

‘A Load of Bull from New Zealand’  
or  
‘Ruminations over the changing international landscape  
for dairying’.

Hon John Luxton.  
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Jack Welch the former CEO of General Electric once said about change that ‘Anytime there is change there is opportunity. So it is paramount that an organisation gets energised rather than paralysed’. We live in a time of continual change and hence one might suggest continual opportunity.

I grew up on a dairy farm so I have been observing this industry for over 50 years and one of the most exciting things about it has been that it has continued to change and to remain internationally competitive in both New Zealand and Australia. My late wife and I purchased our first property in 1971 on the back of New Zealand’s traditional market the United Kingdom joining the European Union or EEC as it was then. So for 35 years I have been a player in this industry and it has been an exciting 35 years.

The greatest advantage that we have had to my mind has been that we have had to be internationally competitive. We have had to ride international commodity cycles, exchange rate cycles, and restrictive marketing regulation, so often limiting our returns. We were in business and had to continue to change to survive as we did not have a Government ready and able to pump in subsidies. With 95 percent of New Zealand’s dairy production going into processing for export onto the world market there was little choice.

In 1984 we thought CER with Australia would open up a larger domestic market, but it took 20 years for your market to open up in dairying. New Zealand’s competitive dairy industry was one of the largest obstacles to the CER agreement. However there is now largely a free market between the two countries dairy industries today although you have some advantage with a larger domestic market and lower cost supplementary feeds and land prices. I am sure that your industry is the better for now being internationally competitive even though 50 percent of your market is domestic.

Your industry has changed dramatically from the dairy industry I saw around Coff’s Harbour in 1974 after being the recipient of a dairy competition prize trip to look at Australian dairying at that time. So too, has New Zealand dairying. In the 1970’s, 300 cows was a large herd in New Zealand and today our average herd size is around 315 cows.

So we are both competitive today because we have to be and also because the largest dairy industries in the world have been protected by their Governments. Spare a thought for the European, US or Japanese dairyman, who has Governments still prop up their payout for milk. These Governments prevent their farmers from operating at world market prices with a variety of mechanisms. Tariffs on imported dairy products often in excess of 100 percent mean that their cost of production will continue to be twice ours. Direct subsidies on farm inputs mean their farmers are often over capitalised.

To top it off the EU and the US Governments stand in the market and guarantee to purchase surplus's and then dump them into the market at an artificially low price or use them as food aid in markets which other wise may have bought on the open world market. This actually has often lowered the price received by New Zealand and Australian dairy farmers below the world price.

Unfair as this may seem it has actually been character building stuff on farm, as we have had no alternative but to cut our cost structures to survive and as a result we have continued to become even more internationally competitive. We have gone through a few of these periods over the last thirty five years and will no doubt do so again in the future.

In our good payout years we often add unnecessary cost which we then remove in lower income years. Mind you higher payouts also allow a catch up in deferred maintenance. I see no change to this regular challenge of change in our industry.

In fact back to Jack Welch's comment that change brings opportunity. We live in a time of great opportunity and it is great to see younger farmers taking up the opportunities which dairying presents.

So what about the pressures for change going forward? It would be easy to look only at the positive influences such as; progress with WTO, growing world GDP and with it demand for dairy based products, higher oil prices giving open dairy markets greater purchasing power to buy our production and lower currency exchange rates against the US dollar. All of these are creating new market opportunity for dairying in Australia and New Zealand. These add to income but do not necessarily increase productivity or our competitiveness.

So I would like to concentrate on some of the challenges we face on farm.

#### **International competition.**

1. This comes from substitute oil and protein ingredients. The oilseed and particularly the palm oil and soya industries have increased in their sophistication over recent times and with relatively high dairy prices they become substitute products in our markets. World oilseed production has increased by nearly 25 percent since 2000. GM Soya being the main contributor and Brazil is now the largest producer.

2. Other low cost dairy producers. South America and some parts of China currently produce milk at a lower production cost than either Australia or New Zealand. This is somewhat dependent upon currency exchange rate movements.

3. Increasing milk production in the US. Over the last 5 years the number of 2000 plus dairy farms has doubled to over 500. Those 500 farms now produce as much milk according to the USDA as the 60,000 smallest US dairy farms with less than 100 cows. This is also more milk than the total milk produced in New Zealand and one and a half times Australian milk production from just 500 farms!

In the last year US production has increased by around 3 percent, which is about the equivalent of 10 percent of the combined production of Australia and New Zealand. While the US cost of production is still generally higher than ours there is a warning here as their production costs are reducing. This has also led to some softening of world dairy prices.

Production in Exporting Countries, 2004 - 2005				
Region	Share of global exports (%) (1)	Milk production	Change on previous year	
EU 15	31	114.4	-1.0	
NZ	30	14.0	-4.0 (2)	
Australia	12	10.3	-0.9	
USA	5	77.5	+0.3	
Combined	78	216.2	-0.7	

(1) 2003 data; (2) Rabobank estimate

Source: Dairy Australia, USDA, Eurostat, Rabobank

### Domestic Competition

Other land uses has become a significant internal competitor for our dairy industries. Urban development takes a considerable area of prime dairy land out of dairying around our cities.

Horticulture has taken some key areas out of the New Zealand dairy industry, particularly into kiwifruit and avocados.

Higher sheep farming returns dramatically slowed down dairy conversions in New Zealand over the last five years.

The high cost of dairy cooperative shares is also a limiting factor to increasing production.

### Productivity

Increasing our industry productivity is the best way to counter such competition. Both, Dairy Australia and Dairy Insight / Dexcel in New Zealand see increasing productivity as a key to our respective ongoing competitiveness. Over time commodities tend to reduce in cost at about 2 percent per year, this together with inflation of around 2 percent ensure a need to increase productivity just to keep our current position as world dairy leaders.

Many of our most notable innovations in productivity have been initiated, promoted and rapidly adopted by farmers. There are plenty of examples, such as the herringbone and rotary milking systems, tail painting, zinc to prevent facial eczema, etc. Others have come from industry research with pasture grazing systems and genetic gain in pasture and animals. Other innovation has come from the commercial sector with milking machines, irrigation, feed-out systems and electric fences.

In Australia you have had your Dairy Moving Forward initiative aimed at increasing productivity in your industry. In New Zealand, Dairy Insight / Dexcel have worked to put together a Strategic Framework around increasing on farm productivity and ensuring that our industry keeps ahead of societal and market demands. In other words we have identified the areas where there is potential to increase productivity and where productivity might be threatened in future. We have also identified areas where new capability is needed and where Dairy Industry levy money should be spent particularly in the areas of Research, Development and Extension.

**On farm productivity** can obviously be improved in three key areas, feeding, animals and farming systems. Research, development and extension are all very important in making progress here.

1. **Farm systems** have the largest potential to increase productivity and they have brought about significant increases in productivity over recent times. The US changes illustrate this with larger generally more efficient farming systems. Milking parlour design and layout, grazing management and how the various inputs to dairy combine is a key to productivity improvement. There are also large variations between our top farmer's productivity and those further down the scale.

I am unaware of any farmer who does not wish to see their farming enterprise be sustainable over time and we need to ensure that farmers have the tools to ensure sustainable farming practices.

2. **Feed** is another key area to improve productivity. The old adage, if you can grow two blades of grass where you previously only grew one, then productivity will increase accordingly. New endophyte ryegrasses, supplementary feeds and the responses to them, the use of grazing off the milking platform and the potential for GM of dairy forage are all ways to improve feed productivity.

3. **Animals.** The great work over the last 50 years in bull selection inside New Zealand and internationally has continued to improve the dairy genetics and will continue to do so. It is good to see crossbred animals now considered mainstream in our dairy industry. But improving animal production through selective breeding, and even GM over time will increase productivity.

### **The farm business**

The complexity of our farming businesses brings new challenges which need to be met.

1. **Human resources (labour).** One of the challenges in societies with near full employment is retaining good staff on farm. We have to meet the market. Attracting top skills to our sector is vital for our long term competitiveness. Providing career paths, traditionally to farm ownership, has become more challenging.

2. **Financial.** Farm business structures are changing with larger farms and multiple ownership structures. Equity partnerships are eroding traditional sharemilker arrangements. Corporate farms are appearing and long term manager roles are more important. Larger farms employ their own accountants and management structures, something previously very rare in our dairy industry.

3. **Compliance and infrastructure.** Compliance with increasing regulation in areas such as quality, safety and health at local and central government can become a nightmare. Permission must be sought from butt covering or risk averse bureaucrats who ensure farms abide by often ridiculous rules. Building permits, road management plans, resource consents, and licences and so on as the political process continues to bind us up in more and more red tape. All this has a cost particularly if not done properly. Unfortunately local and central government has the coercive power of taxation and continue to increase their take at about twice the rate of inflation. Infrastructure of broadband internet connections, continuous electricity supply and adequate roads also challenge our industry in some areas.

## **Societal demands**

With a smaller proportion of our societies now with links to the land, new challenges have arisen. This combined with scepticism about the role of science and the credibility of public office creates a different environment to that of a generation ago.

Special interest lobby groups grab headlines with smart public relations campaigns and before you know it public perception becomes the reality, even when science might not back up the assertions of such vocal minorities.

Classic illustrations would be the response world wide to BSE. With about 30 human deaths world wide there was huge trade disruption and cost both public and private. Ten's of thousands die each year from preventable influenza without comment.

The green movement has actually prevented our ability to reduce chemical and fertiliser use with their strident opposition to genetically modified crops in particular. Genetic modification has been around for over 20 years without a recorded death. GM crops have been grown commercially now for over ten years. About 100 million hectares (or about four times the total area of New Zealand) will be planted world wide this year and their use is expanding much faster in developing countries than developed countries outside of the US. Campaigns by small single issue pressure groups in our societies have currently closed off one of the most potent tools to increase our productivity.

In New Zealand the fish and game lobby group which is generally in the business of killing animals has successfully campaigned against water use in the dairy industry and against trout farming in New Zealand.

### **1. The environment**

With intensification of land use, the impact on the environment has become a significant issue that is being addressed and which will continue to be a challenge in future. Fish and Game have been at work lobbying against our dairy industry here also.

I believe that there is much we can learn in this area from Europe and the US dairy industries here. Environment issues include water, effluent, nitrogen leaching, rural odours and the like. For some farming near urban locations there are some real challenges to keep multiple neighbours happy, onside and not complaining to the powers that be.

### **2. Animal Welfare**

The lack of farm knowledge in our cities also sees pressure through the political process on issues of animal welfare. No caged hens for egg production, no farrowing crates to prevent sows squashing their litter. Likewise close neighbours often ring the SPCA or the Ministry of Agriculture before they call the farmer when a cow is laying spread out in the sun. This is not to say that farmers are not aware of the importance of their animal's welfare, but sometimes it is wise to keep the bobby calf collection and dead cow collection out of the public eye as much as is possible.

Tourist and urban dwellers are our customers and the customer is 'always right' or at least they have choices. What's more if we are in any way seen as uncaring about animal welfare or the environment, then this can be used to further restrict or prevent market access.

**3. Biosecurity.** With increasing international travel and trade come increased risks to our business from imported disease or pests. Clover root weevil has done considerable damage to the growth of clover in our New Zealand pastures over the last decade, once again highlighting how vulnerable we both are in this area. Foot and Mouth disease outbreak in the UK also showed the considerable cost of such an incursion into a dairy industry. We must remain vigilant and contain pests which are there.

**4. Influencing the policy makers.** Being able to influence policy makers early in the process of making the rules on likely outcomes of their interventions is also important if we as farmers are to continue to have viable businesses. Others as I have indicated have been very successful in getting Government to change the rules to their advantage and this need to be countered where possible by the farmer lobby.

Allowing GM pastures before we are left behind by our competitors in the US or South America is one such area. Governments still acknowledge that in both New Zealand and in Australia our dairy industries are significant employers and export industries. We need to continue to reinforce that when some of the more crackpot lobby groups get their ear on regular occasions.

New Zealand and Australia face similar challenges on farm in our dairy industries to remain acceptable to the societies in which we live and to ensure that we remain internationally competitive or better than our competitors in production costs and in quality.

### **Manufacturing**

Our manufacturing sectors are also important in providing product at internationally competitive prices. Both countries are emerging from monopoly marketing rules. I suggest that monopolies may not be the best form of enterprise ownership over the longer period as they can add to costs at the expense of farmer's returns. Competition is vital to ensure performance, it is what makes us re-evaluate, innovate and improve performance.

I was involved in the abolition of the single seller right of the New Zealand Dairy Board in the 1990's, much to ire of some farmer politicians and some industry management. Their position was nice and cosy, no bench marks, no competition. The two major players were busy breaking the rules in any case.

Currently the average dairy farmer supplying our cooperative dairy companies has about 20 percent or more of their capital invested off farm in cooperative processing and distribution. I wonder whether this is the best thing for farmers. Some suggest that too little investment is going into growing the value add component of the business as farmers get paid out 100 percent of their returns.

The New Zealand dairy industry has been talking about increasing the added value part of their business for over twenty years with little if any increase in the proportion of product going into really adding extra value to our payouts. Farmer politicians become over cautious in making changes which a commercial board would generally just get on and do. They become like governments, rather risk averse. As an ex politician I know that politics often precludes a long term view and incentivises expediency.

New Zealand has seen some small changes since deregulation largely into a Fonterra monopoly. Just one new proprietary dairy company, Open Country Cheese Co Ltd has attracted sufficient capital from investors to now process

about 2 percent of the New Zealand milk supply. Even so Fonterra is on record as saying that competition has arrived! Real competition would see at least 20 percent of the milk being processed by a competitor.

Any new milk processor has to be able to pay farmers a higher payout than Fonterra if it is to survive without being restructured. An interesting case study might one day be made of how Fonterra and Graeme Hart's Dairy Holdings started with similar sized local market businesses four years ago and how Hart was able to double the value of his Dairy Foods when selling/swapping it back to Fonterra last year. Graeme Hart is now in the process of reinventing the swapped business which was a part of Fonterra.

This example dramatically shows the difficulty of change in our cooperative structure and the ability of the private sector to change far more rapidly. There are examples of companies listing a part of their business and really beginning to grow their added value globally. The Kerry Dairies from Ireland is a classic case of a former cooperative dairy company really adding shareholder wealth. The Bunge Company in the oilseed sector is another.

In New Zealand one of the strongest competitors in our meat processing industry AFFCO was formerly a farmer cooperative. At the end of the day if there is competition for ones milk or meat then one is more likely in my view to see performance in our processors than if we maintain a monopoly position in the name of so called farmer control.

Farmers are no better in my view at processing milk or meat than they are in distributing it or marketing it and they have not sought to own the shipping companies or the supermarket chains. What we are good at is behind the farm gate.

The rationale behind farmer ownership of processing arose in the late 1800's through to the 1930's when information from the market often took months to arrive. We are in a new century now and while I am proud of what Fonterra and Tatua have achieved I certainly do not see continuing complete cooperative ownership as the sacred cow that so many other farmers appear to.

I have probably stuck my head out sufficiently to once again to invite political rebuke from my farmer friends and colleagues. Sometimes one has to suggest that 'The emperor has no clothes' but then 'sacred cows make the best burgers'.

In concluding these ruminations let me say that we must continue to change and that that change is bringing opportunities like never before in our respective dairy industries. We are internationally competitive and we must ensure that we keep that way by taking up the opportunities that we have ahead of us.

John Luxton  
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