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FARMING FOR THE FUTURE FORUM

**AGRICULTURAL MARKETING AND
STRUCTURES: MULDOONISM LIVES ON**

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AGRICULTURAL MARKET MULDOONISM LIVES ON

When I last spoke to a farming group in the Wairarapa a few years ago, I had a very simple message.

I said that while the economy was in much better shape after a decade of reforms, government policies were going badly off track again. Second, I pointed out that nothing serious was being done to fix the self-inflicted problems of outdated agricultural marketing regulations and structures. For those reasons, I thought the outlook for traditional farming in New Zealand was poor.

The audience wasn't very receptive. The economy was growing strongly, farm incomes had recovered, land prices were moving up, and the producer boards were dismissing their critics as a bunch of theorists who knew nothing about agriculture. It got worse. Federated Farmers, previously a reliable ally and sharp critic of poor policies, kept praising the government's economic management despite the massive increases in government spending that were underway. It even promoted more spending – arguing, for example, for the removal of the superannuation surcharge. Farmers resisted important reforms in areas like postal services, electricity and roading. Arguments about producer board reform continued to fall on deaf ears. Finally farmers realised they were being hit by the pressure on monetary policy of excessive government spending and by the government's failure to press on with microeconomic reforms. However, the responses of their representatives of the time bordered on the eccentric. The Dairy Board started agitating for intervention to bring down the exchange rate. Federated Farmers kicked off an argument about how migrants' transfers were recorded in the balance of payments and wanted the Reserve Bank to be given the power to manipulate GST. Not until Malcolm Bailey took over as president of Federated Farmers did sanity return, and media releases appeared with headlines like "1997 Budget Largely Fails Farmers."

What happened since 1993 is that New Zealand progressively lost the plot. By reverting to 'do nothing' mode, Jim Bolger's government let New Zealand slip backwards relative to countries which kept working to improve their economies. By presiding over a spending programme of 'Think Big' proportions, Bill Birch killed the goose that was laying the golden eggs. The result was inevitable: a balance of payments blow-out, a credit rating downgrade, a reversal of the fall in unemployment and a recession in the first half of last year.

Investors finally blew the whistle – only the timing and details of their responses were influenced by factors like Asia and the drought. They marked down the New Zealand dollar, forcing adjustments including a transfer of resources back to the internationally competing sectors of the economy. Now the government is claiming credit for a recovery from the recession we didn't have to have.

The reality, however, is that the economy is still woefully underperforming relative to its potential, to the achievements of the mid 1990s, and even to Australia which notched up 5 percent growth last year despite the Asian crisis. National is not within sight of achieving the 3.5 to 5 percent average annual growth rates which it set as a target going into the last election. When do we hear the government measuring itself against this benchmark and telling us how it is going to achieve it? Although the outlook for the export sector is now at least temporarily better, my assessment is that agriculture is in dire straits. Last month Owen Jennings bluntly said that farming is going broke. Most of the indicators are pointing in that direction. This is happening despite the fact that the real exchange rate is now below its long-run average and may well appreciate somewhat in the period ahead. An analysis of the predicament of agriculture usually starts with an observation about the downward trend in commodity prices over the long term. But there is nothing special about this trend. Car and aircraft manufacturers, for example, have seen declining real prices for years. The prices of products in the booming telecommunications and information technology industries have been falling dramatically. Yet these industries are highly profitable and growing because they are increasing their productivity and bringing new products to market at phenomenal rates. Competition in deregulated markets forces these continuous improvements.

The response of these industries to competition and price trends has been completely different from that of New Zealand agriculture. For years farmers have seen themselves as takers of declining prices on world markets and have wanted to be price makers. Whenever prices fell they blamed the marketers. So they backed the regulation of product marketing, sometimes to the extent of supporting statutory single-selling organisations, in the belief that they could somehow rig world markets and improve their returns.

At least in today's world, this producer board ideology is a naïve and fatal conceit. New Zealand is selling into deep and sophisticated markets for all its agricultural

products, no matter how much those markets may still be distorted by government interventions. On the supply side it is facing competition from domestic and other foreign producers. On the demand side, there are substitutes for everything we produce, and consumers will switch to them if New Zealand exporters attempt to rig prices. The monopoly mindset of the boards leads to arrogance towards consumers, one of the deadliest of business sins. Our statutory arrangements cause friction with our trading partners. Mike Moore used to defend them on the grounds that monopolies were bad at home but fine when they exploited foreign consumers. Such a view is equally arrogant, naïve and flawed – he will need to change it if he really wants that job in Geneva. The trading boards are much more in the nature of monopoly buyers than monopoly sellers and, like the former monopoly trade unions, the people they really exploit are their own stakeholders.

It makes no difference to this analysis whether our farm exports are commodities or processed products. We simply cannot manipulate markets by using producer boards. At the commodity end of the spectrum, whoever heard of an Australian iron or nickel producer suggesting Australia would achieve better prices with a single seller? At the sophisticated end of the market, who advocates a marketing board for the American computer industry? Such structures simply don't fit anywhere in the world economy today.

It may well make sense in some cases for our farm industries to move away from commodities to more highly processed products. Because of price averaging, the need to handle unconstrained volumes, and one-size-fits-all strategies, producer board structures have biased the pattern of exports towards the commodity end of the range. But competitive markets will sort out where the best returns lie; we don't need central planners to do the job. The economic law of comparative advantage tells us that some industries in some countries will do best by specialising in commodities for at least some part of their production. It may make sense for New Zealand to grow wool, scour it, spin some of it and produce some lines of carpet but not to aspire to be a leading producer of, say, men's woollen suits. All parts of the so-called value chain are highly competitive – there are no automatic gains to be derived from farmer investment in off-farm activities. Entrepreneurs risking their own money, not statutory boards or industry 'visionaries' with access to compulsory levies, should make those decisions.

The preoccupation with product prices has had another major downside. It has diverted attention from the only thing that finally matters in business, namely profitability. To this day, producer boards seek to justify their performance in terms of the price received for a kilo of wool, a kilo of milk solids, a tray of kiwifruit or a carton of apples. But such measures are irrelevant in the absence of information on what is happening to returns on investment. And it is precisely accurate information on returns on investment that is sparse or non-existent for most of our agricultural industries, as the ACIL report for the Business Roundtable emphasised. With the present structures, farmers and other decision makers are navigating in a fog, and without navigating instruments.

There are many other elements to the case against producer boards. Sir Dryden Spring's claim last year that the case had not been made was itself a giant hoax. A brief list goes as follows:

- There are almost always operating inefficiencies associated with monopolies – we have yet to see a monopoly whose performance did not improve when opened up to competition.
- Single-seller arrangements stifle entrepreneurship and innovation by preventing people with other ideas finding better ways to do business.
- One-size-fits-all strategies expose whole industries to mistakes like the recent foreign exchange disasters or the Customs issue in the United Kingdom;
- In the case of meat and wool, the threat of changes to regulations and board interventions creates uncertainty and hampers long-term planning and investment.
- Foreign investment, and through it the development of new linkages with markets, is blocked or discouraged.
- To varying degrees, price signals to farmers in most industries are distorted by the bundling of payments for raw materials with returns on off-farm investments. Land prices are artificially inflated as a result.
- In order to do business, farmers are often compelled to invest heavily in off-farm processing and marketing operations; they are unable to diversify their risks efficiently.
- There are weak disciplines on the performance of the cooperatives given the absence of share prices and the potential for takeovers, and the accountability of boards for the use of levy payments is also weak.

- With cooperative structures there are constraints on capital raising, and on business strategies which would involve participation in other industries and markets.
- The existence of the boards and their regulations means the industries are bedeviled by politics – both industry politics and national politics. An enormous amount of the time of industry leaders, managers and farmers is diverted from commercial priorities. As the chairman of the Dairy Board, John Storey, put it recently, "what I see is more and more politics and less and less practicality".

This is by no means the full set of constraints and distortions in the main pastoral and horticultural industries. Each is different, but the main problems are common. However, the argument should really be turned completely around. The basic question that should be asked is why we should prevent anyone in these industries doing business with anyone else, at home or abroad, on any terms they choose. Why do we treat the marketing of dairy products, meat and wool, apples and pears and kiwifruit differently from all other industries in the economy, including forestry, fishing, other meat, other horticulture, wine, cut flowers, vegetables and the rest of the primary sector?

As a matter of public policy, there must be very compelling grounds for denying people such commercial freedoms. In general there are none with these industries. Analysis has shown beyond doubt that arguments such as weak selling, scale economies and distorted world markets do not justify different commercial laws. Essentially we should normalise and depoliticise these industries. The only situation which may warrant intervention is where New Zealand is selling into unusual quota markets where competitive marketing would erode significant premiums that can be obtained if exporting is restricted. The only large markets where this issue arises at present are the European Union markets for butter and sheepmeat. These justify at most specific export licensing arrangements, not the present paraphernalia of boards and regulations.

The critics of producer boards do not argue for doing away with them, merely for removing their statutory privileges and putting them on the same basis as all other industries. It should then be for farmers to decide such things as whether to demutualise the cooperative structures and whether to raise levies for research and development under a generic framework like the Commodity Levies Act.

Personally I have no doubt that the present structures are costing New Zealand farmers and the economy hundreds of millions of dollars a year in lost income. The economic gains from deregulation and corporatisation would rank with those from the removal of tariffs and the deregulation of industries like transport and communications.

The Business Roundtable took up the issue of producer board reform after the efforts of people like Jim and Bill Sutton in the Labour government failed in the late 1980s. We did so because we see these structures holding back the economy, not because the corporate sector wants to take over agriculture as board propaganda would have it. A moment's reflection shows that claim lacks any logic. Given a competitive environment, the returns from investment in those industries will be much the same, adjusted for risk, as in other industries here and abroad. In general, it is only if individual firms are consistently better than their competitors that they can sustain abnormally high returns.

Removing the statutory privileges of producer boards will allow enterprising people to look for new ways of doing business in agricultural processing and marketing industries. When they are successful, people in related industries, including raw material suppliers will also benefit. There is no logical reason why profitable innovation would somehow harm them – rather it would make their products more competitive on world markets.

Despite this, board politicians will no doubt keep on making spurious claims about the corporate sector turning farmers into peasants. Farmers should remember the similar arguments by trade union leaders that industrial relations reforms would reduce workers to slave labour, and treat them with the derision they deserve.

Almost a decade after we took it up, progress with agricultural marketing deregulation in New Zealand contrasts woefully with changes in the rest of the world. South Africa has deregulated all its producer boards and Israel is on the same track. The free-market agricultural and horticultural industries of Chile and Argentina are going from strength to strength. Our horticultural boards like to claim that deregulation elsewhere has been a mistake but they overlook a vital test of that proposition: there are no signs that these countries agree with them and are about to turn back. Their exports have grown significantly post-deregulation. Even Australia has done much more to reform statutory marketing arrangements than New Zealand, with obvious benefits for industries like dairying. This year the

Australian Wheat Board will be listed on the sharemarket and a current inquiry into the wool industry could see its statutory arrangements wound up.

What are the prospects for change in New Zealand? Frankly, they do not look good. The National Party has found it convenient to place the blame for our general policy paralysis on coalition government. But it was New Zealand First that pushed National into last year's budget announcement that the statutory powers of producer boards would be removed. Once it became a minority government, National seems to have returned to its Muldoonist roots. Muldoon, you will recall, used to say that import licensing would be removed only if manufacturers wanted that to happen. That position was indefensible – import licensing concerned everyone because it harmed the economy, and so does producer board regulation. It took a Labour government to put national interests first and abolish import licensing, with the support by then of many elements in business.

By contrast, National governments continue to put sectional interests first, telling us they will only abolish the boards' privileges if the boards agree. That's like asking a turkey how it feels about Christmas. They seem unprepared to listen even to broader elements of farmer opinion: last year, for example, Federated Farmers' Meat and Wool Section in a well-argued paper took the position that the statutory backing of the meat and wool boards should be removed. Clearly the fabled wining and dining of National Party members by the boards at farmers' expense is still working its magic. And with an election coming up, Jim Sutton and the Labour Party seem to have abandoned their former principles and to be pandering to the diehard supporters of the boards.

So I conclude much as I did when I last spoke on this subject in the Wairarapa. The sound economic framework of the early 1990s has progressively disintegrated. The return to Muldoonist spending habits means that government spending will have increased as a proportion of national income for four successive years by the coming financial year, according to the government's projections, making a mockery of its goal of reducing the ratio. Again like Muldoon, the government's regulatory habits are becoming more and more interventionist, often showing little respect for property rights. All this is squeezing the private sector, including agriculture. There is no sound strategy for growth, or for dealing with risks such as the current account deficit and the level of external debt. On present indications the policies of the centre-left parties would be even more damaging to the productive sectors of the

economy. A weak policy environment affects the outlook for all industries and businesses. The agriculture sector continues to carry, as an additional burden around its neck, the albatross of producer board regulation. In an underperforming economy, I can only see farming continuing to decline. As someone who grew up on a farm and with a close affinity to agriculture, I find that a pitiful prospect. The only good news in this story, if there is any, is that the dismantling of producer board regulation is, in my view, only a matter of time. Like import licensing, the overwhelming case against it will be increasingly accepted, and the political constituencies supporting it will fall away. The internal dynamics in most industries are working in that direction. The views of the heavy hitters now leading the dairy industry about where the industry needs to go must be the country's best kept secret. And support for the meat and wool boards keeps falling away – more farmers each year are asking what they get for their average \$5,000 levy payment. However, change could still be a long time coming. Malcolm Bailey has compared the process with the abolition of slavery. Unless more farmers themselves push for change, those fighting to defend the boards' privileges in the National Party and any alternative government may well hold out for some years. In that event, a great deal more damage will be done to the farming sector and many more opportunities will be lost before deregulation comes around. I leave you to draw the obvious conclusions.