

**Sharemilkers Subsection of Federated Farmers
National Conference**

The ACIL Report Six Months On

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THE ACIL REPORT SIX MONTHS ON

I'm pleased to have the opportunity to speak to an important dairy industry group on agricultural marketing, or more precisely on the regulatory controls affecting marketing in your industry.

It's now six months since our organisation published the ACIL report on agricultural marketing regulation. This was a 2-year study aimed at evaluating the system of controls which, directly or indirectly, affects nearly half New Zealand's total export trade. These controls are by far the most significant form of intervention that remains in place in the private commercial sector of the economy. We wanted to find out whether regulatory policies with such a pervasive economic impact, which affect the welfare of all New Zealanders, were justified in today's domestic and international economic environment. Did they generate benefits in excess of the costs that are always involved when governments constrain competition and business decision-making?

As is well known, the ACIL study concluded that most of the present controls did not meet this test and should be modified or removed. It did not advocate dismantling the boards but argued that their commercial activities should be corporatised and their markets opened up to competition.

I want to reflect today on the debate that has followed the release of the ACIL report over the past 6 months. Judging by the interest the report has aroused, it would seem we have raised an issue whose time has come. I am sure the economic arguments are by now familiar to most of you. At the same time, the debate has not been without its sound and its fury. I want to concentrate in this address on the politics of the agricultural marketing debate.

Shortly before the release of the report, Alan Gibbs predicted the producer boards' reaction to it. He said they would say something like this:

"The ACIL report is grossly inaccurate, full of misconceptions, written by someone who does not understand New Zealand agriculture, naive, ideologically driven, blatantly serving the interests of big business, ill-conceived and prejudiced, designed to place New Zealand farmers under foreign domination and to reduce them to the status of peasants."

We resolved that we would turn a blind eye to any rhetoric and just keep on asking where the study had got it wrong.

Perhaps conscious that its standard response to any questioning of its role was so predictable, the Dairy Board initially took a somewhat different tack.

Before the report came out, its first move was to approach a number of Business Roundtable members to see if they would dissociate themselves from its findings. Having no luck with this tactic, it then launched what *The Dominion* called "a pre-emptive strike" in which it defended itself and its monopoly as "a unique New Zealand creation in its structure, processes and strategic drive - a case study in realism and results."

When the report appeared, the Board had decided to take an apparently thoughtful and progressive stance. It said it was "an interesting, if very academic study containing some ideas and thoughts which are relevant and which the Board will look at in more depth." However, the Board denied there was any over-production of milk or problems of profitability in the industry.

Next, Neville Martin of the Dairy Board wrote an article focusing on two central issues in the debate, the distorted nature of world markets and the 'commercial cocktail' of returns reflected in the pay-out price. He argued that the former problem justified export controls and he disputed the analysis of bundling.

We believe the Board's arguments on these issues are wrong and have set out our reasoning at length in articles in the farming press and in papers that Denis Hussey of ACIL has given to the New Zealand Dairy Industry Executive Conference and the Large Herds Conference. There has been almost no further public comment from the Board - no genuine effort to deal with the analytical issues and no attempt to challenge the estimates of the bundling distortions presented in the ACIL report.

Last month publicity was given to a report from the Director-General of MAF to the minister of agriculture on the ACIL report. MAF's advice was that:

"... the analysis of the ACIL report is sound and its facts are materially correct. Producer boards have alluded to inaccuracies and dated examples, but have not been forthcoming on specific problems with the analysis. We doubt that the range of uncertainty surrounding the data would substantially affect the analysis or the conclusions."

MAF went on to say that:

"We are drawn to broadly agree with the ACIL report that there is a need to:

(a) remove all the regulations (with some minor exceptions) which are preventing competition and choice in agricultural processing and marketing; and

(b) corporatise all the statutory marketing businesses, issue the shares to producers and allow the shares to be traded freely."

The Dairy Board's tactics after the release of the MAF report have been a reversion to form. The chairman blasted the ACIL report as "based on economic theory and dogma." He claimed that the Board had evaluated objectively the points and recommendations made in the report. However, nothing has appeared in the public domain, and I doubt whether any evaluation of substance exists.

Latterly the Board has complained about our organisation following up the study by speaking at conferences such as this one. We have had literally dozens of requests from farming and industry groups to talk about the report. It appears we are supposed to turn them all down.

We can see in this pattern of behaviour the classic response of monopolists or protected interests whenever the threat of competition to their position arises. In my career I have seen it with agricultural lobbies in Europe and protected rail bosses, road transport operators, manufacturers, bankers, taxi drivers, trade unionists and teacher organisations in New Zealand, to name just a few. In agricultural marketing, the phenomenon is not confined to New Zealand. Earlier this year, a report of a committee of inquiry into agricultural marketing in South Africa had this to say:

"The Committee was presented with some evidence that the submissions of certain Control Boards may not always have represented the general producer views but often were the views held by a select group of board members and their staff. The Committee also perceived a disconcerting level of arrogance, self-righteousness and self-imposed omniscience among some of those in favour of maintaining the status quo. At the same time those who were prepared to face change ... felt powerless to change the system. ...This arrogance and tyranny of the status quo was best expressed in the view that South African farmers have to be forced to cooperate; that a few 'knowledgeable experts' knew what was best for the farmer; and that there was no alternative to specialised Boards for separate commodities."

There are signs in New Zealand of similar reactions to producer board politicking and unwillingness to engage in serious analysis. Earlier this year *The National Business Review* observed that, from its base just around the corner from Parliament, the Dairy Board, as well as the Apple and Pear Marketing Board, "has oiled enough politicians to ensure the political patronage from which it derives its monopoly of the sector's export business continues." But this tactic may be wearing thin. In a recent article in *Rural News*, MP Ross Meurant was reported as saying he found board responses to the Business Roundtable report disappointing and that a "new breed" of politicians were questioning whether producer boards are the best mechanism to deliver returns to farmers. And MP Bill English told *Rural News*:

"These producer boards, whose very existence depends on political support, are quite out of date in how they maintain that support. Nowadays you can ask questions and get hard answers from a whole range of bodies. It takes more than a good feed and some simplistic graphs to please people. Their (producer boards') public relations is quite dated. ...Asking questions is not personal but they take the discussion very personally. Their standard tactic is to reduce the argument to personalities. Politicians on both sides of the House are very dissatisfied with the answers they get."

The statement of the Dairy Board chairman that was triggered by the release of the MAF report bears out what Mr English was saying. It attacked the Business Roundtable for what Dryden Spring said was "a concerted, highly political campaign against the Dairy Board and other producer groups." It is nothing of the sort - all we are doing is questioning monopoly marketing. Similarly, the Board chairman stated that:

"It is particularly disappointing that MAF no longer appears to see its role as supportive of New Zealand agriculture, but rather appears to be following an agenda all of its own."

It certainly used to be the case that when the producer boards said "Jump!" MAF's answer was "How high?" But the days are long since gone when government departments were taxpayer-financed lobbyists for "their" industries. Today their job is to give dispassionate advice in the wider community interest. A relic of the old days which does raise serious conflict of interest problems is MAF's continued representation on one of the boards. But the current Director-General, who was appointed by a former government to deal with teacher unions, is unlikely to be pushed around by producer board chairmen.

When the MAF report was released, the government attempted to make some play of the fact that an internal paper by an Australian economist working in MAF was not released at the same time. But the media quickly realised that the government had in fact scored an own goal. Although the paper questioned (invalidly in my view) a few aspects of our study, the author's basic conclusion was that:

"Overall, I am in general agreement with the thrust of the ACIL report, especially with respect to the assessment that New Zealand is a price taker on world markets for most, if not all, of its agricultural products and to the need to 'unbundle' returns to farmers."

Even more interestingly, the paper went on to make a statement that reflects a detached outsider's perspective on the New Zealand debate. It said that, despite the author's agreement with the thrust of the report, change was unlikely to occur *inter alia* because of:

"...the enormous influence and power which producer boards and farmer organisations can exert over politicians and individual farmers."

We need to stop and ponder the implications of that statement very carefully. We need to ask ourselves why the boards should have such enormous political power. They are, after all, creatures of statute and Parliament should be answerable for them to the wider community. Because the regulations affect such a vital and large part of the economy, all New Zealanders have a legitimate interest in them. Yet it seems to be an article of faith among some in government that politicians should do what the boards or industries want, and should only take away their statutory privileges if they ask for them to be removed. But when did governments, as custodians of the public interest, let manufacturers decide whether they wanted import licensing to be removed, or trade unions whether the labour market should be deregulated, or welfare beneficiaries whether benefits should be cut? Despite the political unpopularity of these measures among those affected, governments acted in the public interest.

Even at the industry level, it is extraordinary how political processes have supplanted normal commercial decision making. In the kiwifruit industry we have recently had the spectacle of competing groups undertaking polls and referenda to establish the degree of support for alternative marketing arrangements. Nowhere outside the regulated agricultural industries would we dream of applying such political tests. Producer boards aren't governments. If only one producer in an industry, let alone a significant minority, wanted to take a different approach to marketing, there would be

no obstacles to doing so. The tyranny of the majority should not be applied to thwart entrepreneurial innovation, experimentation and risk taking.

As people with a vital stake in the future of the dairy industry, I suggest it is incumbent on you to get your minds around the issues that are being raised. I am frankly beginning to doubt whether the Dairy Board is capable of doing so. The Board refused to have anything to do with our study when we sought their cooperation with it. It has rejected suggestions, including from people within the industry, that it should sit down with ACIL and work through the issues. In selecting Board executives and directors, the Board's prime concern is whether they would be committed to defending its monopoly.

In the wider economic policy debate, the Board was on the wrong side of most of the central arguments in recent years with its repeated calls for a softer monetary policy and devaluation. A person with long experience in the agricultural sector put it to me recently that those in the Board were not being obtuse, they simply did not understand how a competitive market economy worked. Like old communists under a more extensive version of socialism, they had never known any other system. Others have questioned whether they understand the concept of competition, full stop. The board chairman was recently quoted as advocating a strategy of getting in on the ground floor in Peru rather than having to battle away against entrenched competitors like Nestle. As Warren Hughes of Waikato University commented:

"One interpretation of this statement is that Nestle quality and/or marketing is better than what the New Zealand Dairy Board can achieve. Furthermore, it suggests that any effort the Board spends in developing a market in Peru will ultimately benefit Nestle. The idea that the first supplier into a market gets to keep that market forever has little merit as we approach the 21st century... . Competitors such as Nestle and its multinational compatriots cannot be avoided. They must be engaged and challenged in all markets..."

I am bound to agree that the rhetoric and smokescreens that continue to pass for argument do suggest a serious lack of understanding of the fundamental issues in the debate. For example, as someone who has had an involvement with producer boards in one form or another going back over 25 years, I find it slightly tiresome to receive the standard lecture that "they are all different." Of course they are, and the ACIL report has specific chapters on each industry, but many of the regulatory problems are common to all. Having to all intents and purposes worked for the producer boards in Brussels for 4 years in the early 1970s, I don't need to be told that world agricultural markets are distorted. The case for competition in marketing is not based on any romantic notion that the world is full of level playing fields. It is based on an analysis of what is in New Zealand's interests given the real world situation we face. And we continue to be told that as a marketer the Dairy Board has done a good job despite having pointed out, on innumerable occasions, that the prime issue is not its marketing performance but the misuse of resources resulting from the perverse incentives of the regulatory system.

In the report and in subsequent articles and papers we have worked through the long list of other myths and shibboleths in the debate. You have heard them all before:

- "competitive exporting results in weak selling;"

- "bundling distortions are trivial and we'll fix them if they become serious;"
- "all businesses bundle their returns, don't they?"
- "we must own our industry or multinational companies will turn us into peasants;"
- "returns in processing and marketing don't matter because we must have an outlet for our milk;"
- "the returns on off-farm investments are capitalised into land prices anyway."

And so forth.

None of these propositions stands up to scrutiny. The onus must be placed on those who defend monopoly arrangements to show why competition in agricultural marketing would not bring the benefits that are apparent to all in air travel, telecommunications, transport, energy and other markets that have been opened up to competition. They should also be asked to come up with convincing arguments why corporatisation would not bring the same improvements in accountability and performance that are there for all to see in the state-owned enterprises and their privatised successors.

No doubt there are still some who believe that the Ansett and Air New Zealand story is a coincidence, just as there are some who believe that socialism would have worked if only people had tried harder and some who still think that the world is flat. There is no such thing as positive scientific proof. Controlled experiments are not possible either: we cannot stop the world and run both a Dairy Board and an industry with competition from Kraft and Nestle. No amount of empirical research will resolve the issue. Nor will throwing around words like 'ideological' - there is as much ideology in the proposition that monopoly marketing is superior as there is in the proposition that we would do better with competition.

Ultimately, policy makers will have to decide whether the principles and logic that have motivated the reforms in all other sectors of the economy apply to agricultural marketing or not; whether ACIL, the Porter report, the OECD, the Economic Development Commission, Treasury, MAF and others who have criticised monopoly marketing are right or wrong; and whether this so-called "unique New Zealand creation" still makes sense in a world that is moving ever more rapidly towards open markets and global competition - whether all the rest of the world is out of step with us.

Consider the current situation in all our major agricultural industries. The kiwifruit industry is in serious crisis. There are signs that the apple and pear industry may be heading into similar difficulties. The wool industry is still reeling from misplaced Wool Board interference with the market, and the meat industry has not yet fully recovered from the legacy of years of government meddling. In your industry there is now talk about the "butterfat problem" and the problem of unwarranted conversions,

despite the Board's claim only 6 months ago that there was no problem of unprofitable production.

I believe it is high time that producers in all the major industries got involved in the agricultural marketing debate. No group has more at stake than sharemilkers, as your future will be bound up with the fortunes of the dairy industry. Nowadays policy decisions are more often determined on the basis of the strength of competing arguments, not vested interest group pressure or political muscle. If you don't engage seriously in the analysis, someone else may do it for you. The climate is changing, and you should be part of the debate.

Already the government has announced that there will shortly be a review of the Kiwifruit Marketing Board, and there will be strong pressure for it to be genuine and fundamental. The Labour Party has announced that there will be reviews of all producer boards if it is elected to office. Federated Farmers should not sit on the sidelines and risk being overtaken by events. I am told that on a show of hands at the recent Large Herds Conference, only about 30 of the 500 farmers present were Federated Farmers members. That group comprises some of the most commercial and forward-looking operators in the industry.

There is no reason why the Dairy Board itself should not take a positive, leadership role in the debate. It has enormous resources of information and much industry talent to draw on. If it is serious about playing the ball and not the man, the next response will not be "Roundtable Gets a Rise out of Spring", as it was in *Rural News* last month. It will be a detailed, objective, published evaluation of the facts and analysis that are under debate. You, as stakeholders in the industry, ought to insist on nothing less. And government policy makers, for their part, must undertake the same inquiry themselves, without regard to political pressures, and ultimately make decisions in the overall national interest.