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TRADE POLICIES AND THEIR EFFECTS ON FARMING

A NEW ZEALAND FARMER'S EXPERIENCE

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New Zealand

This paper discusses the implication of the recent Uruguay GATT round for New Zealand farmers and concludes that when implemented it will be positive for farming in New Zealand.

Because GATT will mean less support for many farmers in the world, the paper goes on to discuss the New Zealand farmers experience of removal of subsidies.

New Zealand agriculture has survived the removal of subsidies, and is the stronger for the exercise.

There are 48,000 farmers in New Zealand and each is an individual business in its own right.

Personally I have no authority to speak on behalf of New Zealand farmers - I am not a farming leader. So I have changed the title of this paper slightly from the wording given to me to indicate that this paper is presented from an individual perspective, and reflects my experience of the last 20 years in New Zealand agriculture. In this paper I want to briefly review what the recent GATT Uruguay round will mean to New Zealand. Because the implementation of GATT will probably mean a reduction in government assistance to some farmers in countries represented here at this conference, I will then describe how New Zealand farmers fared when subsidies were withdrawn.

NEW ZEALAND AND GATT

New Zealand is a country of 3.5 million people situated in the South Pacific and has an area of 270,000 km² or slightly larger than United Kingdom. Because it has a moist, temperate climate grass generally grows all year round, although there is a seasonal pattern. Almost all stock is grass fed and lives outdoors.

New Zealand is a trading nation, and farming has always been a strong feature of our economy. Currently 50% of export receipts are agricultural based.

**NEW ZEALAND EXPORTS 1993-94
JUNE YEAR**

	\$ Million	% of Production Exported
Wool	1,054	90%
Lamb	1,534	92%
Mutton	<u>269</u>	64%
Sheep	2,857	
Beef	1,691	80%
Deer	194	
Dairy	3,379	80% Est
Other Agriculture, fruits etc	<u>1,389</u>	
 Total Agriculture	 9,510	
 Fish	 1,209	
Forest Products	2,371	
Aluminium	676	
Other, manufactured etc	<u>5,384</u>	
 Total Merchandise Exports	 19,150	

Agriculture = 50% of Export Receipts

A high proportion of New Zealand production is exported and New Zealand is an important player on world agricultural markets.

- the world's largest exporter of sheepmeats with 47% of trade
- the world's largest individual exporter of dairy products with 20% of trade
- the world's second largest exporter of wool with 30% of trade
- New Zealand also supplies 6.5% of world beef exports

Over the past decades we have observed that agriculture, more than any other sector has been penalised by foreign subsidies and import restraints.

The amount of those subsidies is mind-boggling - in 1992 the total to OECD agriculture from consumers and taxpayers amounted to \$354 billion American! If we break that down, it works out at US\$21,900 for each of the OECD's more than 16 million farmers. This would be enough to give every farmer, every year, a brand new Toyota Corolla GLX, complete with alloy wheels and an anti-skid braking system!

These subsidies have made exporting of New Zealand agricultural products increasingly difficult, and led to lower prices for our products at the farm gate.

As well as having to compete with subsidised production, there have been barriers to trade such as high tariffs, quota restrictions, unreasonable product standards to name a few.

Therefore the recent Uruguay GATT round has great significance for New Zealand and particularly New Zealand agriculture.

New Zealand farmers see the GATT round as the opportunity to bring down the barriers to trade that have been imposed by governments on agricultural imports that enter those markets.

Specifically, the Uruguay Round agreement provides that, over the 1995-2000 period:

- Internal support be reduced by 20% from 1986-88 base levels.
- All non-tariff barriers be converted to tariffs and reduced by at least 15% from 1986-88 base levels. The average cut is 36%.
- The volume of subsidised exports be cut by 21%, and budgetary expenditure on export subsidies to be cut by 36%, from 1986-90 base levels.
- Sanitary and Phytosanitary (SPS) measures be revised and tightened, with the aim of ensuring that they are imposed only to the extent necessary to protect human, animal or plant health, according to objective scientific criteria.

That is an important point: access opportunities would mean little if governments remained free to impose arbitrary standards.

The OECD have estimated that the Uruguay GATT Round will add \$US200-\$US300 billion to world GDP.

So New Zealand farmers are positive that GATT will bring increased export opportunities for them but the converse to that is that some farmers in the world will receive less government support and lower prices.

Over the last decade New Zealand farmers have had a significant reduction in support from the government, and the rest of this paper shares some observations of that experience.

The changes that have occurred have been as exciting and stimulating as they have been dramatic, and I am very positive about what has occurred in New Zealand agriculture.

I would like to break the rest of my paper into three sections: the past, present and future.

PAST

In the 1960s New Zealand had a particularly strong economy. By most counts we were in the top three in terms of standard of living. We had full employment and our farmers thrived on the export of food and wool to Britain.

But then the world changed, and we didn't. The oil shocks of the seventies, the entry of U.K. into the European Community and the consequent loss of much of our traditional access to this market called for decisive action. But instead of making the necessary changes at that time, we had a series of governments who believed we would avoid reality by an array of interventions, controls and subsidies.

By 1984 our economy was a basket case. A supposedly conservative government had constructed a raft of regulations, licensing and subsidies. We had a marvellous system of social welfare, but one which we could not afford. The government borrowed heavily, and kept inflation under control by wage/price freezes. The financial sector was particularly heavily regulated with the government setting interest rates and exchange rates.

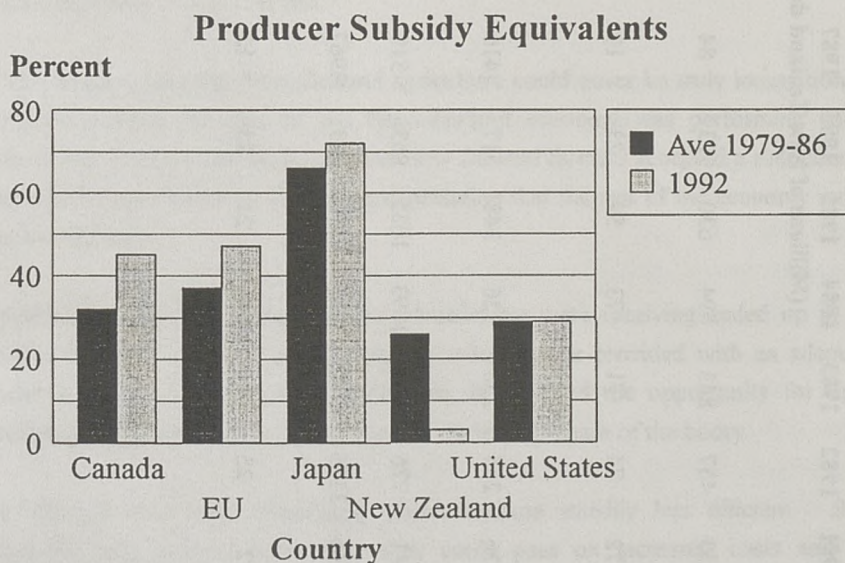
In short, you had to go to Eastern Europe or Russia (as they then were) to find an economy that was more regulated than ours.

Part of this process was the introduction of subsidies to agriculture.

Prior to the 1970s New Zealand farming had little support. But by the mid 80s pastoral agriculture was the recipient of a range of subsidies that meant that in 10 years we had moved from a low level of support to a peak of 34% PSE in 1983.

Since that date we have wound back to virtually no support as the attached table shows.

For interest I have included 1992 OECD figures showing comparative PSE's for a range of other countries.



Source: OECD

This support was delivered in a variety of ways. Input subsidies, particularly for fertiliser attempted to maintain the traditional low cost structure. (In hindsight we have found that the fertiliser subsidy led to luxury use; and now farmers are finding that medium use plus more subdivision to better utilise the grass grown is the best production system).

Low interest rate loans and grants were available to develop land and export production.

NEW ZEALAND ASSISTANCE TO PASTORAL AGRICULTURE

YEAR(1)	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994(2)
	(Millions of New Zealand dollars)																
Assistance on Output	-13	141	136	53	457	863	694	630	323	84	42	35	35	13	9	5	4
Assistance on Inputs	9	33	79	72	74	71	73	57	23	19	14	14	18	29	12	11	3
Assistance to Value Added Factors	27	59	189	216	245	258	326	348	517	416	487	235	153	124	105	99	101
Total Assistance to Pastoral Agriculture	23	233	405	341	776	1192	1093	1035	863	519	543	284	206	166	126	115	108
Total Value of Output	722	960	2621	2766	3165	354	3631	4577	3831	3967	4575	5407	6148	5392	6029	6615	6936
Producer Subsidy Equivalent (PSE)	3	24	16	12	25	34	30	23	23	13	12	5.3	3.4	3.1	2.1	1.7	1.6

NOTES

- (1) 1970-1990 Year ending March
 1991-1994 Year ending June
 (2) 1994 estimated

Source:-New Zealand Ministry of Agriculture & Fisheries

Output subsidies in the form of minimum prices were set for our main products and whenever the world market failed to deliver the government made up the shortfall.

So by 1984 it was obvious to many New Zealanders that the economy was unsustainable and a reformist Labour government was elected to power.

The process of deregulation and opening up of the economy was implemented with great speed, and agricultural reform was high up on the agenda.

It may seem surprising, but the reform was generally welcomed by New Zealand farmers.

There were three reasons for this.

Firstly, farmers saw that New Zealand agriculture could never be truly internationally competitive while the rest of the New Zealand economy was performing badly. Reform had to be across the board, and New Zealand farmers accepted a reduction of subsidies for agriculture on the strong expectation that the rest of the economy would also be reformed.

Farmers had come to realise that the subsidies we were receiving ended up in the pockets of other sectors. As long as our industry was provided with an adequate income by virtue of government assistance, it provided the opportunity for those sectors servicing agriculture to help themselves to their share of the booty.

For example, our meat processing plants became steadily less efficient. Both employers and workers knew that they could pass on increased costs and the government would compensate the farmer for the consequent loss of farm income.

Secondly we had found expensive ways to run our farms where we once did it more cheaply.

One of the fundamental laws of agriculture is that giving farmers a high price for their product will ensure they find an expensive way of producing it.

For example, sheepfarmers decided that it was more comfortable to put a roof over their sheep handling yards. While in New Zealand covered yards are a luxury, and not

a necessity, they appeared up and down the country, paid for in part by the government through subsidised loans and grants.

Subsidies and support prices are always capitalised into the value of land and livestock. This created a debt problem as farmers borrowed against this apparent equity using income supported by government. Farmers often farmed for capital gain rather than for farm profitability. Financiers loaned money on the basis of security without needing an understanding of the farm business. New Zealand farmers only had to be technically efficient to be profitable. There was little emphasis on farm business management.

These high capital values also made it more difficult for young people to enter the industry.

The third reason for farmers not being unhappy at the removal of subsidies was that they could remember how farming had been before subsidies, efficient and competitive. With subsidies there was an element of dependency on the government and taxpayer - a loss of independence.

PRESENT

There are several aspects of farming that have changed now that New Zealand agriculture is completely unsubsidised.

1 Agriculture is Market Driven

Farmers are now focused on the real market. There is a hunger for market information. Farmers are constantly researching and assessing market opportunities, and there is a proliferation of weekly newsheets published with market information and management tips.

Farmers now respond directly to international price signals, and are increasing farm business management efficiency, changing enterprise mix and diversifying farming operations. Less profitable sheep have been replaced with more profitable beef and dairy cattle. After simply trying to maximise output, farmers have started producing fewer, better quality, outputs. Farmers are demanding more market information and are producing products to meet consumer demands.

Whereas previously, there wasn't much energy put into understanding what the world market was saying. We had started farming the subsidies. Price signals were being distorted by government price support. There was higher price support for sheep than

dairy, so more sheep were run. Thus, in the mid 1980s with price support New Zealand ran 70 million sheep and surplus product was rendered down. Now, without subsidies the national flock is down to 50 million.

Artificially high prices, as well as land clearing subsidies, led to marginal land being brought into production. Generally this was steep erodable land of lower fertility. Now that incomes are dictated by world markets, this land is reverting back to scrub cover, or is being planted into forestry. Incidentally, this is also positive for the environment.

2 Risk

In addition to normal business risk, New Zealand farmers face two major risks, climate and market.

Previously, when minimum prices were underwritten by the government, farmers tended to discount risk. We were insulated from the vagaries of the market. Also, there were schemes to help farmers through climatic disasters such as drought and flood.

Now, farmers recognise that their farming system must take account of both risks. Risk has moved back to the farm game. To minimise the adverse impact of poor prices in a particular commodity astute farmers will have three or four product lines.

Farmers now generally farm with lower levels of debt and seek to have a financial buffer to protect from a future downturn. They are more likely to farm conservatively, with lower stocking rate, but a better per head stock performance.

This summer the North Island had a widespread drought, and with no government assistance it is worth noting the individual farmers response.

He recognised that there was a problem; it was the individual farmers problem, and he had to quickly get on with working through the options such as grazing off, sale of livestock, or supplementary feeding.

Whereas previously the response would have been; there is a drought what is the government going to do to help the farmers; how can the individual farmer maximise the benefit of the government assistance. Without government support, farmers reacted more quickly and decisively.

An example from the past is livestock cartage assistance. There was a government subsidy to assist with the cartage of livestock back to the drought affected area when the drought broke. So all sorts of deals were done with the transport companies to cart stock out for very low prices, and offset the low price with the high (subsidised) return price.

Finally on risk, in contrast to most other farmers in the world New Zealand farmers have very low risk exposure to change in government policies. In the past when we were dependent on government policy there was always a risk that that policy could change dramatically overnight. We are now more secure in that although market prices and economic environment can change, generally it is more modest and predictable than governments reacting to political demands etc.

3 Quality vs Quantity

When agricultural subsidies were first introduced they were to a large extent aimed at securing increased production from farmers. Subsidies were largely blind to the matter of quality. It was a numbers game. The more you produced, the more you collected from the government.

But, as New Zealand found out when it had a flock of 70 million sheep at the end of the day you can only produce what the market requires.

So now farmers are much more conscious of the true market requirements particularly as it relates to quality. Quality is what the ultimate customer - the consumer - requires.

Farmers are now aware of the consumers concerns for animal welfare, and codes of practice are being developed to provide assurance that production systems are humane. Processing companies are also conscious of consumer requirements and many plants are now ISO 9002 accredited.

4 NZ Agriculture is again low cost

Farmers have relearnt the lessons we had started to forget, that is that in the competitive market you can only prosper by being more efficient than your competitor. Output per labour unit is rising, attention is paid to the cost of all inputs and all expenditure is scrutinised to ensure that it adds value to the business.

The same drive for efficiency is now seen in the farm servicing sector. Our meat industry now knows that it can not pass on costs to the farmer. A massive turn around in productivity has meant that our meat plants are now amongst the leaders in world standards of efficiency. For example the costs involved in taking a lamb from the farm gate to F.O.B. the export vessel reduced by \$12.80 from 1981-91. This made a significant contribution to the \$30 a lamb received in 1991. \$30 was the magic figure farmers deemed necessary to economically produce lamb. Also those supplying inputs, be they fertiliser, animal remedies or pesticides know that farmers are now ruthless in their buying decisions.

One of the consequences of the reform of the economy is that the world has more confidence in the N.Z. dollar and it has strengthened considerably. To some extent, as an exporter, this is a disadvantage but farmers now have the option of sourcing manufactured inputs such as fertiliser direct from the world market which helps keep costs down. Farm supply companies can no longer charge what they think the market can standard. We now have stable and competitive prices.

It is a fact that the service sector was more seriously affected than the farmer by the removal of subsidies. During the transition from subsidies to no subsidies farmers 'threw away the cheque book' which meant no income at all for the farm service sector.

5 Farmers prefer the real world

During the relatively brief period in New Zealand agriculture when subsidies prevailed farmers were uneasy. Farmers who had seen themselves as the backbone of the country, the driving force of the economy, were becoming beneficiaries of government welfare.

Rural pride was dented by the jibes of the urban sector who saw subsidies being directed towards what urbanites regarded as a privileged and already wealthy sector.

Furthermore, farmers instinctive dislike of government made us uneasy about our livelihood being dependent on government decisions during that time. Now, without subsidies farmers recognise that they are in the real world. No-one owes us a living, and the following changes have occurred:

- Farmers monitor their businesses more. There is more time put in the office doing cash forecasts for the bank manager.
- There is less political involvement than ever before. Farmers ask "what is the point in becoming involved" and get on with running their own businesses.

- Farmers are less likely to blame the government when things go wrong. If the price of export meat goes down, it is the meat companies that get the blame.
- Probably the top quartile of farmers are pushing out the production frontiers faster than they were under subsidies.

There has been a release of management energy which is being used to advance the farm business.

In summary, farmers are now focusing on creating wealth for themselves, rather than scheming how to use subsidies to best effect.

FUTURE

Looking to the future is a speculative business, but as a result of the reform of the NZ economy one thing is clear. The New Zealand government won't have much influence on the state of New Zealand agriculture. (This assumes New Zealand continues along the path of economic reform undertaken over the last 10 years).

The future of New Zealand agriculture is in the hands of producers and the marketing and processing companies that work with them to service the world customer. Assuming the spirit of the recent GATT round is implemented there will be good opportunities opened up to us.

But the markets that are opened to us are also generally opened to our competitors. Competition will intensify. The consumer will become more discerning. To stand out from the crowd, New Zealand exporters and marketers will have to get their act together even more than the present.

We will have to assure our customers of excellent and consistent quality. There will be a need to demonstrate management systems that run from the pasture to the plate.

These systems will take account of not only the product produced, but also the impact on the environment and animal welfare issues.

With this greater emphasis on management and documentation of systems I believe it will lead to larger farms.

The increased scale will be necessary to cover the increased management overheads, and also will allow processors and exporters to form partnerships with reasonable sized producers.

CONCLUSION

The Uruguay GATT round has the potential to level the world trade playing field. The New Zealand view is that it is about time, and we are looking forward to the opportunities it will bring. To capitalise on the gains made we also need freer international trade. Not only will this be good for New Zealand farmers, but it will be good for the world economy with the better use of resources and increased world economic activity.

New Zealand has had a short period with subsidies, but over the last 10 years we have been weaned off subsidies and are once again truly unsubsidised. We have found that there is life after subsidies.

Lessons learnt include:

- Exposing New Zealand farming to international market signals improved the efficiency and international competitiveness of New Zealand's farming sector.
- Farming which is internationally competitive can be profitable without government support (even in the absence of free international trade).
- People will undertake strategic planning and make longer term decisions in a stable political and economic environment.
- People and organisations are required to be more innovative in a less regulated economy exposed to international competition.
- Farm business management practices improve considerably in a market driven environment.
- Quality has become a very important issue. Consumers determine quality not producers.
- New Zealand farmers would now rather farm under the current situation than where we were previously.

Farmers in New Zealand have made significant efficiency gains by moving to a more market environment.

We hope the rest of the world's farmers respond to the challenge of farming without subsidies, and wish you luck.

Reference

Walker, A. & Bell, B. Aspects of New Zealand's Experience in Agricultural reform since 1984. *Ministry of Agriculture & Fisheries Technical Paper 94/5.*