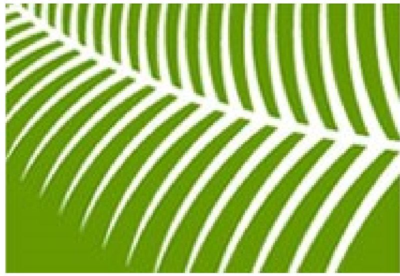

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New Zealand Economic Reforms

Implications for U.S. Farm Policy

by E.C. Pasour, Jr. and F.G. Scrimgeour

Reform of U.S. agricultural policies during recent decades has been slow and limited, as it has been in most places throughout the world. However, reform of farm policy need not be trivial, as shown by the economy-wide restructuring of the New Zealand economy that occurred between 1984 and 1994. The wide-ranging and dramatic reforms, including a significant deregulation of the agricultural sector, occurred following a dramatic loss of public confidence in the effectiveness of government control and a consensus that government's role in the economy should be reduced. What implications might New Zealand's deregulation offer for U.S. farm policy?

New Zealand before the reforms

Government control has a long history in New Zealand. Many of its nineteenth-century settlers wanted to establish a society free of the faults of the Britain they left behind. New Zealand was one of the first countries in the English-speaking world to officially endorse socialism, and "socialism without doctrines" became the slogan there before World War I. Indeed, before the reforms of the 1980s, the New Zealand government owned and operated forests and forestry industries, railroads, telephone systems, schools, hospitals, gambling facilities, radio and TV networks, airlines, and banks. It also led the world in providing tax-financed welfare programs for the elderly, the disabled, and the unemployed. Moreover, in the decade just before the reforms began, the leader of the ruling National Party launched a massive industrial development program to stimulate the economy. This "Think Big" program of government investments in steel, petroleum, and synthetic fuels laid a huge debt burden on New Zealanders ($2,500 per capita annually).

New Zealanders bore the burden of socialist policies for decades because their per-capita incomes ranked among the highest in the world. The prosperity was based on sales of agricultural products in overseas markets, particularly Great Britain. Agricultural exports in 1993 still contributed 50 percent of export income with more than 80 percent of these receipts coming from pastoral farming—primarily sheep/beef and dairy farms. The heavy cost of government controls and income redistribution became evident when Britain joined the European Common Market and OPEC oil prices skyrocketed in the 1970s. Inflation increased from 2 percent in 1965 to 17 percent in 1982. The increased inflation led to the introduction or tightening of wage, price, foreign-exchange, and investment controls. By then, New Zealand had the lowest growth rate of per-capita income in the World Bank's survey of industrial market economies.

In agriculture, extensive government controls distorted both input and product markets. Tariffs and import licenses reduced imports, raised farm costs, and reduced exports of farm products. The web of regulations throughout the economy affecting labor, transportation, and finance further increased agricultural production costs. Input and output subsidies and a constantly changing tax structure severely distorted production decisions. Farmers especially "overproduced" sheep.

Statutory authorities also tightly controlled marketing activity through licenses and regulations. The heavily regulated markets for milk, wheat, apples, and other products both hampered changes in technology and raised food prices to consumers. In short, pervasive regulations in both the farm and nonfarm sectors reduced the competitiveness of New Zealand exports, distorted price signals, and reduced living standards.

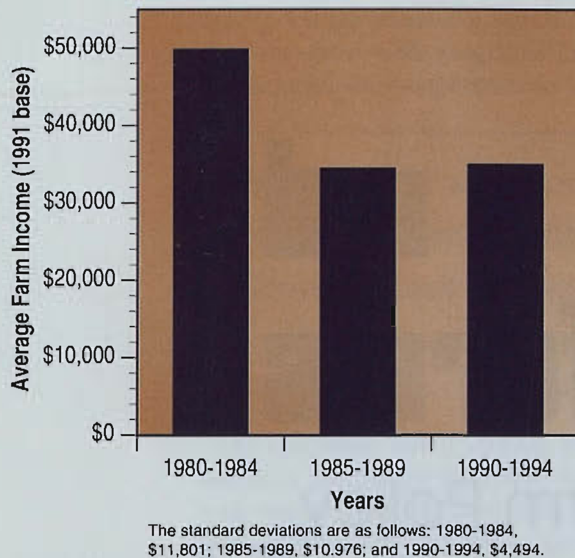

Figure 1. The New Zealand reforms and real incomes, sheep and beef farms

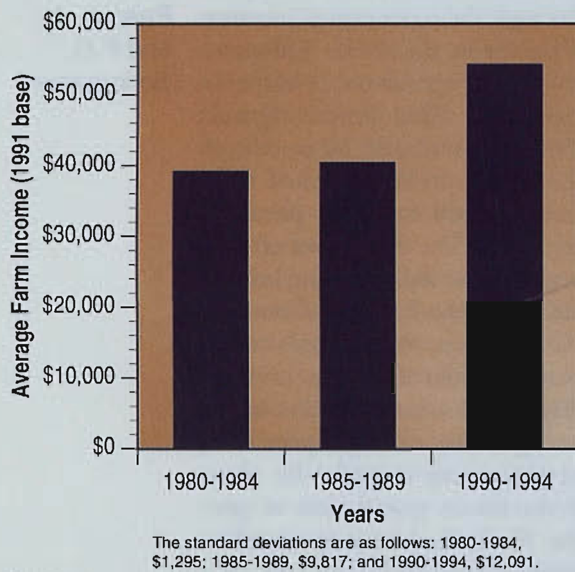

Figure 2. The New Zealand reforms and real income, dairy farms

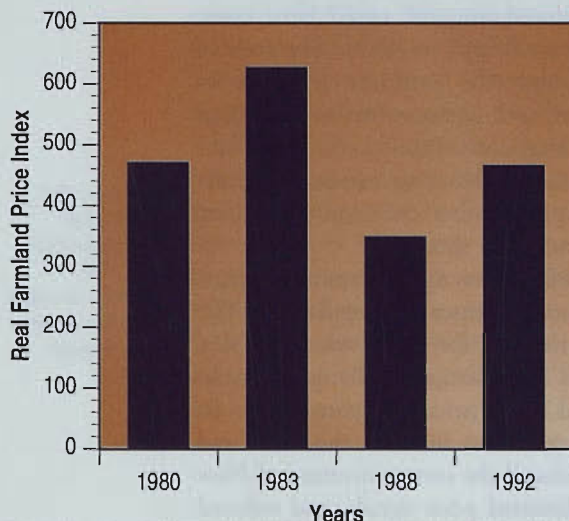

Figure 3. The New Zealand reforms and real farmland prices

The New Zealand reforms

Reform was motivated by a dramatic shift in business and public attitudes about the appropriate role of government. Economic analyses of various programs that restricted competition helped to convince groups currently benefitting from narrowly-targeted subsidies that the gains from a comprehensive restructuring of the New Zealand economy would be larger than the losses of these subsidies. The business community, including agricultural interests, swung behind the reforms because market activity became more profitable than lobbying for political favors—activities from which returns had became more and more uncertain in the heavily regulated economy. Key officials in the newly-elected government, many of whom were younger and more knowledgeable about the harmful effects of protectionist policies, were willing to conduct a bold experiment.

Economic reform began with the 1984 election and change of government. The Labour Party finance minister in the new government, Roger Douglas, launched a broad, economy-wide reform program that caught everyone by surprise. Douglas floated the New Zealand dollar, lifted all financial controls, deregulated the banking industry, removed all quantitative restrictions on imports, and began phasing out tariffs. The reform program, known as "Rogernomics," allowed foreign competition in services such as banking and airlines, initiated a massive privatization program, and levied a 10 percent sales tax on goods and services linked to a reduction in the top marginal income tax rate from 66 percent to 33 percent.

The reforms eliminated output and input subsidies to agriculture, deregulated the markets for many products, and eliminated the Poultry and Wheat Boards that formerly controlled production and marketing. They privatized the U.S. agricultural-extension-type farmer advisory services and allowed Ministry of Agriculture activities such as meat and food inspection to operate on a self-sustaining basis. Marketing boards and export authorities continue, however, to exert a heavy influence on marketing decisions for about 80 percent of agricultural and horticultural exports.

Reform effects on New Zealand agriculture

New Zealand agriculture was one of the first sectors hurt by the reforms. Farm incomes fell dramatically. In 1985–86, for example, sheep and beef farm incomes fell by more than 50 percent and dairy farm incomes dropped nearly 20 percent. Between the first and second half of the 1980s, sheep and beef farm income fell in real terms by 31 percent, although dairy incomes were stable (figures 1

and 2). Sheep and beef farm incomes were lower even though export prices of beef, lamb, and wool were, on average, higher during the second half of the 1980s.

Despite the initial shock, the agricultural sector rebounded. During the first half of the 1990s, with the reforms in place, dairy incomes increased by 34 percent in real terms and sheep and beef farm incomes stabilized (figures 1 and 2). The impact of the reforms on average farm income was offset to some extent by changes in income volatility. Sheep and beef farm incomes were less volatile and dairy farm incomes were more volatile during the early 1990s when contrasted with the first half of the 1980s.

Reform was motivated by a dramatic shift in business and public attitudes about the appropriate role of government.

Land values also fell sharply following the reforms, but have since made a strong comeback. Both the decline in farm income and a huge drop in inflation, from 17 percent in 1986 to less than 2 percent in 1994, caused land prices to fall by 45 percent between 1983 and 1988. By 1993, however, real prices of farm land had returned to levels corresponding to those immediately before the advent of subsidies and excess production (figure 3).

While sheep numbers have remained substantially below prereform levels, there have been modest increases in both the dairy and beef sectors and a significant increase in other livestock production, notably deer. Moreover, during the period between 1984 and 1993, export receipts from kiwifruit and apples, adjusted for inflation, increased at average annual rates of 4 percent and 8 percent, respectively.

Agriculture's contribution to gross domestic product (GDP) fell from 17 percent in the high-subsidy year, 1982, to 13.4 percent in 1987 after the reforms were underway. But since that time, agriculture's share of GDP has stabilized, and increased to 14.3 percent in 1993.

Implications for U.S. farm policy

There is no persuasive evidence that price support, credit subsidies, and other U.S. farm programs generally improve producer incomes or stabilize the agricultural sector. Farm programs have little long-run effect on income because the programs, particularly price supports, confer once-and-for-all gains on owners of farm real estate and other specialized resources (Pasour 1990). Moreover, the programs, on average, result in a transfer of wealth from the less affluent to the more affluent (Luttrell 1989). Furthermore, the use of price supports, subsidized credit, crop insurance, and other programs to achieve short-term political goals has created uncertainty and exacerbated the instability in U.S. agriculture during the past twenty years (Pasour 1990).

A reduction or elimination of price supports and other programs whose benefits are capitalized into prices of farm assets would mean a sharp decline in value of some farm assets and a corresponding reduction in wealth for owners of these resources (Luttrell 1989). Thus, it is highly predictable that these farm interests will aggressively fight to maintain farm programs, even given a broad consensus that such policies are not in the "public interest." Moreover, the widespread desire for a change of policy may not be sufficient to ensure its

legislative success because of distortions in the political process. In short, the likelihood of fundamental change in U.S. farm policy hinges upon both the public perception of current programs and on political considerations.

The New Zealand experience, although yielding mixed signals, shows the possibility of agricultural policy reform in the United States. It is much easier to change farm policy if the economic reforms simultaneously restructure other sectors to the benefit of agriculture. Agricultural interests in New Zealand "bought into" the reforms because the benefit from deregulation of other sectors was expected to be larger than the loss sustained in giving up existing legislated privileges in agriculture. The U.S. economy provides fewer opportunities for simultaneous, comprehensive restructuring. However, recent congressional and administration actions have achieved some broad policy reforms that make significant cutbacks in farm programs more palatable, as happened in New Zealand. The new NAFTA and GATT trade agreements, for example, which limit agricultural protectionism and rein in farm subsidies, also offer expanded markets for U.S. farm products. And current initiatives on Capitol Hill to trim government programs go far beyond cutting just agricultural programs.

There is no persuasive evidence that price support, credit subsidies, and other U.S. farm programs generally improve producer incomes or stabilize the agricultural sector.

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What would be the long-term effects of deregulation of the U.S. farm sector? The record for the New Zealand reforms supports the thesis that the effects of a fundamental restructuring of U.S. farm policy would be largely transitional and have little effect on long-run profitability in agriculture. Following the initial economic shock that resulted from the New Zealand reforms, farm land prices, and to a large extent farm incomes, returned to prereform levels. It is likely that the pattern of effects following fundamental reform of U.S. farm policy would be similar to that experienced in New Zealand. There would be significant reductions in U.S. farm incomes and land prices in the near term, but little effect on profitability of agriculture over time as prices of farm land and other agricultural assets adjust to lower product prices. ■

■ For more information

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