



Life After Subsidies

The New Zealand Farming Experience - 15 Years Later -

FARMERS in many countries are facing radical change. They are confronted with the reduction or elimination of government subsidies. Farmers and their supporters fear for the future of those who work on the land, their families, and for the communities in which they live. The fear of the long-term destruction of the traditional family farm haunts many farmer discussions.

Yet, the truth is otherwise. For family farming, there is life after subsidies. Indeed, life after subsidies is better than farming that is dependent upon state handouts.

This paper has been prepared by Federated Farmers of New Zealand (Inc), which is the premier sector organisation representing New Zealand's farmers and rural communities.

It tells a story of how, in the early and mid 1980's, farmers in one country -New Zealand- were faced with the sudden and unexpected removal of subsidies. Its conclusion is that New Zealand farmers have come through that experience stronger than ever. Left to face the market, they have prospered and are determined never again to be dependent upon government handouts. The New Zealand experience shows that in a modern economy, farmers do not need to rely on state charity. Farming families can live well and prosper by their own efforts.

Federated Farmers is not telling other countries how to manage their affairs. Our intention is to provide a message of reassurance to farmers, policy makers and others facing change.

So what happened to subsidies in New Zealand?

In 1984, nearly 40% of the average New Zealand sheep and beef farmer's gross income came from government subsidies. A year later, almost all of these subsidies were removed. New Zealand farmers were on their own, and remain so today in 2002.

As they saw it at the time, New Zealand farmers were cut adrift by their government. Yet, more than 15 years later, the farming sector in New Zealand has grown and is more dynamic than ever. The intervening years have been a struggle for many, but now farmers are proud of their achievements. They remain without subsidies, earning their living by their own efforts without interference. Farmers now fiercely defend their independence.

Where once farmers were treated with derision and scorn by the rest of the nation, now there is respect and even admiration. Much traditional animosity between town and country has gone.

What is farming like fifteen years after the subsidies have ended?

The removal of farm subsidies in New Zealand has given birth to a vibrant, diversified and growing rural economy. New Zealand's experience over the last fifteen years of reform has thoroughly debunked the myth that the farming sector cannot prosper without government subsidies and the environment cannot remain healthy.

In the fifteen years since 1986-87, the value of economic activity in New Zealand's farm sector has grown by over 40% in constant dollar terms.

The farming sector's contribution to economic growth in New Zealand has held at around 5.5%.

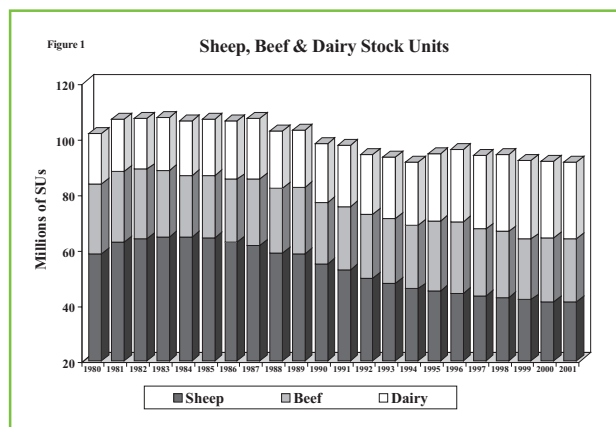
The total agricultural sector remains as important to the economy as it was fifteen years ago. Its contribution to the New Zealand economy has risen from 14.2% of GDP in 1986-87 to 16.6% in 1999-2000. Economic growth in the agricultural sector has outpaced growth in the New Zealand economy as a whole.

The removal of farm subsidies has proven to be a catalyst for productivity gains. Since 1986, productivity in New Zealand's agricultural sector has improved by an annual average of 5.9%.

By comparison, the period before the removal of farm subsidies saw agricultural productivity languish at an annual growth rate of 1%.

Such improvements in productivity are readily apparent at the level of the individual farm. For instance, lamb carcass weights have risen by 3kg, 13%, since 1986-87, and the average dairy cow produced 27kg, or 20%, more milk-fat per year in 1999-00 than 1986-87.

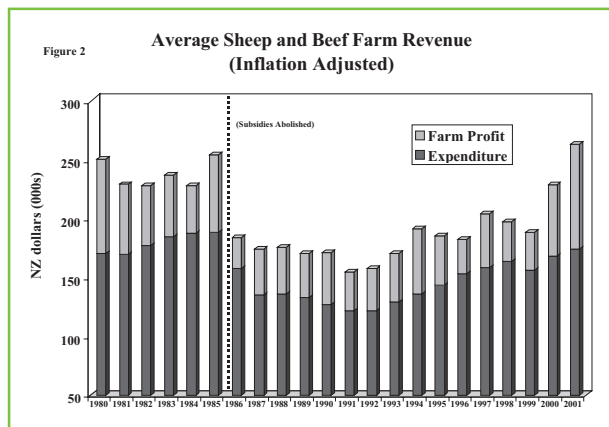
Total stock numbers in New Zealand have fallen since the removal of subsidies (as shown in figure 1). However, early predictions of massive de-stocking have been proved wrong. Since 1987, the total number of stock units on New Zealand farms has fallen by 9%. Sheep numbers are down by 29%, but cattle numbers are up by 35%. Yet despite the fall in sheep numbers, total lamb production in New Zealand has actually increased.



The diversification of land use prompted by the removal of subsidies has been beneficial for farmers and has increased the size and scope of the New Zealand agricultural sector, as new innovative products have been developed.

Real farm profits are not as high as they were under subsidies. Nonetheless, farming in New Zealand continues to offer an income high enough to provide a return on capital similar to other countries and a good standard of living. Figure 2 shows the profitability of the average sheep and beef farm in New Zealand since 1980.

Farmers are now farming better; they are much more conscious that their activities must make good business sense. No longer are they chasing subsidies, pursuing maximum production at any cost. Farmers maintain cost structures that reflect the real earning capacity of their farms. They



invest in protecting their environment, and the value of their land is based on its earning capacity in the market.

Good management of the environment is an integral part of sustainable agricultural practice by farmers. With the removal of subsidies, agricultural practice is now driven by the demands of the market and by consumers. The removal of subsidies has also broadened the base of farming to encompass activities, such as rural tourism, that brings management of the landscape and the rural environment to the fore.

The New Zealand agribusiness sector has become far more professional and innovative. As a result, it is more efficient at providing the world with top quality foodstuffs and fibres. The farm servicing sectors have also had to become more efficient, as farmers have insisted on greater value for money.

The effect of change was to highlight longstanding issues such as the use of marginal land, excessive debt levels, and managerial incompetence.

New Zealand has gained environmental benefits as well. Water quality has improved as wasteful practices fuelled by subsidies have stopped. Farmers have adopted more efficient, targeted use of farm inputs such as fertiliser. Farming of marginal land unable to sustain agricultural activity has declined and truly marginal, unstable, or infertile land went out of production and is now reverting to native bush. Subsidy-driven land management problems ended.

New Zealand farmers are now more in charge of their own destiny and less at the mercy of government price/subsidy fixing. Farmers have proved far more resilient and adaptive than was expected when subsidies were first removed.

What happened when the subsidies were removed?

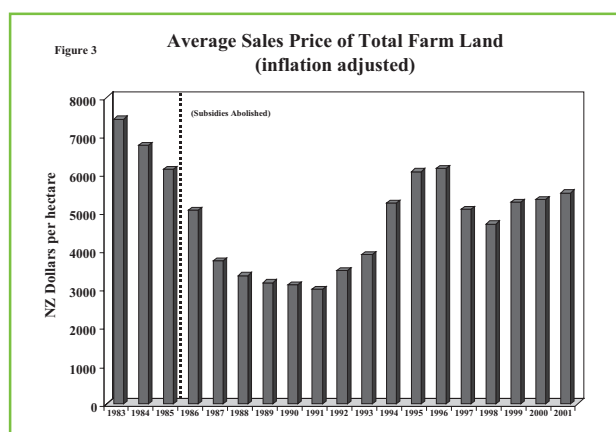
Almost 30 different production subsidies and export incentives were abolished in the New Zealand Government's November 1984 budget. The removal of assistance was the first step in a long line of market reforms designed to bring the New Zealand economy back from the brink of bankruptcy.

The New Zealand Government floated the exchange rate in early 1985. The New Zealand dollar rose dramatically following the float, further penalising farmers during this difficult period of adjustment. Like many other countries during the 1980's, New Zealand was fighting to control inflation. Interest rates climbed sharply and remained at historic highs for a number of years.

The impact on farmers did not fully bite until 1987. By then, falling commodity prices and increasing on-farm costs served to depress incomes and to exacerbate the debt problems of many farmers. The price of land, which had risen to artificially high levels because of farm subsidies, plummeted.

Many farmers felt increased pressure. However, the rapid transition to a market economy proved less daunting than expected. Early predictions of huge numbers of farmers walking off their land did not occur. Official predictions were that 8,000 farms would fail. In the end, only about 800 farms, or 1% of the total number, faced forced sales.

Fifteen years after subsidies were abolished, farmland values have more than recovered as farm profitability has been restored. As shown in figure 3, land values have returned to the levels seen during the early 1980's. Land prices are based on genuine earning capacity, allowing young people to continue entering farming.



During the transition, many farmers supplemented their incomes. Often a spouse worked in town to supplement income derived from the farm business. Some farmers diversified into farm tourism and altered their enterprise mix. But mainly farmers just reduced costs and focused on producing higher value products where profitable.

Financiers were quick to realise that there was little point in forcing farmers off their land. Throwing away the skills of farmers made no business or banking sense. Many farmers had their debts restructured and then continued farming.

From 1986 to the present day the rural population did not decline but in fact held its own, growing at the same rate as the whole population.

Farm practices quickly adjusted to the new market environment. For example, farmers had previously received fertiliser subsidies but no fencing subsidies. This resulted in wasteful and indiscriminate fertiliser application, while fencing requirements were often neglected. That all stopped when subsidies were removed.

For example, although the level of fertiliser application fell during the 1980's as subsidies were removed, stock weights remained virtually constant and have improved significantly during the 1990's.

Many of the input-costs that farmers faced have declined. Previously, those supplying farm inputs, including labour, contractors, processing and so forth, gained much of the benefit of farm subsidies. Suppliers knew that farmers, who were funded by the taxpayer, had the money to pay and they charged accordingly.

That situation no longer occurs in New Zealand. All investment decisions became subject to strict commercial and good-farming disciplines. When subsidies were removed, farm expenditure was slashed as farmers spent only on absolute essentials and as more efficient production methods were adopted. Suppliers were forced to become more competitive.

Many farm production costs are now much lower. Reforms introduced elsewhere in the economy have reduced farm costs and increased the competitiveness of the economy as a whole. Important examples included transport and labour market deregulation, and reduced import duties on farm inputs.

What was done to assist farmers through the transition?

Financial assistance from the New Zealand Government to assist farmers make the transition to an unsupported market was minimal. The Government provided a one-off “exit grant” to farmers who were leaving their farms, which was equivalent to about two-thirds of their previous annual income. In addition, farmers with extremely low incomes were entitled to social welfare income support on the same basis as unemployed or very low income New Zealanders.

The New Zealand Government supplied some funding for a trust established to provide financial advice to farmers on whether they should leave the land or stay in business. The trust employed eight advisors nation-wide, assisting farmers to decide their futures. Corporate sponsorship and Federated Farmers of New Zealand also contributed to the trust’s costs. Overall, there was no substantive government effort to soften the effect of change.

How does New Zealand compare with other countries?

New Zealand has around eighty thousand farm holdings covering approximately 15.5 million hectares. Agriculture in New Zealand is largely based upon pastoral farming. Dairy farms account for about 18% of the total number of farms in New Zealand, while sheep and beef farms account for 20%. New Zealand’s agricultural sector consists of various other activities including horticulture, forestry, cropping, and rural tourism.

New Zealand’s agricultural sector in total remains an important source of employment. The agricultural sector accounts for 11.4% of New Zealand’s total workforce.

About 90% of New Zealand’s total farming outputs are exported. Agricultural exports account for over 55% of New Zealand’s total merchandise exports. In 1999-00, New Zealand accounted for around 55% of the world’s trade in sheep meat and 31% of the world’s trade in dairy products.

New Zealand can boast the lowest level of agricultural support for industrialised countries in the OECD.

The level of assistance to agriculture in New Zealand was just 1% of the value of output in 2001. This compares to the OECD average of 31%. The remaining 1% support in New Zealand mainly refers to the provision of agricultural research funding.

How did the pre-1984 New Zealand Subsidies compare with those that now apply in other countries?

The subsidies that applied to farming before 1984 were substantial. They came about as New Zealand tried to defend itself from the oil shocks and from New Zealand’s traditional market - Britain - joining the European Economic Community. For more than twenty years up to 1984, there was a steady increase in production grants, fertiliser subsidies, taxation schemes (including incentives for land development) and concessional loans to increase livestock numbers.

The level of assistance to agriculture in New Zealand increased from 15% of output value in 1979 to 33% in 1983. After 1980, as external markets deteriorated, farm incomes began to be supported through supplementary minimum prices. By 1984, pastoral farmers in New Zealand were receiving so much assistance that overseas competitors began discussing taking action against New Zealand farm exports.

The long-term damage to agriculture in New Zealand by subsidies was significant. The subsidies restricted innovation, diversification and productivity by corrupting market signals and new ideas. This led to wasteful use of resources, with a consequently negative impact upon the environment. Many pastoral farmers were, in fact, farming for subsidies.

In the early 1980s, New Zealand produced thirty-nine million lambs for export. Yet in one year, a proportion of these had to be rendered down because there was no market for them. Now, such occurrences are inconceivable.

The removal of subsidies in New Zealand has given birth to a vibrant, diversified, and sustainable rural economy. Farmers in New Zealand are proud of their independence and are determined never again to be dependent upon government subsidies.

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