questioning of current arrangements, just as there has been no shortage of defenders of other institutions that have come under scrutiny in the past decade ranging from the former state-owned enterprises to our labour market arrangements to the education system. Those who dare to raise questions are usually dismissed as being self-interested or theoretical or both. The issue, however, is not whether present arrangements are broke but whether they can be improved upon. Relevant theory, careful analysis and evidence from other comparable commercial situations at home or abroad can help in this regard. There is no basis for denigrating theory and analysis: there is a body of theoretical ideas that implicitly or explicitly underlies the present arrangements, just as there are theoretical grounds for challenging them. The question is which theories make more sense.

Statutory marketing arrangements have a long history in New Zealand, but their precise role is not the result of careful analysis and comparison with alternative organisations or state interventions. Historically they were a response to the strongly-held belief of producers that their share of the total return from their product was unfairly low and that it could be raised by producer controlled statutory marketing boards. Such beliefs are particularly strong at times when producer prices are low, such as the period between the first and second world wars which saw the establishment of the main producer boards, as well as many of New Zealand's other experiments with heavy regulation and state control.

One historical irony, given farmers' longstanding opposition to industrial protection, is that one of the foremost advocates of marketing boards was Dr W.B. Sutch, better known as the father of import controls in New Zealand. The common theme in Sutch's thinking was a desire to isolate and insulate New Zealand from events in the rest of the world. His two theses, 'Commodity Control in New Zealand' and 'Price Fixing in New Zealand' were concerned with the regulation of commodity markets. His distrust of markets, preoccupation with monopolies and critical view of 'middle men' led him to advocate not just price fixing but widespread state intervention to control production and distribution.

Sutch's support for import controls was based on the view that markets abroad did not conform to textbook models, that many governments subsidised and protected their industries and that New Zealand could not make itself "an island in the sea of controls". In respect of marketing his rhetoric included the familiar phrases: small country, price smoothing, irresponsible exporters, undercutting, unnecessary competition, industry unity.

Although Sutch's arguments have been widely discredited with respect to industry protection, they remain a central plank of the defence of statutory marketing arrangements. For example, the Chairman of the Dairy Board stated earlier this year:

"I'm all for free markets. Competition is what hones efficiency. Our problem is that the competition we face in international dairy markets bears no resemblance to the free market competition of the economic textbooks ...

"The pricing signals coming back to us are, to say the least, a jumble. They are neither coherent nor consistent and in no way reflect cost and normal economic influences on our competitors."

Absolutely true. But it is also largely irrelevant to our own policies whether the place of, say, France in world agricultural markets is based on natural or artificial factors. We can and should try to persuade others to adopt better policies, but by and large a small country has to take the rest of the world as it finds it. Our own resources are best allocated - and we get the highest income from them - if we allow them to respond to world prices, no matter how distorted they may be. Adding further distortions of our own just makes us poorer.

In general, the existence of an imperfect world does not justify interventions in agricultural marketing any more than it justifies import controls, export incentives, production subsidies, shipping cartels or purchasing consortia. All these, as the Chairman of the Trade Development Board, Barrie Downey, has pointed out, weaken or destroy communication between market and producer. But what of the other arguments used to justify government-backed marketing organisations either doing the marketing or controlling it extensively?

The need for 'collective strength' not 'fragmentation'

This is an argument about market power and its counterpart, 'weak selling'. But it is based on a fallacy that New Zealand suppliers can generally influence prices in world markets through organisational structures. Typically we are competing with a range of other suppliers in the importing market and from third countries, and consumers often have many close substitutes for the goods we produce. Any pricing latitude is minimal beyond the short term. Barrie Downey describes our "morbid obsession" about being played off against one another as part of our generally defensive view of the world. 'Weak selling' and 'undercutting' of an irrational kind are largely fictional, since such competitors are unlikely to make profits and survive. There may well be a need to exploit economies of scale in parts of the international food business, but Nestle, ConAgra and Chiquita are not statutory monopolies. If size is important, as it is for parts of the international forestry business, large firms will emerge naturally and there appears to be no basis to fear 'fragmentation'.

Ironically, the tendency of statutory monopolies to concentrate on commodity lines - more than half our dairy exports are still in commodity form - may be denying us opportunities to 'price up' in world markets through branded products and the development of more sophisticated customer relationships.

The existence of single buyer markets

It is worth noting firstly that if the way the commercial world actually worked was to give market power to 'single-desk' sellers, it would equally make sense for buyers to organise themselves in the same way to avoid "being played off against one another". But single buyers are a rarity, at least in successful countries, reinforcing the view that the analysis does not hold water.

Currently the USSR, Algeria, Peru, Mexico, Iran and Iraq are important markets for New Zealand dairy produce which are organised on a single buyer basis, but whether this situation will continue in cases such as the USSR and Mexico is open to question. However, the existence of single buyer markets does not necessarily call for a single seller response, still less one for all markets (as is the case with three of the boards). New Zealand meat and wool exporters deal with single buyer markets without such a structure. Multiple suppliers can and do share information when that is in their interests, and can if necessary cooperate in more formal ways to handle such situations.

Arguments for 'producer control'

Farmers have long been suspicious of private enterprise involvement in their sector; this explains, for example, the prevalence of cooperative ownership and the hostility from some farming quarters to Fletcher Challenge acquiring the Rural Bank at the time of the sale.

One strand of this concern is a belief that as owners of relatively small economic units, farmers will be disadvantaged in dealing with larger marketing or servicing organisations and get ripped off by them. The Chairman of the Meat Board, believe it or not, has even argued that under free enterprise New Zealand agriculture would be driven into feudalism and farmers into serfdom - the slaves of foreign-owned banks or multinational oligopolies.

This view of relative bargaining power is a pervasive 20th century economic fallacy. We have seen it in the 'wage slavery' rhetoric of the labour relations debate and in arguments over consumer protection. Small players are not typically at a disadvantage in dealing with larger players *provided markets are competitive*. Large firms have to pay as much as small firms for workers; consumers able to vote with their feet are hard to exploit. Paradoxically it is the existence of monopolies (whether in the form of marketing organisations, closed shop unions or licensed importers) that creates the risks of exploitation.

Another strand in the arguments for producer control is the suspicion of the 'middle man'. As John Hyde has put it:

"Farmers once set out to eliminate middle men in the belief that they could capture the middle man's margin for themselves. But between farm gate and

consumer, middle men perform necessary services and all farmers have done is substitute their own middle men for the "rapacious" merchants whom they saw as the cause of poor prices.

Now the inefficiencies of the statutory monopolies may be far more costly than the merchants' margins."

I believe these various arguments about market power have been at the core of the agricultural marketing debate, although there are others. For example, various institutional arrangements have been aimed at smoothing volatile farm prices or incomes. This argument has faded over time, and we may hear less of it after the disastrous efforts of the wool marketing organisations in both Australia and New Zealand in recent years. There are superior options, such as futures and options markets, for performing this role. Similarly statutory arrangements have been advocated for research or promotion on alleged 'free rider' grounds. The recent action by forest owners to raise a voluntary levy on log exports to back a promotion campaign in overseas markets for radiata pine indicates that private solutions to such problems may be available.

None of this is to argue that there are no grounds for intervention in agricultural marketing. The R and D issue just referred to does raise the question of how best to promote agricultural research of a 'public good' (non-appropriable) character. Industry and Crown research institutes are likely to be an important part of the answer. The issue of the United Kingdom quota market for butter raises the question of how best to capture the economic rents created by restricted access, but I am not aware of other cases of comparable significance. Periodic auctioning of the right to export to such markets would be one solution. What this suggests is that such cases need to be examined in their specific detail to evaluate the best way of handling them. It is unlikely that the use of wall-to-wall controls or monopoly selling powers is typically the right answer.

In evaluating policy options, it is also crucial to weigh any possible benefits from interventions against the costs that they impose. Chief among these in the present context is the suppression of entrepreneurial risk taking, diversity and innovation associated with more competitive marketing structures. The wealth-creating power of competition and private ownership is being demonstrated around the world. The truly distinguishing feature of a private enterprise system is the combination of private property, competition and freedom of entry into any and every field of economic endeavour. These features are absent to a greater or lesser degree in most of our agricultural marketing structures. We are likely to be making major sacrifices in performance as a result.

I have only sketched out in this talk the barest framework for thinking about agricultural marketing regulation. Much more needs to be said about the difficulties of measuring the performance of the marketing organisations, the problems of accountability, the cost-padding associated with monopoly production, the conflicts between the commercial and regulatory roles of some of the boards, the uncertain environment for private sector operators created by the powers of the boards to intervene in the market, and their role in ancillary activities such as shipping. Other problems which are commonly recognised are the illiquid and non-diversified investments by farmers in off-farm processing and marketing, the potential constraints on capital expansion imposed by present ownership arrangements, the barriers to foreign investment and vertical integration in our food industry (by

comparison with, say, forestry or fishing) and the ties with markets that such investment brings, the distorted investment signals which result from the bundling of returns from diverse activities, and the many income transfers between producers arising from a multiplicity of market interventions.

My thesis is simply that there is a case for a careful, fundamental and impartial examination of present agricultural marketing regulations, as recommended in the Porter study and endorsed by the Prime Minister's Enterprise Conference. We need to get past the one-liners like:

- "What about Judgecorp and Equiticorp? - they're no advertisement for private enterprise." (Response: Poor decisions are made in all organisational structures; the issue is which arrangements create the strongest incentives for more good decisions than bad ones to be taken over the long run. The producer boards have been responsible for massive losses, not just to those who risked their investments in them but to taxpayers as well.)
- "Look at the great job the Dairy Board has done compared with the 'free enterprise' meat industry". (Response: (i) How do we know it has done well? (ii) The meat industry has been plagued by incessant government intervention. (iii) Returns from dairying over the long run have been no better than returns from sheep/beef, and the dairy industry has not grown vigorously.)
- "The Apple and Pear Marketing Board has succeeded whereas the 'fragmented' Australian apple industry has been a weak competitor in world markets". (Response: Its performance is probably due largely to the artificial incentives to supply the domestic market and a lack of real comparative advantage; New Zealand pears have not been a success story in world markets either.)

There is no reason to suppose that the boards that are directly involved in marketing would be threatened if the conclusion of a review led to further deregulation of their markets. If, as they claim, they are pre-eminent in their field, they will not need to be protected from competition to survive.

Our organisation is completing a study which will give these important issues the kind of fundamental examination they deserve. We hope it might help provide a basis for a more informed debate in the period ahead. There is a great deal of thoughtful discussion going on among younger farmers, in farming organisations and in official circles about statutory marketing arrangements in both New Zealand and Australia. No less an establishment figure than Geoff Miller, the head of the Department of Primary Industries and Energy in Australia, recently noted that the rate of progress in agricultural reform had been "glacial" compared with other sectors of the economy and with the rest of the world, and presented his vision for the year 2000 along the following lines:

- " • Further phasing-out of the major role played by statutory marketing authorities in Australian agriculture.
- Marketing systems dominated by big, vertically integrated agribusiness companies, often with farmer shareholders.

- An end to the export monopoly held by the Australian Wheat Board.
- An end to the dominance of the auction system in selling wool, with most growers selling direct to agribusiness companies.
- Much more processing of rural commodities in Australia, including the bulk of the Australian wool clip being sold as branded wool tops and yarns."

I have no idea whether Geoff Miller's scenario is a likely one for either Australia or New Zealand. What I would lay money on is that, just as we have seen some significant changes in recent years when formerly 'no go' areas of protection and regulation were opened up to scrutiny and debate, the chances that the present agricultural marketing arrangements will remain unchanged to the year 2000 are remote indeed.