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Economic Deregulation and the Adjustment of New Zealand Farmers

by Gerald
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In a nutshell, New Zealand's need for economic deregulation and reform resulted from the severity of the effects of market distortions and inefficiency induced by well-intended but, in hindsight, misdirected government intervention. Over three decades, the distortions induced by government intercession, economic controls and assistance had imprinted themselves on most facets of economic activity. Through the 1970s and 1980s, the pace of government intervention had quickened to stem fiscal and balance-of-payment problems. Prime Minister Muldoon's policies created a "straight-jacketed" economy. Economic regimentation increased as more controls were put in place to offset the distortions induced by earlier regulations. Interest rates, exchange rates, and wage rates were all manipulated to dampen distortions. The population

became increasingly concerned and polarized between those who continued to gain from government assistance and inflation and those whose opportunities were persistently eroded. Despite the intervention, New Zealand's balance of payments worsened. Losses became pronounced in the early 1960s after Britain joined the EEC, and New Zealand's access to its major market for agricultural products was constrained.

Assistance to agriculture

Special taxation incentives for farm inputs were introduced in the mid 1960s. Their intent was to boost foreign exchange income and to counter the protection given to other sectors of the economy. Initially incentives were only given for fertilizer use, but the increase in agricultural output petered out by 1969. In the 1970s, to recharge output, taxation exemptions and subsidies were added for herbicides, pesticides, labor, machinery, livestock increases, and capital investment in forestry, buildings, irrigation, fencing, and general farm development. Few inputs remained unsubsidized and interest rates for farm development were pegged. Throughout the 1970s the real rate for farmer borrowers was commonly negative. Intervention policies strongly favored borrowers and did little to discipline bad investment decisions.

As the output rise again waned in the late 1970s, minimum prices were introduced, with most funds directed to the support of lamb, beef, and wool. Grain prices were fixed. In 1983 total assistance to agriculture peaked at 32 percent of the total value of output. (The annual value of assistance as a per-

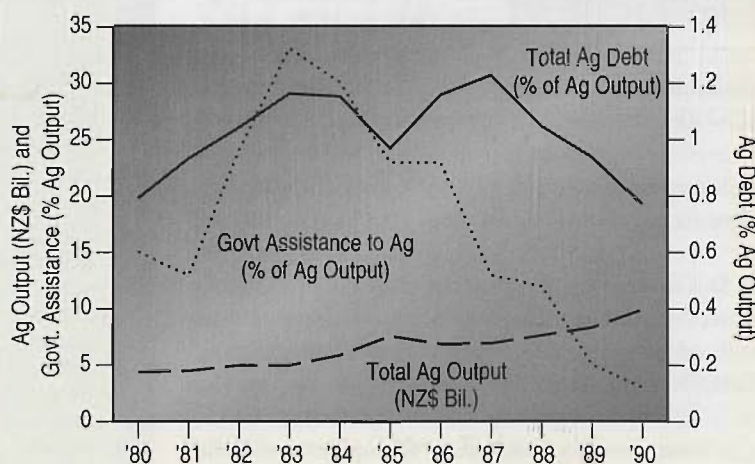


Figure 1. Selected New Zealand agricultural indicators (immediate pre- and postderegulation)



Colin Gault

Sheep and Mt. Hutt

centage of the value of total output is shown along with debt and value of output in figure 1.) Price uncertainty diminished, adverse events were offset by grants, and, with escalating inflation, opportunities to make capital gains from land purchases increased. Land prices and debt soared.

Government intervention affected products and inputs unevenly, constraining product substitution and preventing transition to the most efficient use of land. Economic adjustment throughout the agricultural sector was perverted by the intervention. The mist of artificially distorted prices impacted on farmers' optimal management decisions. Inordinate use of variable inputs (encouraged by special tax deductions and the high marginal tax rate)—labor, fertilizer, seed, fencing materials, machinery, livestock—distorted output and caused exaggerated growth in the farm servicing sector: meat processing, wool handling, fertilizer production, farm contract services, transport, retail, banking, finance, shipping. Even rural schools and hospitals were affected by the expansion in farm labor employment. Later, with the removal of assistance, the immediate retrenchment of farm inputs caused a severe collapse of businesses in the farm servicing sector.

Economic reform

Deregulation was sudden. The public considered wholesale deregulation to be an unlikely event, although for agriculture supplementary minimum

payments for lamb had already been targeted for removal. In November 1984, the near bankruptcy of the economy from excessive external debt led to immediate reforms and the introduction of deregulation. (The reform policies are commonly referred to as Rogernomics after their architect, Sir Roger Douglas, the then minister of finance.) Farming leaders had already decried the distortion of market prices by government assistance, and agriculture became the first sector of the economy to bear the brunt of reform. As an offset in 1985 the exchange rate was devalued by 20 percent, but the benefit to agriculture was largely overwhelmed by inflation of 18 percent in the following year. By 1987, agriculture had been deregulated. (By 1987 total government assistance had fallen from 32 percent to 3 percent of the value of output.) Arguably, other sectors were not reformed until 1990.

The reform of the economy has been far-reaching and ongoing. Apart from the abolition of assistance to agriculture and most industries, controls on foreign exchange, wages, prices, and imports have been removed. Add to this cuts in direct taxation, the introduction of a goods and services tax, the downsizing of government and privatization of government commercial ventures, ongoing budgeted surpluses, reforms in the labor market, and the removal of the Reserve Bank from political control. The economy has been transformed as the changes continue the drive toward increased economic effi-

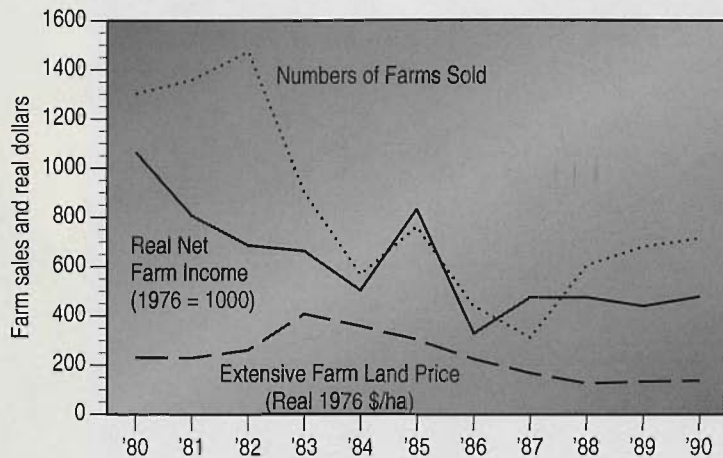


Figure 2. New Zealand sheep and beef farm income and land sales (immediate pre- and postderegulation)

ciency and sustainable growth. New Zealand's public debt to foreign countries has been repaid.

While the aggregate economic gains of deregulation have been positive, they have not been costless, and the agricultural sector has been among the most affected. Farmers' management decisions have altered as the safety net of government assistance has gone, exposing them to all but extraordinary natural events.

Deregulation's impact on agriculture

While detailed sectoral input and output data for the pre- and postderegulation periods are available (see referrals for further information), information about the responses of individual farmers is sketchy. Farm sales detail is known (as shown in figure 2), but the true reasons why farmers have sold have not been recorded. Those with highest debt/asset ratios were most affected, and with land prices collapsing in the autumn of 1986 to levels as low as 40 percent of the prederegulation values, numbers of farmers had negative equity. (After the collapse in land prices, the market remained destabilized for nearly five years.) Farmers with cash flow losses



Canterbury Plains

were commonly forced to sell if renegotiation with their bankers proved unsuccessful. It is likely that the majority of farm sales during 1987 and 1988 were induced by financial pressures. Although some farmers were severely distressed, suicide rates did not change.

Long-term risk adjustment: product substitution

Farmers are now fully exposed to climatic and market risk. Prior to deregulation, assistance was given as interest-free loans and grants for disaster relief or price support when product prices weakened. The economic law of gravity affecting farm product prices—that the price would fall to the average cost of production—was offset by the subsidies. Real undistorted prices were obscured and inefficient farmers were protected from the ongoing fall in prices (spurred by subsidized science research and consultancy assistance to foster the adoption of the new technology).

Following the rapid removal of the sources of the price distortions and the immediate reduction in farm inputs, farmers became better able to make adjustments to minimize longer-term real risk. Reliance on income from sheep and beef products fell, and substitute products were introduced. On the better land, dairying and cash cropping has expanded and extensive areas of exotic pine forests have been planted in joint ownership ventures on marginally productive land. (Farmers provide the land and the investors provide capital.) Deer have been substituted for sheep and beef on extensive rangeland properties as well as on finishing farms. Intensified systems have become highly efficient and farm tourism has increased. Reliance on off-farm income has also increased. Although sheep and beef farm output has fallen significantly, the proportions attributable to lower inputs or to the shift to new products is not known. (New Zealand's total lamb kill fell from its prederegulation peak of 39 million to fewer than 20 million by 1992).

Whereas meat companies could formerly hide their inefficiency as the government hedged livestock prices, their number has dwindled as the most inefficient failed when stock numbers fell. The downside is that competition for livestock by the processing companies has been reduced.

Survival of efficient farmers

Inefficient farmers were also protected by the subsidies. Subsequently they have become fully exposed to market competition. Those with little debt survived the immediate postderegulation period, but less able farmers are now having difficulty as their profitability is eroding. The difference between the more able and the less able farmers is widening.

Intervention inhibited the top managers and protected poor performers. To remain competitive, farmers are now compelled to be efficient in all aspects of their business; choosing best products, and using the best technical and financial management and trading practices. There is little room for error in management practices and top farmers have the management system under continuous review as the environment and markets change. Top farmers eat, drink, and breath farming to anticipate changes and set new targets. Farmers now have to be more adaptable; if they are not, they fail. To overcome declining profits in the new unprotected and competitive environment, they cannot afford to stand still.

While some farmers attempt to offset declining profits by minimizing costs and back themselves into a financial corner, better farmers spend wisely and emphasize output per dollar input to obtain high net income. Top farmers take carefully calculated risks, and the present market environment favors their opportunities and diminishes the prospects for the less able. Good farmers think more about productivity and efficiency—they plan better and are more conscious of flexibility—and the management finesse of better farmers has advanced, widening the gap between themselves and poor farmers. Computer use is commonplace, with programs to monitor and control the management system, record inputs and output, and optimize cash flows. Risk is minimized by better farmers by working with known measurements via sound recording.

Climatic risk

New Zealand's agricultural output is largely pasture based and most farmers' management strategies to offset climatic and biological risk have changed. By reducing the real cost of variable inputs, subsidies focused production on increased output per hectare. Increases in stock numbers (especially sheep and beef cattle) were promoted by the incentives, and this heightened the frequency with which pastoral farmers were affected by periods of restricted pasture growth—droughts and cold weather. In the absence of protection from adverse events, farmers have lowered stocking rates, reduced emphasis on output per hectare, and increased per head livestock performance. Better farmers plan well ahead of time, make fast decisions to offset pasture growth losses, and take advantage of new competitive opportunities. In the regulated system the grain price was frozen, and the subsidies enabled the poor performers to survive bad events and did not reward the initiative of good decision makers. Grain and other feed prices are no longer buffered by price support, and farmers who react slowly face higher costs in feed shortages.

Financial adjustment

With the revived exposure to risk, farmers' input mixes have changed; greater use of nitrogen to boost pasture growth, increased conserved feed reserves on tough properties, reduced debt, and reliance on cash reserves have increased to offset unexpected events. Farmers talk more closely to the end users; there are fewer opportunities for confusing the market messages between the final consumer and the farmer.

Farmers and their financiers recognize that they cannot expect assistance when market and climatic conditions are bad. Attitudes toward financial risk have changed, affecting overall management and investment decisions. Poor farmers are still confused by the changes; their attitudes tend to be negative and reactive. Better farmers are positive and proactive; they drive and remain in control of their farming system.

In general, resource allocation decisions have improved, and farmers have become more deliberate in timing investment decisions. Strict cost-benefit



Sixty million sheep

criteria are applied to investment decisions by better farmers, and those farmers who do not apply these criteria are commonly refused assistance by their financiers. However financiers are still fair-weather friends to farmers and retreat fast if prospects for any major farm products are gloomy, fearing the problems of ten years ago; as an offset, better farmers have increased their credit reserves to reduce the likelihood of the bank constraining their inputs. Commonly, financiers ignore differences in prospects between the sheep, beef, and dairy industries, and although the real value of land is no longer obscured, some banks have not learned to restrict mortgage lending.

Family adjustment

Deregulation has had its effects on farm families. The initial shock was dramatic. Attitudes to farming have changed. Young adults are no longer ob-



Agroforestry (Ian Moore)

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essed with coming back to take over the farm, and the expectation that the family farm should go on forever has diminished. Inheritance decisions have become more logical and financially rational, as decisions to farm are no longer distorted by continually inflating land prices driven by intervention. Sound, sustainable profits are needed in order to benefit from the independence conferred by the farming lifestyle. When farm land prices fell and profits were nonexistent or negative, the reality of the situation hit home very clearly.

Consensus and reflection

Most farmers are now better attuned to their bio-

logical system. They have greater confidence in their own judgments, as there are no induced price distortions to cloud them, and the feeling that there is any likelihood of government affecting their decisions has diminished. There are still some farmers who have not accepted the totality of the need to change following deregulation, with the absolute necessity to be proactive rather than reactive and the realization that their success now depends as much on good business skills as good farm husbandry.

Better farmers now enjoy their farming more than before deregulation. While they were angry with the adjustments when they occurred, they are happier now, especially as they gain rewards for their excellence. The free market rewards management excellence and encourages self-reliance. Farmers who were especially bitter were frequently inefficient or less able and less mindful of the need for change. Overall, farmers have learned to deal with factors which can be changed on their farms, to ignore what can't be changed, and to get on with their future. Not all farmers are blissfully content with deregulation and there is insecurity among livestock farmers. But their self-esteem has improved, as expressed by one farmer: "I could not stand tall with my hand out." Farmers are united behind the idea that they would rather have control in their own hands to manage their own destiny. ■

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