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Global Forum on Competition

COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from New Zealand

-- Session I --

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- New Zealand --

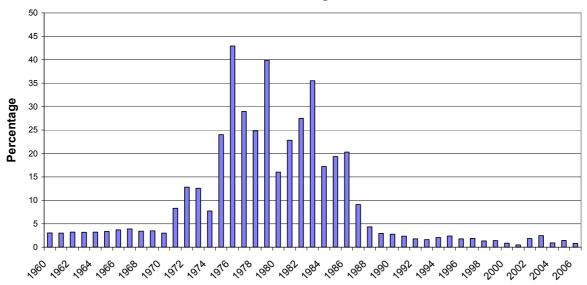
- 1. As a small economy that is geographically distant from major markets and heavily dependent on agriculture, New Zealand has always been affected by price movements in commodities that are essential inputs into the agricultural production process, as well as price movements in agricultural commodities. Until the mid 1980s, the government provided support to the agricultural sector through subsidies, largely as compensation for the high tariffs on inputs that farmers faced. This support was rapidly removed during the period in 1984-1990 as part of a broader economy wide liberalisation process. As a consequence New Zealand's agricultural sector was exposed to international competition almost overnight. Since that time there has been an on-going process of reform and adjustment, which has resulted in a more diversified sector, increased innovation and improved productivity. Today the sector is more exposed to external shocks and price volatility but the reforms have resulted in a sector that is better able to manage risk including price volatility. New Zealand's floating exchange rate also enables the New Zealand dollar to adjust to changes in (particularly agricultural) commodity prices, given the New Zealand economy's dependence on agriculture, and so often mitigates against price volatility. This paper provides a brief summary of some of New Zealand's experiences.
- 2. New Zealand has a long history of trade in agricultural products. The first exports were consignments of cheese that were shipped to Australia in the 1840's. The advent of refrigerated transport at the end of the nineteenth century enabled New Zealand to sell beef and sheep in offshore markets. Following the Second World War, New Zealand had guaranteed access to the British market and good terms of trade. New Zealand's agriculture producers were sheltered from international markets and competition, and the country developed a high standard of living under favourable conditions.
- 3. In 1973 Britain joined the European Economic Community limiting market access for New Zealand exporters and consequently agricultural products became exposed to other markets and returns were more volatile.
- 4. Over the same period, government protection of the manufacturing sector with import quotas and tariffs had resulted in a high cost structure for agriculture. By 1984, the level of government support to the sector was around 30 percent of total agricultural sales. Farmers were making investment decisions not based on movements in international markets and consumer demand but on the level of government support. In other words, government support had resulted in higher, but inefficient, production (with inefficient use of subsidised products, services and land). It had reduced the competitiveness of New Zealand farmers in international markets and concentrated the risk of poor farming decisions solely on the government.¹
- 5. The 1984 reforms were spurred by widespread dissatisfaction with the government's economic management and intervention. The fiscal deficit was 9% of GDP, government debt was at 40% and the

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Evans, L, Structural Reform: The Dairy Industry in New Zealand, APEC Conference on High Level Structural Reform, April 2004.

consumer price index was at almost 20%. New Zealand could no longer afford to support inefficient sectors, including the agricultural sector. Almost overnight, sweeping changes were made across the economy. These included floating the exchange rate and ensuring that monetary policy targeted inflation, eliminating government support including subsidies and significantly reducing tariffs. A number of sectors, including agriculture, were exposed to international competition.

Producer Support Estimate New Zealand Agriculture



Source: New Zealand Ministry of Agriculture

- 6. The reforms had a significant effect on farmers. Land prices and profits dropped substantially, costs rose and incomes fell. Nevertheless, the reforms were supported because they were being undertaken across the entire economy and overtime it was expected that the costs of inputs into the production process, such as labour and manufactured items, would decrease and enable agricultural products to once again become internationally competitive.
- 7. The reforms continued into the 1990s because although subsidies had been removed, producer boards remained. One of the main functions of a producer board was to market products in internationally. Until that time greater scale and coordination in production and marketing was seen as advantageous so producer boards also limited the rights of companies to export on their own account. However, the small size of the domestic market and the single desk export policy made it difficult for any new entrant to obtain the production efficiencies needed to be competitive. Furthermore, in some sectors the producer board structure led to overproduction because farmers received a bundled price and as a result were not able to distinguish between the cost of producing the raw product and the return on processing plant and equipment. Although the benefit associated with producer boards were considered on a case by case basis, for many agricultural products they inhibited competition and innovation.
- 8. Today production decisions are driven by domestic and overseas markets, not by government. As a result, sheep numbers have fallen from 70 million to 32 million as farmers have diversified and expanded into dairy, deer, goat, horticulture and forestry. Large farms still tend to be specialised to take advantage of the scale and scope. Small farms are more likely to produce a range of products to protect themselves from external shocks.

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- 9. Currently, the government provides limited assistance but only for:
 - general spending only for research, sanitary and phyto-sanitary measures and pest/disease control; and
 - direct support only for large scale emergencies, climatic events and erosion control
- 10. To maintain its global competitiveness, New Zealand has continued to consider ways that it can improve productivity in the agricultural sector. These days such innovations are generally spurred by the private sector.
- 11. One such example is the recent launch of a dairy futures and options market by the NZ Stock Exchange. Dairy futures and options are designed to manage risk and smooth out volatility, creating price certainty, transparency and a forward view of market sentiment. It is anticipated that by trading on the futures and options market, dairy participants create price certainty. The market was established in 2010 so it is still developing, however, all signs point towards it being a success.
- 12. The New Zealand experience with the removal of government support has demonstrated that farming in a de-regulated environment is feasible, and yields a portfolio of activities associated with better resource allocation; within the sector and among sectors. Exposing the sector to international competition has also meant that it has had to innovate and adapt in order to maintain its international competitiveness. Consequently the sector is better able to manage risk, including that associated with price volatility in commodity markets.