

CHAPTER ONE

BACKGROUND

Introduction

In this first chapter on land use issues we describe the main features of the market situation facing the agricultural, horticultural and forestry sectors. In doing so we run the risk of implying that these sectors warrant special consideration and treatment in view of their common dependence on land as a major input and/or their contribution to overseas earnings. This is not our perspective. Indeed our concern is 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. It is precisely the 'quick-fix' solutions aimed at patching up yesterday's perceived problems in individual activities and markets that have led to most of today's problems.

It will be noted that farm incomes are not mentioned. This is deliberate: in our view the approach which seeks to ensure 'adequate' farm incomes is one that has inhibited the adjustment process by protecting farmers from the realities of markets. This has had a major cost to the nation and, indeed, has been to the longer term disadvantage of the farming community.

The following discussion on markets in the main land use activities (i.e. primary products and forestry), together with the Appendix provided at the end of this chapter, serve to introduce the discussion in Chapter 2 about the various forms of government intervention in the land use area. Chapters 3 to 10 present a number of particular issues of current importance.

Pastoral Product Markets

a *Introduction*

Currently many of New Zealand's traditional primary products are facing a loss of, or decline in, quota assured markets, and increasing competition. It is important to note that, while in a number of cases our exports form a large proportion of international trade in the respective commodities, they comprise only a small part of total international production and consumption. The small proportion of the total 'market' that New Zealand products supply is even further reduced if, as is necessary, possible substitute products are included. In looking for solutions to perceived marketing problems, it is therefore necessary to first consider carefully the nature of each market.

b *Meat Markets*

The major development in meat markets over recent years has been the increased efficiency in the production of chicken and pork. This has resulted in large increases in internationally traded quantities of these products, especially chicken. The increase in exports of chicken from Brazil and the EEC to the Middle East has been particularly marked. Since 1976 Brazilian exports of poultry meat have risen by about 300,000 tonnes (i.e. about two thirds of the volume of total New Zealand lamb exports). The average fob price for the Brazilian product in 1983 was US\$831 per tonne, a drop of US\$372 from the 1981 price level. This is about two thirds the average fob price of New Zealand lamb. This has seriously affected the market for the red meats which New Zealand produces. New Zealand meats also face strong competition from meat in alternative forms (fresh and chilled), meat from other suppliers (domestic and imported), other foods (especially fast foods), and other competing consumer products. Consumer tastes in the western developed countries have also changed in favour of these products. The last year or so has also seen increased production, stocks, and hence subsidised exports of beef by the EEC. These exports, while not currently competing in the markets where New Zealand sells beef, have been to countries (e.g. Russia, Africa, and the Middle East) where New Zealand might expect to sell sheepmeats. There is little to suggest that these trends in respect of beef will not continue. Overall, production and export volumes of meats have increased only slightly over the last five years. Beef prices have moved ahead during this period, while lamb prices have been roughly static and mutton prices have slumped to levels which do not cover processing costs. Prior to devaluation this meant declining real prices and lower returns on the resources employed.

c *Dairy Markets*

The state of the international dairy products market has been well publicised in recent months. The position is that, with production exceeding domestic consumption in both the EEC and the United States, large stocks of dairy products have accumulated. Both the EEC and the United States have taken steps to reduce milk production, but these measures are unlikely to greatly affect stock levels for at least two years. The EEC quota system will only freeze milk production at 1983 levels, which are still in excess of consumption. The United States measures, which involve a reduction in prices paid to farmers, are likely to be more effective in actually reducing production. Without some unexpected event adversely affecting dairy production in the EEC, it is difficult to foresee international dairy product prices increasing by much over the next few years. Prior to devaluation market returns at farm gate in New Zealand, expressed in cents/kg of milkfat, were expected to fall back in 1984 to a little over the level of five years ago.

Again this means lower real prices and lower returns on resources employed. It should be noted however, that productivity improvements have in the past offset the effects of lower real prices.

d *Wool Markets*

The general levels of wool exports and prices (excluding Wool Board and government supplementation) have been roughly static over recent years although they are now expected to benefit from devaluation. Part, perhaps 25c/kg, of the increase in price between 1982/83 and 1983/84 shown in the Appendix (B—Wool) is due to the March 1983 devaluation of the New Zealand dollar. That prices have remained relatively static, especially in 1983/84, at a time when an international economic recovery occurred, shows that the dynamics of the market have changed.

e *Concluding Comment on Pastoral Production and Prices*

For all the main pastoral products it would now seem that separate factors for individual commodities and markets influence market returns, and that it is no longer the overall level of international economic activity that is the only, or the dominant, influence. Static nominal prices mean of course that, in real terms, prices for most of our traditional primary products have fallen significantly, reducing the return on investments in those areas.

Productivity improvements can of course offset this, as noted above in the case of the dairy industry. However the general price situation has significant implications for investment decisions and raises serious questions about the desirability of trying to 'pick winners' by channelling resources to particular types of activity (e.g. to pastoral production as under the LIS and LDEL schemes and by subsidies for pastoral irrigation schemes). Rather, present circumstances emphasise the need for non-discriminatory, relatively uniform, rates of assistance.

Disparities in assistance rates apart, other factors have also been at work. Additional sheepmeat volumes brought about by past assistance policies have depressed prices on the world market. It has been suggested that a 10 percent increase in New Zealand sheepmeat exports would depress world prices by approximately 4 percent (AERU Research Paper No.138 refers). If this is the case it would follow that two policy objectives have been in conflict: the objective of increasing output, and that of maximising the profitability of New Zealand's resources.

Falling real prices and difficulties of market access bring into very sharp focus the need for exporters to improve marketing performance. They also bring into question the desirability of controls that might lessen innovation and initiative in processing and export marketing. Of considerable concern here is the increasing tendency to provide marketing boards and authorities

with compulsory controls over exporters. This was discussed in Chapter 15 of Part Two of Treasury's post-election brief and is also referred to in Chapter 2 of this volume.

Horticultural Markets

a Fresh Fruit and Fresh Vegetables

The phenomenal expansion in the market for kiwifruit has been well documented. Expansion of New Zealand's export markets for most other horticultural products has been steady, although less spectacular. Returns from exports are dominated by kiwifruit and apples and will continue to be so as production increases from recent plantings. In the main, New Zealand supplies out of season produce to northern hemisphere countries. In particular, sales to countries bordering the Pacific are expanding. Our main competitors there and in Europe are Chile and South Africa. Recent improvements in storage techniques, especially the introduction of controlled atmosphere shipping containers, are expected to improve market access for many horticultural products.

b Processed Vegetables, Processed Fruit, Cereals and Seeds

New Zealand exports a large variety of non-fresh horticultural products. In value terms these exports are dominated by frozen, dried and dehydrated peas to Australia and Japan. Other important products are herbage seeds and malting barley. Many of the markets for non-fresh products are variable and rely to some extent on shortfalls in international markets due to the effects of weather.

Forestry Markets

Since annual world wood production is only 1.4 percent of world resources (mainly natural forests), and New Zealand's annual production is only 0.3 percent of total wood production, the prices we receive for our forest products are very vulnerable to harvesting decisions made elsewhere in the world.

Although the data available are limited, it appears that prices for higher grades of timber such as clearwood are likely to be firmer and less volatile than lower grades. Because of past harvesting of virgin forests, the proportion of the world's forests which are capable of producing clearwood is decreasing. This is reflected in recent price trends which show that higher quality grades of timber in the United States have risen in price relative to lower grades over the last fifteen years. Recent research work undertaken at the Forest Research Institute and elsewhere suggests that clearwood may be economically produced by the adoption of appropriate management regimes for New Zealand's forests. However, because existing forests were

planted before the new management techniques were known, only 2 percent by volume of wood produced from the current forest estate can be clearwood. By adopting more intensive management regimes, this proportion could be lifted to 15 percent on new plantings. The proportion of clearwood by value would be considerably higher.

As a consequence of past planting decisions, the total of Forest Service and private roundwood removals is expected to increase from an average of 8.6 million cubic metres per annum over the period 1981/85 to 24.1 million cubic metres per annum over the period 2001-05. Practically all of the increased output will need to be exported in one form or another. This suggests that a higher priority for market research is needed to receive maximum economic benefit from both the existing resource and future plantings. The private sector already has the incentive to choose an appropriate level of market research. It is important for management systems to be put in place which will encourage the Forest Service also to undertake the appropriate level of market research.

The Director-General of Forests is to report to the Minister of Forests shortly on overall market research needs for the sector and proposals for future research.

Macroeconomic Perspectives

The profitability of traditional agriculture has been adversely affected for a protracted period by a cost/price structure that has been out of line with that of the rest of the world. This is evidenced by our failure to achieve internal and external balance. In other words the problems of agriculture are not just those of marketing and of assistance: there are macropolicy problems as well. In particular, agriculture was less profitable than it should have been because of the over-valued real exchange rate, and hence it attracted fewer resources than it should have. In recent years substantial compensatory assistance delivered via SMPs have led to different, though also serious, distortions.

The recent devaluation will improve the profitability of the traded goods sector. It will be essential that the relative price changes are maintained: this will primarily be a matter for monetary and fiscal policy. However, how agriculture fares relative to other traded goods activities in the medium term (assuming a real exchange rate is held) will depend upon international price levels, productivity changes and other changes in the domestic economy including changes in assistance levels for primary products relative to other products. A floating exchange rate would, inter alia, promote a greater responsiveness to price movements for the significant part of New Zealand's exports which still consists of agricultural products.

APPENDIX

PRIMARY PRODUCT PRODUCTION AND PRICES

Production and Market Trends

The following tables show the main developments over recent years in terms of production, exports, and prices for the main products from the land-based industries. Longer term series for most of these parameters are available, but the patterns over the last four or five years when viewed together are sufficient to convey the broad trends in prices and production.

The figures on exports are given not because of any particular importance attaching to exports but as indications of trends in the demand for, and value of, that part of New Zealand's production traded in the international markets.

It has been traditional that agriculture's role in the New Zealand economy is expressed in export earnings because of the importance that has been attached to foreign exchange earnings. This flows from the notion of a 'balance of payments constraint'. However, the imbalance in New Zealand's external transactions is only a symptom of the internal imbalance between the traded and non-traded parts of the economy. This internal imbalance arises from a whole mixture of inter-related macroeconomic and microeconomic issues. A number of the parameters affected by those issues impact adversely on all sectors of the economy, including agriculture.

Production

Analysis of Total Meat Production

A MEAT	(000 Tonnes Bone-in Weight)				
Year Ended 30 September	1980	1981	1982	1983	1984*
Beef	479	481	495	500	443
Veal	17	17	21	19	19
Mutton	169	201	196	206	201
Lamb	391	426	429	477	453
Pigmeats	35	33	34	38	40
Total (excluding offal & other)	1090	1157	1175	1240	1156

* Estimate

Exports

Meat Exports by Volume¹

(000 Tonnes Shipping Weight)

Year Ended 30 September	1980	1981	1982	1983	1984*
Beef, veal	226	226	234	233	203
Mutton	100	91	111	95	96
Lamb	350	379	351	428	420
Other	58	73	71	72	69
Total	733	769	767	827	788

¹ These figures comprise a composite of boned and carcass meat and therefore are not strictly comparable with those in the previous table on production.

* Estimate

Export Prices

Estimated Average Market Realisation

at Schedule for Benchmark grades (c/kg)

Year to 30 September	1980	1981	1982	1983	1984
Lamb (PM)	99	120	104	77	NA
Mutton (MLI)	47	56	21	5	
Beef (M Cow)	94	89	100	132	
Beef PI Steer	116	123	132	160	
Beef Bull	126	117	129	152	

B WOOL

Year Ended 30 June	1980	1981	1982	1983	1984
Production—(Greasy Equivalent) (000t)	357	381	363	371	363
Exports—Greasy Basis (000t)	349	338	343	385	367
Actual Average Price at Auction (before Board and Government Supplementation) (c/kg)	265	248	256	256	296*

* Provisional

C DAIRY

<i>Year Ended 30 June</i>	1980	1981	1982	1983	1984
Production Milkfat (000t) (Year to 31 May) ..	291	282	282	290	323
Exports Total (\$m) ..	811	1174	1441	1564	1495*
Exports by Volume (000t)					
— Milk fats					
• Butter	178	151	167	193	
• AMF	51	48	31	27	
• Ghee	2	3	2	3	
— Cheese	69	81	81	75	
— Condensed and evapo- rated milk	1	2	1	1	
— Wholemilk and infant food	70	75	101	100	
— Skimmilk powder ..	174	163	135	144	
— Buttermilk powder ..	21	17	17	17	
— Casein and caseinates ..	68	50	55	55	
— Lactose	9	7	10	10	
Market Return at Farm Gate c/kg milkfat	229	265	330	400	345

* Estimate

D KIWIFRUIT —(Fresh Fruit)

<i>Year Ended 30 June</i>	1980	1981	1982	1983*
Total Production (tonnes) ..	17,975	28,806	25,353	
Volume Exports—fresh (tonnes)	16,029	17,895	20,221	29,357
Value Exports—fresh (\$m) (fob)	34.5	41.8	52.7	86.8
Export Return (\$/tonne) ..	2,150	2,340	2,610	2,960

* Provisional

E APPLES AND PEARS

<i>Year Ended 30 June</i>	1980	1981	1982	1983*
Total Production (000t) ..	229	261	196	201
Volume Export—fresh (000t)	94	102	99	94
Value Export—fresh (\$m) (fob)	36.6	48.6	53.4	60.7
Export Return (\$/tonne) ..	390	480	540	650

* Provisional

F CEREALS

<i>Year to 30 June</i>	1980	1981	1982	1983
Production: (000 tonnes)				
— Wheat	306	326	292	324
— Oats	62	45	61	50
— Barley	228	271	356	368
— Maize	156	152	170	176
Exports (cereals and cereal products) (\$m fob) ..	21.2	20.3	18.4	28.7*

* Provisional

G OTHER HORTICULTURE —(Exports)

<i>Year to 30 June</i>	1980	1981	1982	1983*
Fruit and Fruit Products (Other than Apples, Pears and Kiwifruit) (\$m fob) ..	11.5	15.2	28.5	36.2
Vegetables, Seeds and Ornamental Flowers (\$m fob) ..	64.4	82.3	104.4	110.2

* Provisional

H TERMS OF EXCHANGE AT FARM GATE

<i>Year to 30 June</i>	1980	1981	1982	1983	1984*
Dairy	902	916	971	961	912
Sheep and Beef	965	846	893	825	800

* Estimate

I AGRICULTURE'S PART IN THE NEW ZEALAND ECONOMY

<i>Year Ended 31 March</i>	<i>Gross Agricultural Production</i>				
	1980	1981	1982	1983	1984*
Total Output (\$m) ..	4,354	4,549	5,013	5,189	5,556
Less Intermediate Consumption (\$m)	2,215	2,388	2,748	2,997	3,130
Agriculture's Contribution to GDP (\$m)	2,139	2,161	2,265	2,192	2,426
Gross Domestic Product (\$m)	21,092	24,340	29,117	32,092	34,000
Agriculture as a % of GDP	10.1	8.9	7.8	6.8	7.1

* Estimate

Gross Agricultural Production by Product Group

(Gross Output in \$ millions)

<i>Year Ended 31 March</i>	<i>1980</i>	<i>1981</i>	<i>1982*</i>	<i>1983**</i>
Wool	823	811	803	750
Sheep and Lambs	477	560	605	591
Cattle	630	545	564	720
Dairy Products	691	850	1022	1183
Pigs	64	65	80	86
Poultry and Eggs	97	110	124	136
Crops and Seeds	168	221	279	265
Fruit and Nuts	124	154	183	206
Vegetables	153	183	227	226
Other Horticulture	79	104	125	146
Other Farming	33	50	58	76
Agriculture Services	223	261	295	275
Value of Livestock Change	200	100	93	-55
Sales of Live Animals	592	536	557	585
Total Output	4354	4549	5013	5189

* Provisional

** Estimate