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Dialogue: Going Global for fresh start

ALEX SUNDAKOV argues that the proposal to set up the Global Dairy Co allows farmers to 'vote with their feet.'

Over the past few weeks, Tony Baldwin, leader of the previous Government's producer board project team, published a series of newspaper articles arguing that the Global Dairy Co proposal is a bad idea.

He appealed to farmers to reject the proposal, and to the Government to subject it to Commerce Commission scrutiny.

In his view, GlobalCo will be inefficient because it will remain a co-operative, will not face domestic competition and will lock farmer wealth in an "all eggs in one basket" business. Consumers will suffer because it will be a monopoly.

GlobalCo is, indeed, a complex commercial and policy proposition. There is no doubt that both farmer shareholders and the Government have much to think about.

However, their thinking will not be helped by the misconceptions contained in Mr Baldwin's articles. I will try to clear some confusion.

The first misconception, which underpins much of Mr Baldwin's argument, is that the cooperative form proposed for GlobalCo is inherently inefficient. He argues that farmers should cast off the "security blanket" of a cooperative in return for the choice and incentives provided by the standard corporate form.

Under the standard corporate (investor owned) form, shareholding and supply are not linked. Shares are traded and farmers can choose whether to invest in dairy processing or elsewhere.

Where Mr Baldwin is wrong, however, is that there is simply no evidence from around the world that the corporate form of organisation tends to perform better in the dairy industry than the cooperative form. There are some good cooperatives and some bad cooperatives, just as there are good and bad investor-owned companies.

But, if you believe that over time only the most efficient form of organisation will survive competition, you would have to pause before the fact that the co-operative remains the dominant form in the dairy sector in all developed economies: US, EU, Australia and New Zealand.

In fact, overseas research suggests there are some very good reasons for the continued dominance of the cooperative form in the dairy sector. Cooperatives are, in essence, an extension of the farm and must be viewed in this light.

The objectives of a cooperative milk processor are thus different from those of an investor-owned milk processing firm. In particular, investors in a corporate firm are concerned with maximising the return on their investment in the processing business alone.

Investors in a cooperative (i.e. its farmer members), on the other hand seek to maximise joint returns from both the farm and the firm. Given the particular risks of the dairy industry - milk is highly perishable and must be collected daily - this joint focus appears to work best.

Of course, Mr Baldwin is right in one respect: the survival of the cooperative form should be assured by its performance, not by legal barriers to alternative structures. In this respect, however, it is difficult to see how GlobalCo can be seen as anything but a step forward.

First, the proposal ensures that on exit from GlobalCo, farmers will get the "fair value" of their shares as determined by an independent valuer. This significantly improves their ability to "vote with their feet."

Yes, any valuation is, at best, an approximation of the possible market price of the shares. However, it is clearly an improvement on the present nominal share standard - where farmers get out the nominal amount they put in, without any regard for the increase in the value of the company.

The second aspect of the proposal, which enhances farmers' ability to "vote with their feet," is the removal of the single-desk monopoly right to export and the divestment of the NZ Dairy Foods. NZ Dairy Foods will initially depend on GlobalCo for its milk, but it will have a strong incentive to seek its own supply base.

Hence, it will provide an exit option for some farmers. More importantly, however, the removal of the single-desk restriction for the first time gives foreign processors an incentive to set up in New Zealand and gives local firms opportunity for growth through access to exporting in their own right.

Previously, alternative New Zealand processors and foreigners who came here were essentially restricted to our very small domestic market - not much of a prize to induce investment. Under the GlobalCo proposal, they will be able to set up in New Zealand for export.

The removal of the single desk is very important for extracting greater efficiency from the New Zealand dairy sector. Apart from farmers' own interests, it is also critical to protect New Zealand from a "one-way bet" of having to rely on the success of a single organisation for this very important export sector.

And herein lies the second key misconception of Mr Baldwin's argument. He invites us to think of the merger part of the proposal and the single desk part as two separate events.

His key message is: it would be best if the single desk went and the merger did not proceed. I happen to disagree with him on this point, but in fact, it is not relevant who is right.

The reality is that the two elements are intertwined. Dairy farmers have strongly signalled that they would not accept deregulation without something like GlobalCo, while both present and previous Governments have equally strongly indicated that they will not impose deregulation without farmer support.

GlobalCo - even if it does not fit some idealised vision of radical reform - offers a realistic path for progress in the dairy sector.

And this takes us to Mr Baldwin's last main argument - that the proposal should be subject to the Commerce Commission scrutiny to protect both farmers and consumers.

The problem with this argument is that the Commerce Act is designed to scrutinise business transactions.

It is not designed to consider complex regulatory changes, where a business transaction - the merger between Kiwi and NZ Dairy Group - is only one part of the package.

In fact, the normal process for such regulatory reform - for example, as happened in the electricity industry - is for the Government and Parliament to take responsibility rather than to pass it to the Commerce Commission. This is completely sensible.

In conclusion, I come to a point of agreement with Mr Baldwin: farmers should be very concerned to ensure that Global Co is a well-run cooperative.

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