THE ROLE OF AGRICULTURAL POLICY IN NEW ZEALAND:
PAST, PRESENT AND FUTURE

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Introduction

For many individuals, although the movement from childhood to maturity is essentially a gradual evolution, nevertheless in retrospect there is typically one event, one point in time, from which adulthood commences. The same has been true of agricultural policy in this country. Ten years ago the industry was as pampered and carefully nurtured as if it were a helpless toddler. Today the approach is to treat it as an adult, responsible for its own future.

The single event which marked the demise of the earlier paternalistic policy took place on 14th July 1984, with the election of the Labour Government. It is certainly true that significant liberalizing changes had taken place before that date, and also that the full implementation of the new policy approach was not to be seen until the budget in November of that year. Nevertheless with the change in government came an essentially complete acceptance of the view put forward by Treasury that:

"all the various sectors of the economy should, in the interests of efficient resource allocation, be increasingly subject to the same criteria as regards investment decisions, assistance levels etc." (Treasury (1984B), p.1.)

This paper falls into three main parts. The first two take a positivist approach of describing the policy environment before and after July 1984 and discussing the economic and political reasons for the changes that occurred. The third section then moves to a normative evaluation of the residual place that remains for agricultural policy in this country.
Agricultural Policy before 1984: The Past

In order to understand the state of agricultural policy in New Zealand at the start of the present decade it is necessary to take into consideration both the evolution of general economic policy in this country over the past fifty years, as well as the domestic responses to the policy changes that have taken place overseas.

In New Zealand, as in most other countries, the reaction to the great depression of the thirties was to protect domestic manufacturing by putting in place barriers against imports. In our case, quotas in the form of import licenses were more important than tariffs. In the post-war period, however, this country was unusual in that it continued with the high levels of protection put in place earlier.

There are number of likely explanations for the continued policy of protection. It might have been the standard infant industry argument. If so it failed, since virtually none of the infants grew up. It might have been to protect jobs in this country, yet this appears unlikely, since at the time unemployment levels were infinitesimally small. It might have been to help ease the chronic balance of payments deficits, caused in part by an equally chronic tendency to keep the currency over-valued.

Whatever the reasons for the continuation of this protection, by the 1970s its level was significantly higher than for most other countries.

At this point in time Britain joined the Common Market and access for non-European countries became more difficult. In addition the Common Agricultural Policy of the EC began to have a significant influence on world trade. As a result, world agricultural trade, which had already started to deteriorate, accelerated in its decline, particularly for exporters of temperate products and for those with
traditional export markets in Europe. New Zealand was therefore hit twice.

The combined effect of these two factors was to increasingly disadvantage the agricultural sector. The policy of import protection both raised costs for farmers and tended to increase the value of the currency, thus reducing farmers receipts. In addition, the changes taking place in world markets led to a decline in prices and growing access difficulties.

How did New Zealand's agricultural policy cope with the increasing problems faced by its farmers? By using what can be described as set of band-aid strategies. Year after year the government made ever greater efforts to support the industry and make it expand in ways that the industry was unwilling to do unaided. The general approach is well summed up in two extracts from successive Budget speeches by Muldoon in 1976 and 1977.

"It is clear that farm support policies such as we have had in the past, while maintaining the farmer in business, have been unsuccessful in stimulating increased production. The share of the farming community in total private income has dropped to an alarming degree. .....As it is clear that the form of farm support in recent years has not proved capable of increasing production the Government has decided to make a major change in the method of encouraging farm output..." (Muldoon (1976), p.9.)

"Farming is our greatest single earner of overseas income. If, therefore, our overseas earnings are to increase at the rate required to promote a sound basis for economic growth, agricultural production must play a central role. The Government is determined that farmers be given every incentive to undertake the substantial investment required if
increase in farm production are to be achieved."
(Muldoon (1977), p.11.)

The Government had started to use piecemeal compensation for farmers to counteract the effects of import protection around 1962. By the early 1980s the set of policies used was extensive indeed, encompassing many kinds of input and output interventions.

Very important amongst the input subsidies were those for fertilizers, irrigation works, and MAF services. More significant still were the concessionary loans for farmers at rates well below those which were ruling on the market, if indeed it was possible for non-farmers to borrow at all.

Of particular note were the Livestock Incentive Scheme (LIS) and the Land Development Encouragement Loans (LDEL) introduced in 1976 and 1978 respectively, with the express intent to expand output. This was at a time when it was becoming increasingly difficult to sell the sheep-meat we were already producing and the market was quite clearly signalling that if anything production should be cut.

On the output side the government gave concessionary loans to the producer boards, which allowed them to operate stabilization schemes, that then turned into subsidization schemes whose debts were ultimately forgiven. On top of this the government introduced the infamous Supplementary Minimum Price Scheme in 1978 to subsidize outputs even further.

What then were the costs and benefits of the past agricultural policy? It has been argued that the total effect of all these interferences with the free working of the market was to promote policy neutrality. In other words, a second best approach was adopted which compensated for the effects of New Zealand's protection policy. (Federated Farmers (1985)) However this was only a satisfactory approach if the first best solution of the removal of
protection was truly impossible, (Lloyd (1975)), which was surely not the case.

Even if it had been the case, the non-uniformity of the measures adopted certainly led to considerable inefficiency. Inputs were subsidized at differing rates according to type of input and type of product. Output subsidies again differed by product. In general both classes of subsidies favoured traditional products. As a result the policies hindered diversification at a time when this was becoming increasingly important, since world markets in the traditional meat and dairy products were becoming ever more artificial.

The impact of the input subsidies caused many specific problems; in particular the resulting over-capitalization of farms and the over-valuation of land were to have severe ongoing consequences that have continued for some farmers through to the present day.

While the problems considered so far were of a chronic nature, which decreased the efficiency of the industry, the agricultural policies had two other effects that led to more acute difficulties. The first of these was the overseas reaction to our export subsidies, in the form of the threat of and imposition of countervailing duties by the United States in the early 1980s. As a result the more blatant forms of export subsidies were already being phased out before July 1984.

The second acute problem that was a part result of these policies appeared through their impact on the budget deficit. The combined influence of actual and tax expenditures were a significant contribution to the overall budget deficit, which had reached over 9% of GDP by the 1983/84 tax year.
It had become almost inevitable that a significant policy change would have to be made to deal with this budgetary problem. If the spirit of earlier policy making had been followed, this would have occurred through further piecemeal actions. However the new government that came to power in July 1984 brought a total change in the approach to economic policy, with the result that the changes to agricultural policy that they introduced were fundamental, rather than piecemeal.

Agricultural Policy since 1984: The Present

The approach of the Lange Labour Government in 1984 was to move rapidly towards the "hands off" approach to agriculture and indeed to industry as a whole that had been promoted by Treasury in its Economic Management papers (Treasury (1984A and B)). To give an impression of the extent and swiftness of this policy shift it is worth noting some of the changes that were introduced in the budget of November of that year.

* Interest rates on existing Rural Bank loans progressively to be brought into line with market rates.

* All product inspection services provided by MAF to be put on a partial recovery basis.

* All fertilizer subsidies to be removed.

* Irrigation subsidies to be reduced from 70 to 35 percent.

In addition the major interventions of the SMPs and the LIS and LDBL had already finished, or were being rapidly removed.

It is quite clear that the aim was indeed to withdraw government from agriculture almost entirely and to allow the
market to determine its future. This is not to say that there was no perceived residual role for agricultural policy even in such a market-led environment. The requirement for some minimal intervention is to be discussed in the final section of this paper. Nor does it mean that the government was in practice able to stick perfectly to its general "hands off" approach. As we shall see the adjustment problems that occurred have necessitated some interventions. Nevertheless the general policy of no intervention, as it was implemented, has been subject to little disagreement. There have, however, been three major criticisms about the way in which it was implemented. These concern its speed of implementation, the uniformity of policy application throughout the economy, and questions of sequencing.

It is not considered necessary here to justify the general appropriateness of a "hands off" approach to agriculture. However the three issues raised above have been at the centre of much of the agricultural policy discussion in this country over the past five years, and so will be discussed in this section.

There can be no doubt that neutrality of policy is required if the government is to minimize its impact on the economy. This point has been freely and frequently acknowledged by both government and Treasury. Hence uniformity of policy application has to be the agreed appropriate long term goal. In particular this suggests the removal of protection of all domestic industries, and the freeing up of all markets, including the labour market.

Despite this accepted long run goal, New Zealand at the present time continues to have domestic manufacturing industry with one of the highest levels of protection in the OECD. (It should, of course, be recalled before feelings of guilt overwhelm us, that the OECD typically has levels of agricultural protection that far exceed our protection of manufacturing?) In addition the restrictive practices in
the labour market impose further substantial costs on agriculture, particularly through their influence on the transport and food processing sectors.

There has been ongoing discussion and argument since 1984 about the extent of the resulting bias against agriculture, although no disagreement about the fact that it would be inefficient if it existed. The consensus at present would seem to be that some bias does exist and that the desirable solution is therefore further action on the freeing up of the other markets.

Agreement on an existing bias naturally leads to a counterfactual world. What if the freeing up of the agricultural sector had proceeded at a slower pace, or, what if a different sequencing of liberalization had taken place?

It is probably not worth getting involved in the lengthy debate that has occurred on these issues. While it is certainly possible to argue that slower adjusting sectors should be liberalized first (Kreuger(1984)), it is also possible to argue that the political realities have to be taken into account and that these may limit the feasible set of policies (Lal (1987) and Hayner and Lattimore (1987)).

On the matter of the speed of reform itself, there is again argument as to whether ideally this should be fast or slow. However the real world may determine the pace of a particular policy, whether it is ideal or not. In the case of New Zealand, the acute problem of the size of the fiscal deficit made rapid action on governmental expenditures vital. There is no doubt that this requirement was at least part cause of the rapidity of removal of the various agricultural subsidies and tax concessions.

The very rapidity of change in the agricultural sector was itself part cause of one kind of Government intervention that did not fall within the 1984 masterplan. The rapid
removal of subsidies, particularly the interest rate subsidies, together with the collapse of land values, that resulted from a number of causes, led to a large number of farmers falling into severe financial difficulty. While it might be argued that these problems were an inevitable part of the restructuring of the industry that was required, the government has nevertheless put in place a variety of packages to deal with these financial problems.

Those policies aimed at restructuring debt in order to make the survival of farmers more possible could be argued as being counter-productive, if restructuring of the industry was the aim. However, such debt restructuring has supposedly only been permitted where it was deemed that the farmer had a long run viable future, and in any case more recent policies have had a specific intention of helping non-viable farmers off the land.

As we move into the future, then, we see New Zealand agriculture largely intervention free, adjusting with, or without, government help towards the new market led environment. We see some residual problems about the balance of intervention, but not about the market based policy itself. The following statement by Lange late last year about the achievements of his party's first three years, and their plan for the future, might be too self-congratulatory and over-optimistic about the future, yet the comment contained in it about agriculture is not too far from the truth.

"All these measures, combined with somewhat better prices in the ensuing 12 months, were crucial in helping many farmers adjust to the market, and regain their independence from the State. While the adjustment is not yet fully complete, a sound foundation has been laid for farming to operate successfully, on the same basis as any other private sector business." Lange (1988).
Note in this statement the continuing echo of the first quotation taken from the Treasury's 1984 briefing. From here on in this paper we will assume that this general approach is incontestable, and will concentrate instead on the future of agricultural policy in this type of market led environment.

**Agricultural Policy after 1989: The Future**

This section is not concerned with the probable future of agricultural policy in this country. After the events of the past months, it is not at all clear whether we are to continue to hold to the market-led approach of the Douglas team, or whether we are to start slipping back down the slippery slope of interventionism. Instead of predicting the future, this section is confined to a normative discussion of the residual role of agricultural policy, once it is acknowledged that in general the market should rule the industry.

A second matter that will not be discussed is the appropriateness of the general macro-management of the economy. There is a consensus in the industry that this aspect of government policy needs change. Particularly it is believed that the government should "get interest rates and the exchange rate down". While these general policy matters clearly impinge heavily on agriculture, and indeed are the main policy criticism levelled at the government by farmers, they are not discussed in this paper, which concentrates on agricultural policy per se.

Within specifically agricultural policy matters, we can presumably rule out for the foreseeable future concerns for New Zealand's own self sufficiency or food security, arguments much beloved by the agricultural protectionists as grounds to intervene in favour of agriculture. (Although it has to be admitted that our wheat growers do attempt from
time to time to frighten us with the spectre of overreliance on Australian imports!

With the growth in export surpluses from the EC, so their excuse for agricultural protectionism has started to shift from food security to conservation and the protection of the rural environment. Subsidization is required to cover the externalities inherent in land use. Alternatively the conservationists may stress sustainability. The need for governmental interference may be to ensure sustainability of production, where landowners are using "inappropriate" discount rates.

Of course the concerns of environmentalists can be well founded. Externalities and differences between private and social discount rates can certainly exist. However it is always necessary to show a healthy scepticism towards such claims where they are used to obtain state funding. One test is of consistency. If farmers obtain subsidies for the positive externalities they give to country-visiting urbanites, do they also get charged taxes for the negative externalities they impose through the run-off of effluent, or the damage that their fertilizers do to river systems? If governments pay externality subsidies to farmers do they charge pollution taxes to factories? If it is deemed that farmers are using incorrect discount rates, which ones are used instead, those of the environmentalists or those of the government?

Of potentially more importance to agricultural policy in this country is the issue of whether we are a small country or not. Perhaps all those who are about to embark on policy discussions should first have to state what they believe our export and import elasticities of demand are. There is a wide range of estimates to choose from, for example from from -1 to -500 on the export side (Finlayson et al. (1988)). My own prejudice is that the small country assumption is indeed a good approximation for this country for most of our
exports and for almost all of our imports. Hence I do not believe that export or import restricting policies are advantageous.

One interesting corollary which emerges from the small country assumption is that since we are unable to influence agricultural prices elsewhere by our actions, there is little chance that we will be able to alter other countries policies either. It then follows that we should treat these policies as exogenous when determining actions in this country. It is no economic justification to support agriculture here simply because it is supported in the EC.

Note a second implication of this nihilistic small country assumption. This is that New Zealand's influence on the Cairn's Group is essentially zero. It remains to be seen, in any case, whether the Cairn's Group itself is anything other than a "small country" in terms of its influence on world agricultural policy!

Thus far we have not had much luck in obtaining an economic justification for governmental agricultural policy. However there are a number of smaller matters of particular interest to New Zealand at the moment where there is probably greater support amongst the profession for a governmental role.

The first of these concerns methods of dealing with adverse events/acts of God. Whether or not the greenhouse is warming up, this country appears to be experiencing an unusually frequent occurrence of unusual events, in the form of droughts, storms, continued wet weather and floods. The government has typically responded to these climatic crises by meeting part of the farmers' costs of repairing the damage or of dealing with the ongoing production difficulties.

The usual economic problem potentially inherent in this kind of assistance is that the industry may not make appropriate
adjustments to the climatic riskiness of its situation if it receives compensation whenever problems occur. The extent of this potential problem depends, of course, on the extent that there is compensation for losses. In any case a better solution would be to have in place an adverse events insurance system whereby premiums reflected the inherent risks involved.

It is possible that there may be an incomplete market for this kind of insurance. Its present lack is no proof of the existence of an incomplete market, since the insurance will not exist if it is crowded out by a government which provides partial cover for some kinds of adverse events at no cost to the farmer. If in fact there is not a natural market for this kind of insurance, there would be need for government action, either through subsidizing an insurance scheme, as in North America, or through running its own scheme. In either case it would be desirable to actively explore adverse events insurance further rather than rely on ad hoc compensation. There is already clear precedent for this kind of adverse event insurance in this country through the presence of earthquake insurance.

This suggested approach to the problems raised by the drought is quite different from the way that has been floated by some of the farmers (and agricultural meteorologists) in this area. The argument goes that in drought-stricken areas such as Canterbury, since the agricultural lands are a national resource, so it is only right that the nation should pay for the irrigation that may be required with the greenhouse effect. This is, of course, only justified when the benefits of the irrigation do not go to the land-users. Otherwise, it is they that should pay for the costs of the irrigation. In any case it should also be pointed out that the experts do not agree on the implications of the greenhouse effect for this area: some suggest that it will actually mean wetter weather.
Perhaps the most frequently voiced complaint by agricultural economists about the hands-off approach of the government concerns its attitude to R & D. The present requirement that government research departments/institutes meet a reasonably high proportion of their funding by selling their services has substantially reduced the subsidization of R & D that takes place. Perhaps more significant is the fact that the pressure on research groups to do research that can be sold has significantly altered the kind of research undertaken towards short-run, appropriable projects. Hence research of a long-run public good nature has been cut severely.

The perceived problem in this is that, while the emphasis on more immediately valuable research may be beneficial for a short while, the lack of more fundamental research will prove damaging to the industry in the long run. There are limits to the extent that we can free ride on overseas fundamental research, when some of our needs are specific to this country.

It may well be that the profession in its loud protestations on this matter is largely exhibiting the rent protecting behaviour we tell our students about. However if a real problem does exist it is unlikely that the best solution is for the government to pour large amounts of funds into research in the way it used to. This research would be likely to be ill directed relative to the industry's needs and to be inefficiently carried out. A better alternative would appear to be to follow the Australian model of research trusts, where there is joint industry and scientific control and where funding is obtained from farmers as the main beneficiaries, through compulsory levies as is required in a competitive industry. The residual argument then becomes one of the need for any governmental supplementation of the industry funding.
The final two issues I want to raise both concern imperfect competition. As was pointed out above, agricultural producers are the quintessential perfect competitors. Nevertheless, they exist in an economic environment, both domestic and international, which does not fit in so well with our simplistic competitive models. In these circumstances there may be a justification for governmental involvement in countering the imperfect nature of competition elsewhere in the system. There may be a need to watch over domestic industry, particularly that closely associated with agriculture, to ensure that market power is not used in such a way that it damages the efficiency or interests of agricultural producers. There may be a need to ensure that other countries do not get involved in the short term dumping of agricultural produce here. Finally, there may be a need to give producers their own imperfectly competitive market power, through marketing or producer boards, to counter the imperfectly competitive environment into which their products are sold.

However please note the words "may". While contestability theory is not a panacea for all the problems caused by imperfect competition, there should be no presumption that the small numbers of firms operating in any market will automatically mean that inefficiency exists which requires the government to act.

Conclusion

There now appears to be almost universal acceptance in New Zealand of the fact that agriculture is an industry like any other and that basically it should be treated like any other. Despite the depressed state of some parts of the industry there is essentially no call for the government to get involved in price or income supplementation, or even in stabilization schemes. There is again no call for a return to input subsidization, except in very special circumstances.
This shift in the viewpoint of the industry towards that of the profession is evidence of an extraordinary maturation that has taken place since 1984. There are, of course, many complaints about government policy. But these tend to be about general macro-policy, such as the size of the fiscal deficit, and the level of interest and exchange rates.

There are some small areas where it is believed that the government should still maintain an involvement in the industry, such as in R & D, in the methods of dealing with extreme climatic events and in coping with imperfect competition.

Why is the industry in this country so willing to accept a general market led stance, when in other countries agriculture is so strongly opposed to this approach? Simply because it is in the industry’s own best interest. In this land-rich, population-poor, country, it is clear that land based industry will prosper compared with other sectors of the economy, unless international trade in agricultural products is totally destroyed by the actions of other countries. In these circumstances it is in the interest of the sector to strongly attack government interventionism wherever it is. Perhaps the current wealth of New Zealanders would have been higher if the agricultural sector had refused to be fobbed off with tariff compensation in the 1960's and 1970's and had instead pressured their party to move towards market liberalism earlier.
Bibliography


