Farm Subsidy Reform
Dividends

The Case of New Zealand

Ralph Lattimore
Hope, New Zealand
New Zealand Farming

- Small, distant, poorer soils, good rainfall, temperate climate, hilly
- Very suitable for livestock production
- Farming 7% GDP, 55% exports
- Strong farming culture
- No rural/urban income gap
- High farm subsidies, 1970-1984
Why high farm subsidies, 70-84

- NZ had strong import substitution policy for 100 years
- Strong comparative advantage in agriculture meant the sector was taxed
- Govts provided partial compensation especially 1970-84
- After 1974 (oil shock), govt decided to maintain consumption and heavily invest in energy
• More exports required urgently
• Biggest export sector is agriculture
• Farm subsidies raised considerably
• Initially input subsidies raised on development finance
• Then deficiency payments added
• Sheep sector favoured – largest
• Beef and dairy subsidies modest
• Most other sectors got few extra subsidies
Pressure for Reform

• Economic growth fell, inflation topped 20%
• Productivity fell
• Subsidies without farming developed
• Foreign exchange crisis
• Labour govt elected in landslide
• New finance minister promoted wholesale economic reform
Altogether too many sheep!
Overcoming resistance

- Excellent free trade agreement, CER
- Labour Govt. not reliant on farm vote
- Focus on unpopular old policies
- ‘Take and give’ – remove subsidies and tariffs
- Political environment of shared pain
- Keep doctors, teachers and unions happy
Compensation arrangements

• Cost reductions – tariff removal, general deregulation
• Federated Farmers support system
• Govt. Rural Bank led way on debt holidays
• Income safety net extended to farmers
• Exit package
Immediate Impacts

Real Commodity Prices

- Milk
- Lamb
- Venison
Farmers Real Incomes

Index 1980=100

- Sheep and Beef Farmers
- Dairy Farmers

High Subsidies
Real Farmland Values

Data Source: author calculations
• Cost cutting
• Diversification
• Off-farm income
• Layoffs
• Left farming
Did retail food prices fall?

- Not much for highly subsidised products
- Yes, in cases where import restrictions removed
- Where supply management regimes abolished – eggs, wheat
- Variety of food products increased
- (No longer had to get a doctor’s prescription to buy margarine!)
20 years on

- Competitiveness up
- Output up
- Value added up
- Incomes up
- Land prices up
- Employment down
- Size of farm sector rose from 5 to 7% GDP
- Exports stabilised around 55%
Productivity Increased

Labour Productivity

Index 1972=100

Farming Without Subsidies
Total Factor Productivity

Index 1972=100

Subsidies 1.5% pa

No subsidies 2.5% pa
Farmers Real Incomes

Index 1980=100

Sheep and Beef Farmers  Dairy Farmers

High Subsidies
Real Farmland Values

Data Source: author calculations

High Subsidies

NZ$1999 per hectare

Year

Dairy
Cropping
Sheep

Data Source: author calculations
Avoiding new income support

• Create ‘level playing field’
• Treating farming as just another business
• Put higher priority on dealing with other issues raised by reform – education, unemployment, infrastructure, growth
Impacts on agribusiness

- General reform created better business environment – finance, labour relations, competition
- More control over input quality
- Easier access to imported ingredients
- More competition from imports
NZ Dairy Industry

• Fonterra is a monopsonist but with pro-competitive regulations
• New dairy companies being created
• No current competition issues
• Environmental concerns – water rights, waste management
• Size depends on productivity and global protectionism – already very large
Lessons

• Modest compensation acceptable if equitable and timely
• If subsidies are imperative – deficiency payments or income supplements best
• Farmers will survive with planning and negotiation support
• Farm incomes and land prices will recover
• Reform dividends require resource mobility
NZ did it the hard way

- Farm subsidy removal was very painful because the whole economy was being reformed
- Even so, actual adjustment costs were considerably less than expected
- Other developed countries removing farm subsidies would suffer lower adjustment costs
Real Wheat Prices

C1999/Kg

1981 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005
Real Wine and Timber Prices

Wine

Timber
### Partial productivity measures

<table>
<thead>
<tr>
<th>Productivity Measures</th>
<th>1990-91</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lambing Percentage (ewe)</td>
<td>101.6</td>
<td>123.2</td>
</tr>
<tr>
<td>Average Lamb Wt (kg)</td>
<td>14.35</td>
<td>17.14</td>
</tr>
<tr>
<td>Lamb sold kg/ewe</td>
<td>9.76</td>
<td>15.80</td>
</tr>
<tr>
<td>Wool kg/head</td>
<td>5.28</td>
<td>5.78</td>
</tr>
<tr>
<td>Average Steer Wt (kg)</td>
<td>297</td>
<td>318</td>
</tr>
<tr>
<td>Milksolids per cow (kg)</td>
<td>260</td>
<td>322</td>
</tr>
</tbody>
</table>