NEW ZEALAND
PLANNING COUNCIL

IS FARM SUPPORT THE ANSWER?

A Policy Backgrounder

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Introduction

Problems confronting New Zealand farmers tend to be blamed on recent changes in economic policy. In fact the difficulties caused by interest rates and the exchange rate have only exacerbated the effects of long term failure to adjust to change in world markets. This failure to adjust is largely due to the increasingly large dollops of short term assistance that successive governments have provided to farmers - ostensibly to allow more time for the industry to adjust. In practice, this pattern has allowed marketing and processing industries to put off the hard decisions on adjustment and has seriously distorted the market "signals" reaching farmers.

Pastoral farming is no longer the only substantial source of growth in the New Zealand economy. In the mid 1980's its survival does not have to be assured by government. World markets do provide exciting opportunities for growth in exports from our livestock industries. But those opportunities are only relevant if market returns are high enough to make farming profitable. If the livestock marketing and processing system cannot produce and sell products which yield an acceptable return on the labour and capital invested, these resources should be transferred to industries which can.

Last season was a particularly good one for most farmers. This season is likely to be particularly bad - because of the combination of slow adjustment plus typical seasonal fluctuations plus the impact of change in economic policies. There is a danger that the downturn in farm incomes could be so severe that it might retard rather than encourage diversification and adjustment. Such a downturn could also have serious social and flow-on effects in farm communities, threatening the structure of rural society. However, there is also a risk that government assistance if not carefully targetted, could simply contribute to the long term decline in market performances.

The aim of this paper is to set out the medium-term context in which immediate decisions should be made.

The problems of adjustment affect many parts of New Zealand agriculture. But they are most evident in the sheepmeat industry. Discussion in the paper will refer most frequently to that sector.

Background

The current combination of shocks has placed many farmers, notably younger, more recently established and therefore more vulnerable hill country sheep farmers, in a difficult position.

The problem for government is particularly acute because those farmers got into their present position by responding to previous government policies. In the mid-1970s, pastoral farming in New Zealand appeared to have reached a plateau with land development and livestock numbers remaining static for several years. Government was convinced that apart from the energy based projects pastoral farming represented the only reliable longer term source of growth for the economy. So it instituted policies to boost farm production. These included the Land Development Encouragement Loans (LDEL) and the Livestock Incentive Scheme (LIS). Some measures were taken to encourage competition and efficiency in processing and marketing but the major emphasis was on encouraging production. Deregulation of meat processing brought some new entrants to that industry but did nothing to inject dynamism into the export and marketing effort.

Sheep are the raw material for freezing works and packing houses. Normally an industry must pay its raw material suppliers a price sufficient to encourage them to stay in the business. In this case government seemed to be guaranteeing that it would keep the raw material suppliers in business. Consequently the downstream industries did not have to face the full pressure of developing new markets, new products and greater processing efficiencies which would enable them to pay farmers enough to keep producing sheep.

In addition, cheap finance for farm purchase and development made it easier for farmers to pay higher prices for land. Subsequently, when export market prices fell, or were thought to be too low to provide a reasonable return on capital, government provided farmers with SMP's; ensuring that land prices remained high. Thus big loan commitments were built into the farmers' cost structure, and the effects are being felt today.

International prices are low for the bulk commodities which still comprise most of our agricultural exports. The returns to farmers are directly affected by movements in the New Zealand dollar. Interest payments on loans are rising - gradually for longer-term farm purchase loans but rapidly for shorter-term working capital. Other costs are rising because of inflation, the withdrawal of government subsidies and the introduction of charges for government services. Farm values are falling so farmers have less security to borrow against. Selling up may cover their debts but will not generate the resources needed to finance adjustment and diversification. Nor will it provide the net assets to help farmers transfer out of farming.

Many farmers do face real hardship, and can be forgiven for blaming it mainly on politicians, past and present. The worst aspect is that the ones hardest hit are likely to be the younger more recently established farmers - traditionally the main sources of initiative, adjustment and improved efficiency for the industry.

There are strong arguments on equity, social and economic grounds for some short-term assistance to farmers. What is important is that this assistance should not leave it once again, to the government, and the taxpayer, to ensure that farmers keep producing sheep. At the same time the downstream processors and marketers need to be given a clear and unequivocal message that in the longer term the existence of a sheep industry as the source of their raw material is dependent on their efficiency and their capacity to pay farmers remunerative prices.

The case for short term assistance must also rest on answers to longer-term questions. How vital will sheep farming be as a source of New Zealand foreign exchange earnings? Are there real growth prospects in world markets? Can or should government do anything to encourage longer-term adjustment?

Government action which does not take account of these questions and simply keeps farmers in business could make their longer term prospects worse.

Sources of Overseas Earnings

Arguments that pastoral farming must grow in order to provide the foreign exchange to pay for our imports are no longer valid. Traditional pastoral exports, which provided 85% of our overseas earnings in 1955 now provide about 40%. The following table of sector contributions to total foreign exchange earnings shows how rapidly earnings from other sectors have grown.

TABLE 1

Sector Shares of Overseas Earnings

(% of total)

Sector	1955	1965	1975	1985
Meat	25.0	27.8	22.8	16.5
Wool	34.4	26.0	13.0	10.5
Dairy	25.8	24.6	14.5	12.1
Pastoral	85.2	78.3	50.4	39.1
Horticulture, etc.	0.9	1.3	2.0	3.5
Wood Industries	0.9	3.0	5.9	4.5
Manufactured and Processed Products	7.9	9.6	22.0	33.5
Services	5.1	7.8	19.7	19.4
	100.0	100.0	100.0	100.0

Source: Department of Statistics

The lesson to be drawn from this is not that sheep, and pastoral farming in general, are unimportant. But they no longer dominate our export earnings. Ensuring that livestock numbers increase is no longer an overriding concern for government policy. There are other ways of earning overseas exchange. The aim of policy must be to ensure that the most profitable have the chance to attract resources for growth.

There is ample scope to increase export earnings from further processing of farm products without increasing livestock numbers. Crops, horticulture and trees should be free to compete equally for the available land and skills. Earnings from services, such as transport, tourism, banking and insurance, offshore processing, marketing, and other commercial activities can no longer be ignored as "invisibles". At nearly a fifth of our total earnings of foreign exchange their role has to be acknowledged and examined more closely.

Projections for the next ten years indicate that this structural change in the pattern of our overseas earnings is likely to continue. By 1995 traditional pastoral exports may be earning less than 30% of our foreign exchange.

Until now the sheep industry has been our largest source of overseas earnings. But if meat exports cannot pay farmers enough to cover their costs, it must inevitably decline. That will cause difficulties for those who choose to continue working and investing in the industry. But it will not spell disaster for the economy as a whole.

Export Market Prospects

The future of New Zealand farming depends on its export markets. Over 80% of our agricultural production and 97% of our lamb is intended for export. Do export markets want what we produce?

Demand in any country depends on how many people there are, how fast the population is growing, how much money they have to spend and what they want to buy. In many countries the key is the growth and behaviour of an emerging middle class.

The important distinction is not between rich and poor countries. So called poor countries contain substantial and increasing numbers of rich and middle-income consumers. To take the extreme example, there are more millionaires in India than people in New Zealand.

We have tended to believe that only rich developed countries want and can pay for our meat and milk. Perhaps we have forgotten that it is people rather than countries that consume food. In the developed countries population and income growth rates are declining and consumption of livestock products is already very high - even to the point of health risk. In these countries demand for basic foodstuffs is not likely to grow.

This is in complete contrast to trends in a large number of developing countries. They have high rates of population growth. Many of them have fast-growing economies and an increasingly large and increasingly affluent middle class. Consumption of meat and milk is still relatively low, but as incomes rise consumers want to add more protein, more meat and milk , to their diets. Table 2 compares economic growth rates, past and projected, in industrial economies and a range of developing countries.

TABLE 2

Average performance of industrial and developing economics, 1960-95

(average annual percentage)

Country Group	1960-73	1973-79	1980-85	1985-95 High case	1985-95 Low case
Industrial economies	4.9	2.8	1.9	4.3	2.5
Developing economies	6.3	5.2	2.8	5.5	4.7
Low-income	5.9	5.2	5.9	5.3	4.6
Asia	5.9	5.2	5.8	5.3	4.6
Africa	3.5	2.1	1.7	3.2	2.8
Middle-income oil importers					
Major exporters of manufactures	6.7	5.8	1.6	6.3	5.2
Other	5.3	4.3	1.9	4.3	3.8
Middle-income oil exporters	6.9	4.9	2.4	5.4	4.7

Source: World Bank World Development Report 1984

Our traditional markets in the industrial countries are growing more slowly than developing countries as a whole and slower than all sub-groups of developing countries except low income African countries.

The Western Pacific Seaboard, relatively close to New Zealand, is one of the fastest growing areas of the world. Population and income growth rates have been higher than the world average for twenty years. The real and potential growth in demand for meat is obvious. Yet this area has remained only a minor and usually residual target for New Zealand export market development and trade policy. Significantly the first New Zealand meat company office in mainland Asia was opened only in 1984.

New Approaches to Old Markets

Traditional markets still take the bulk of our exports. But they do not offer volume growth and patterns of consumer demand and product distribution have changed. Consumers will not buy more meat or more milk but they will pay more for what they do buy if it is presented in a more sophisticated form or as part of restaurant, take-away or other prepared meals.

There have been efforts to diversify. Despite its continuing dependence on the U.K. butter market the New Zealand dairy industry has been highly successful in diversifying its range of products, markets and related commercial activities. In the late 1960s the Meat Board introduced a lamb diversification scheme which taxed exports to Britain and paid bonuses on exports to new markets. Then Middle East markets opened up. Meat exporters knew little about them and tried to develop them like the familiar British market. One bulk commodity market was replaced by another and development of a wider range of products and markets was neglected. In 1979, 80% of our lamb was exported in bulk carcase form: in 1984 the figure was still 78%.

Opening New Markets

New markets offer vast potential for the development of both volume and quality markets but the potential must be identified and the ensuing market and product development activities actively targetted and sustained. New products have to be developed and tested. Effective means of processing, packaging, promoting and distributing the product have to be found. This takes time. Market penetration for our meat products has not been achieved because our exporters have been unwilling to look far enough ahead and have generally been unwilling to invest in market development.

World agricultural trade grew quite strongly in the otherwise sluggish 1970's. Many countries achieved much faster rates of growth in agricultural exports than did New Zealand and a much more diversified and integrated world market has emerged. For example New Zealand meat exporters are now competing not just with other red meat exporters, but with exporters of other meats and of cereals and other livestock feeds. American exporters, encouraged by the U.S. government and supported by trade policy initiatives, have been investing heavily in the development of livestock industries in developing countries based on American supplies of cereals, feeds and other inputs. Countries where demand for livestock products is expanding are having to make profound commercial and policy decisions on the balance to be struck between importing consumer products or importing the feeds on which to base their own livestock industries. In short, the shape and future growth of these markets are being worked out between New Zealand's potential customers and its competitors while we remain for the most part passive onlookers.

The thrust of New Zealand trade policy is still heavily concentrated on the rearguard battle against protection and support policies in traditional markets. The continuing need for that battle is accepted, but it is becoming increasingly urgent that more attention and real effort be focussed on ensuring access to the markets of the future. New Zealand is only now beginning to take a serious and systematic interest in the livestock policies being pursued in developing countries, particularly in the Pacific Basin area. But as yet there has been no sign of a significant government commitment of budget and personnel to this task. An appropriate trade policy strategy is not even on the horizon.

Changing Patterns of World Agricultural Production

In addition to these significant trends on the demand side of world agriculture, new challenges are emerging in the supply of livestock products.

In recent years, the increasingly rapid uptake and exploitation of new technology by larger and more affluent farmers, has been the main reason behind the continuing expansion of agriculture in the developed countries. In fact technology-based productivity increases have thwarted the efforts of governments in a number of countries, notably in North America and Western Europe to limit production either through price policies or through more direct supply control programmes. Because technology and capital have been most readily available to large scale farms in the affluent industrialised countries, the benefits of technological development have been unequally distributed. Income and productivity disparities have been accentuated, both between countries and among different groups of producers within countries. The result of these developments is a world in which surpluses are increasing in the developed countries while deficits are increasing in the developing countries as a result of increasing distortions in the allocation and use of agricultural and food-producing resources.

New Technologies

New technological advances are based less on mechanical and chemical than on biological innovation. Scientific breakthroughs in manipulative biology and genetic engineering combined with micro-electronics are rapidly producing a revolution in biologically based industries. Potential is there for a significant longer term shift in the world economy towards greater reliance on biological, renewable resources and processes. Commercial innovations are already affecting the production and replication of plants and animals and the methods of protecting them from disease, pests and climatic conditions. New methods are being introduced in the processing of crops, livestock products and wood to produce existing products more efficiently or new products replacing those based on non-renewable resources.

One example is a new hormone treatment for dairy cows which is expected to be introduced in 1988. This will produce an increase of 25% in average milk production per cow - with enormous consequent structural implications for the world's dairy industries - particularly in the first instance in the USA.

This new wave of technological change poses special challenges and opportunities for New Zealand's land based industries. For those which can use the new technologies effectively there will be new opportunities for improved production and for new uses for their products. Those that do not will find their competitive positions in world markets much worse.

New Zealand politicians and policy makers seem still unaware of the real significance of these changes and we appear to lack adequate machinery for investigating and debating their implications. The fact that, after several years of wrangling, New Zealand appears to be the only major beef exporting country in the world refusing to permit the use of natural hormones to increase efficiency in beef production typifies a narrow and introspective attitude to innovation which could have serious consequences in the future.

Historically farm production in New Zealand has had an excellent record of adopting new technology. If our pastoral industries are to have a future, that record must be continued and both production and processing sectors must radically improve their capacity and their willingness to adjust to technological change.

Agricultural Policies

The importance to New Zealand of agricultural policies in other countries has long been recognised but the overwhelming emphasis given to restrictions on access to our traditional markets has become outmoded. The emphasis on access restrictions seems to have blinded us to the changing character of these markets and to the underlying changes in population, incomes and consumption which have contributed to the decline of these markets.

Import restrictions in those countries occur because of the combination of the slow growth in domestic demand discussed earlier and the adjustment problems faced by their own farmers. As in New Zealand, social and political concern for hard-hit farmers and rural communities has led to the introduction of government assistance.

However, the benefits of that assistance have gone more to the wealthier, well established farmers than to poor farmers who needed help. Technological advances have also helped the larger, richer farms which were better able to attract the capital and skills required by the new technologies.

Adjustment in the agricultural sector has been delayed. Poor farmers are still poor. Rural communities are at risk. Production is well above the level of market demand. Enormous surpluses have been produced which are now being exported with subsidies to the newly developing markets of the world. The costs of farm and export subsidy policies are enormous.

GATT and OECD attention is now focussed increasingly on domestic adjustment problems as the basic cause of problems of agricultural trade, and there is growing recognition in the United States and in the E.E.C. that their domestic agricultural policies are costly in fiscal terms, and are achieving neither their social nor their economic objectives. New Zealand has perhaps more to gain than any other major trading country from moves to link domestic policy adjustment with negotiations on agricultural trade issues. There is undoubtedly scope for a more vigorous initiative by New Zealand in this area of multilateral negotiation. However the political costs of changes in domestic policies are as high elsewhere as they are in New Zealand and our exporters should hold no great expectations of any rapid move towards liberalisation of agricultural trade.

More emphasis is needed on direct efforts to secure future access to the growth markets. Successful exporting countries are influencing not only the way those markets develop but also the policy rules which will determine access in the future. For example, where the new growth in demand is being met by domestic livestock industries based on imported feeds, political pressures will develop to favour trade in feeds rather than in finished livestock products.

By failing to present potential customers with the option of mutually beneficial trade in the products New Zealand exports we run the risk of being permanently excluded from the markets which offer the best prospects for growth. More of our trade policy resources need to go into this vanguard role rather than fighting the rearguard action on access to old markets.

Government policies are still tending to reinforce old patterns not only in trade policy but also in industry structures, research,education and information.

Industry Structures

Much of the recent debate on the meat industry has raged over whether farmers or meat companies should control marketing. The pressure has been put on government to decide and to provide legislative underpinning for the chosen structure. However in New Zealand today agriculture is a sophisticated and integrated part of the commercial and financial economy. It should have little need for government to design and underpin its structure.

All industries need to develop structures to provide a balance between stability and flexibility. Investors and the developers of new products and markets seek stability to provide them with a reasonable chance to reap the benefits of their investment. A healthy industry needs flexibility to allow continuous adjustment to changing conditions and the entry of new people with new ideas.

More extensive downstream control by farmers will not provide the expertise and flexibility urgently needed in the marketing, transportation and processing of farm products. Greater selling strength will do much more than farmer involvement in downstream activities to force the processing and exporting sectors to seek their profits from improving efficiency and market returns instead of passing costs back to the farmer. If one link in the chain is seen to be able to depend on government for assurance of its long term survival, the whole chain will gear itself accordingly. This is exactly what has been happening in the meat industry.

Research

Government provides most of the research back-up for farming. This commitment has tended to concentrate effort in production research rather than research for marketing and processing. It has also distracted government from the more important policy role of ensuring that all parts of our agricultural industries work together to focus research effort on the areas of greatest need and benefit.

The challenges of change in markets, products and technologies argue for a major reappraisal of research priorities.

It is difficult for government to encourage this when it is the major source of research and it is already encumbered by commitments to established research institutions.

New Zealand's resources are too small to "cover the field" in research particularly in new and sophisticated areas, such as manipulative biology. We need to start making more rational and systematic decisions on what research results should be bought in from overseas institutions , what projects should be contracted to overseas institutions and what can sensibly be undertaken in New Zealand.

In this area also government commitments have tended to reinforce old patterns rather than assist reappraisal, flexibility and adjustment.

Education

A trading nation needs to develop a high level of skills and expertise relating both to trade and marketing activities, and also to the countries and the peoples with whom trade relations are being developed. People are needed who have been trained in the languages, traditions, cultures and organizational behaviour of the countries with which we expect to trade rather than just those of historical significance. Priorities based on changing cultural, political and commercial relationships, with increasing emphasis on the Pacific Basin, should be reflected not only in specific trade and market orientated courses, but also in educational curricula from primary school upward.

Information

Identifying and developing new markets requires access to broadly based, forward-looking information systems to support strategic market planning. Our existing information systems concentrate on a narrow range of products in a restricted number of traditional markets. Reliance on this information tends to reinforce existing patterns of trade rather than encourage the exploration of new opportunities.

Through its overseas posts, and in particular the Trade Commissioner service, government has available an information gathering and dissemination system whose potential to support market development is vast but seriously under-utilised. A more structured approach which provides for more systematic collection and dissemination of market and trade information is urgently needed.

The pilot stage of a Trade Information Centre which would improve access to all types of market information and particularly information required for strategic market planning is now underway. Although this project is being undertaken under the development, and to develop and implement appropriate trade policies and policies for other important areas of infrastructure such as education, information and research.

In the absence of a more dynamic and better targetted approach to policies in these critical areas and a clear signal to processors and marketers that in future the assurance of their raw material requirements will be their own responsibility, short-term assistance to farmers may suppress the symptoms, but it will not remove the cause of the afflictions currently besetting the agricultural industries.

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