INFOMETRICS

Global Dairy Company - A Trojan Horse for Privilege

farming - 14 February 2001 – By Gareth Morgan

Last week I considered the three major reasons promoted by the dairy industry for why its protection from competition in exporting should be prolonged. This week it's to consideration of the major arguments against effective legislative defence of that monopoly that are in focus.

There are two main arguments. Firstly, one that was well enunciated in Neil Quigley's consideration of the GDC proposal - his view that the Commerce Commission would likely still consider the GDC proposal falling short of delivering acceptable economic efficiency. This arises because the vast majority of the efficiency detriments from the industry's 1999 MergeCo proposal arose not because of the impact of the merger on domestic consumers, but as a result of lack of effective competition for the new entity in exporting New Zealand dairy products. The GDC proposal, in Quigley's view, has not addressed this major Commerce Commission concern. Little doubt then why the industry wants the Commerce Commission sidelined - it's analogous to asking for a trial but no judge.

Effective competition for farmers milk production is vital if the amount required and the price paid for it are going to be optimised in line with the economics of downstream uses. To retain a dominant purchaser and ensure other parties have extremely limited scope to compete for the purchase of that supply (not enabling them to tender for European quota for instance), enshrines GDC as the dominant player and virtually guarantees the size of the dairy farming business will remain unrelated to the economic value of milk produced.

Of course this is the current situation anyway and we know why - milksolid kgs are little more than

the currency farmers use to access the dividends from the downstream profits of the processing and marketing activities. Which brings me to the second, and I think most damming criticism of the GDC proposition.

There is explicit rejection of the unbundling of farmer returns into those for raw milk and those for their shareholding in off-farm activities. Indeed the industry has put up an extremely weak administrative method of how it's going to enable farmers to come and go from the industry - the so-called "fair value" assessment of downstream assets. Not only will this be open to rort and manipulation in traditional dairy industry style, it ensures that industry politics rather than conventional economics will continue to drive this industry.

There must be a free market of trading of GDC shares - even if some farmer Co-op still maintains the majority ownership. Only this will enable all of; (a) an effective way to establish fair value (b) a means for new equity capital to be available for the downstream activities that desperately need it right now (c) the price of land to fall to level that reflects its true economic value

The main strands of the industry's argument for GDC, all dismissed in this column last week are;

(1) Only an effective export monopoly can deliver economies of scale. The reality that margins are greater in the areas where economies of scale are less relevant, is ignored.

(2) Foreign ownership must be countered by legislative protection. If this is in the national interest why don't we prohibit foreign ownership of any of our productive assets and correspondingly prevent Kiwis from investing abroad? This is Stage I Economics really.

(3) The industry demands no unbundling, no market-set valuation of farms and factories, and no Commerce Commission scrutiny. This has to be the ultimate arrogance of a molly-cuddled sector long overdue to be put on a level playing field with other industries and consumers. It's a demand for government to sanction the monopoly being

extended to a dictatorship over all matters dairy.

Taken together with the two main arguments above on why the industry should be fully deregulated, it is clear government has an important decision here. Either it sanctions the ongoing misallocation of New Zealand's investment resources and harms those New Zealand businesses that would be competitors for the capital dairy farmers currently usurp, or it enables capital to flow to the endeavours of greatest economic benefit. Either it decides New Zealand consumers of dairy products should not get product at the best quality and price or it accepts that consumer sovereignty matters.

With a socialist government ensconced it would be a brave person to expect the deep-seated protectionism of this industry to take a back seat to issues of economic efficiency. There will flow an inevitable outcome from that choice however. The business of milking cows will continue to expand rapidly, the demand for farmland from it pushing those prices ever higher - and the income yields lower. Other land uses and other businesses in general will be crowded out by the dairy monopoly's capture of domestic investment resources. Local consumers will be denied the choice and price of dairy-based products that deregulation would enable.

In the end what is threatened is a Japan-type situation. A favoured industry expands under the protective legislative umbrella it's afforded until eventually the true economics of the business are revealed - its ongoing profits dependent upon ever-increasing burden of capital being diverted from other sectors of the economy. The government of the day then is faced with the unenviable task of the slaughtering the "sacred cow", not just to the chagrin of those invested in the industry but to the huge cost of all New Zealanders who have sanctioned the transfer of investment resources from other sectors and foregone the income accordingly.

Infometrics estimates that currently dairy farmland prices are around 30% higher than they would be under unbundling and deregulation - and that gap is not closing. That is a speculative bubble in anyone's language. All that is at issue is how long it takes the government to end, what has become an

investment distortion of national significance.

You are invited to forward any comments, requests for elaboration to Gareth Morgan. If you have any design related comments about this page please email webmaster@infometrics.co.nz.