Going forward, not backwards

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Speech by Don Nicolson, President of Federated Farmers, to the NZ Shareholders Association annual general meeting, Novotel Hotel Greenlane, Auckland.

It is my very warm pleasure to be here today to address the New Zealand Shareholders Association.

I hope I?m returning the favour to your Chairman, Bruce Sheppard, who kindly spoke at my National Conference last month in the home of the Ranfurly Shield, Invercargill. I wish him and your incoming Chairman all the very best. The Association does a great job on behalf of all shareholders.

Since I don?t wish to be part of the ?not growing trees for wood? business or the ?not farming sheep, sheep industry?, my presentation today will be in three parts.

I?ll start by sharing with you the balance sheet of New Zealand farming. Second, I wish to speak on the emissions trading scheme to dispel a few myths before focusing on some ideas, I feel, may help our struggling capital markets.

Yet before I start, I wish to share you with an actual letter that was sent last year to David Milliband, the former British Secretary State for Environment, Food and Rural Affairs and now the front runner to become Labour leader.

My friend, who is in farming at the moment, recently received a cheque for £3,000 from the Rural Payments Agency for not rearing pigs. I would now like to join the "not rearing pigs" business.

In your opinion, what is the best kind of farm not to rear pigs on and which is the best breed of pigs not to rear? I want to be sure I approach this endeavour in keeping with all Government policies, as dictated by the EU under the Common Agricultural Policy.

I would prefer not to rear bacon pigs, but if this is not the type you want not rearing, I will just as gladly not rear porkers. Are there any advantages in not rearing rare breeds such as Saddlebacks or Gloucester Old Spots, or are there too many people already not rearing these? As I see it, the hardest part of this programme will be keeping an accurate record of how many pigs I haven't reared. Are there any Government or Local Authority courses on this? My friend is very satisfied with this business. He has been rearing pigs for forty years or so and the best he ever made on them was £1,422 in 1968. That is - until this year, when he received a cheque for not rearing any.

If I get £3,000 for not rearing 50 pigs, will I get £6,000 for not rearing 100? I plan to operate on a small scale at first, holding myself down to about 4,000 pigs not raised, which will mean about £240,000 for the first year. As I become more expert in not rearing pigs, I plan to be more ambitious, perhaps increasing to, say, 40,000 pigs not reared in my second year, for which I should expect about £2.4 million from your department. Incidentally, I wonder if I would be eligible to receive tradable carbon credits for all these pigs not producing harmful and polluting methane gases?

Another point: These pigs that I plan not to rear will not eat 2,000 tonnes of cereals. I understand that you also pay farmers for not growing crops. Will I qualify for payments for not growing cereals to not feed the pigs I don't rear? I am also considering the "not milking cows" business, so please send any information you have on that too. Please could you also include the current departmental advice on set aside fields? Can this be done on an e-commerce basis with virtual fields (of which I seem to have several thousand hectares)?

In view of the above you will realise that I will be totally unemployed, and will therefore qualify for unemployment benefits. I shall of course be voting for your party at the next general election.

Yours faithfully,
Nigel Johnson-Hill
Super lamb slide

This is my story of how you can make a small fortune out of farming?

The agriculture sector?s export contribution slide

Let me start by saying that we make a massive economic contribution as you can see. In 2007, 65 percent of all exports came from the agriculture sector, which dipped to 64 percent in 2008 before lifting to 66 percent last year.

So much for the ?sunset? lie then.

There are 26 billion reasons why agriculture is a positive environmentally and economically and each reason is called a dollar.

Small fortune slide

Now some good and bad news. The good is that we are seeing record demand overseas but the bad, the very bad, is that our farm profits are heading south.

Just look at these numbers from the 2008/09 season for pastoral agriculture. After generating $23 billion in gross revenue, we see this gobbled up by inputs and compliance costs.

So we farmers are left with a mere $1.4 billion. Oh I almost forgot, that sum has to pay tax, drawings and capital repayments too.

Yes you can make a small fortune out of farming, by starting out with a larger one, in that year, $23 billion.

Agriculture sector income (as a %) slide

Looking at the last three years, you will see this percentage spiked in 2008 thanks to the dairy sector?s record payout. That year was atypical as 2007 and 2009 both testifies to, as well as what we are tracking so far.

New Zealand?s farmers in 2008/09 got to keep 6.2 percent of everything they earned for New Zealand, so you can understand why Federated Farmers gets a tad grumpy about unnecessary compliance costs. Every cent counts.

Outside of dairy slide

As a meat and fibre farmer myself, things have gone from bad to worse to slightly better then to bloody awful and in this season, just a notch above bloody awful.

Now here?s a conundrum that has Beef+Lamb NZ as well as the Meat Industry Association teaming up to crack. Something that has Federated Farmers full support.

Right now we are getting the best ever returns for our meat protein offshore. It?s flying out of the meat works and we are told, we could sell double what we currently produce.

These are products in hot demand. Yet, right now, we are getting some of the lowest returns, ever. That?s the conundrum. Record prices there but low on-farm returns here.

That makes us vulnerable to losing our means of production overseas to investors looking to secure food supplies in a world where the human population will expand by a third over the next forty years.

Federated Farmers solution for overseas investment rules is simple and that solution is called reciprocity.

We have no issue with direct foreign investment so long as we can buy farmland there, on the same basis as they can do here. Of the twelve major Asian countries we have free trade agreements with - it?s only theoretically possible to buy full title in Malaysia. Reciprocity is a simple test already used by our trading partners.

We mustn?t also confuse free trade with land ownership, because our free trade partners don?t and that includes China. This is why we need a public service that provides timely, proactive and realistic support.

Their spending my money slide (lambs)

Yet how many public servants does it take to change a light bulb or more accurately, how many sheep in a farmer?s flock does it take to fund one MAF employee? The answer is a staggering 881.

Their spending my money slide (milkpowder)

But when it comes to the salary of a Chief Executive of a major public service department, it takes just over 92 tonnes of whole milk powder to pay that one salary.

We realise that everything costs, but it?s also very easy to overlook just what it takes on-farm, to fund those off-farm. In this every New Zealander is a farmer - it?s only a question of degree.

Do we want a carbon state (slide as well)

Which is why the Emissions Trading Scheme is the worst policy we have ever seen at anytime. It?s the Ministry of Silly Gases ascribing value to gases that aren?t scarce nor actually, undesirable.

The Government is sending us some mighty confused signals.

We all support a meat industry strategy to crack the profit conundrum I outlined earlier. Given the high prices for our protein overseas, it?s clear what we produce is desired and in a market sense, scarce.

Yet 20 percent of New Zealand?s sheep and beef farms could be replaced by oxymoronic ?carbon forestry?, if the ambitions of foreign owned carbon foresters and the Government are realised.

The likes of Ernslaw One from Malaysia, Blakeley Pacific from the US and Rayonier New Zealand also of the US, want to plant two million hectares of our farmland in their trees.

Two million hectares, if converted to carbon forestry, is a full fifth of New Zealand?s sheep and beef industry. What we are talking about is the loss of 2,800 farms, the loss of 11.4 million stock and the loss of another billion from our $5 billion sheep and beef industry. There?s a distressing lack of coherence.

A week is a long time in politics? slide

Do you think I trust politicians?

et tu, Brute? slide

The Emissions Trading Scheme (ETS) corrupts market principles, before supercharging them with the power of righteousness to drive what to-all-intents-and-purposes, is a moral crusade.

Nations will be powerless to resist New Zealand?s underlying logic with our goods sailing (but not, of course, flying) out the door, to buyers willing to pay more for carbon neutrality.

Or, more likely, New Zealand has embarked on a badly-timed odyssey that will cost us all dearly. The ETS is writ large, that cynical letter I read earlier, of people seeking to be paid for becoming a ?not-farming farmer?, or as permanent forestry sinks inform us, a ?not logging logger?.

If people are confused as to why farmers have been so grumpy, given biological emissions don?t kick in until 2015, it?s because we?re heavy users of electricity and fuels.

?where are you now, Ministers? slide

According to work done for the Minister of Agriculture, farmers face $92 million in added costs from 1 July of this year. That?s more red ink for many farmers out there. Federated Farmers has not done a 180 degree about turn. Our disenchantment with the ETS is being joined by those in the fishing industry too.

The 2010 Budget reserved $1 billion of taxpayer dollars for the allocation of emission units. That?s almost NZX-15 ranked Vector?s complete 2009 revenue. The ETS doesn?t come cheap. The only ones clapping are forestry investment companies who have swung themselves what are production subsidies.

Is this neo-Muldoonism? Are subsidies out of the economy crypt? Seemingly yes.

Can we have some real numbers?
We now see Government MP?s on a sales and marketing drive, telling their constituents and the media, that the cost per household is a palatable sounding $3 per week. This is also where it becomes a bit *Yes Minister,* so it?s no wonder Nick Smith got ?Gored in Gorrre?, as the *NBR* recently put it.

Using $3 per week over New Zealand?s 1.7 million households, you end up with the ETS costing households ?just? $265 million.

But is the Government truly saying the total combined fuel and electricity bill for New Zealand?s 350,000 businesses is only between $85 and $113 million per annum, dependent on whether you use figures put out by the office of the Minister of Climate Change or the Minister of Finance. On the day of the 2010 Budget they put the total societal cost of the ETS at either $350 or $378 million.

Farmers are understandably displeased to find they?re shouldering 26 percent of the scheme?s year one burden or virtually the entire business component.

When you produce 66 percent of New Zealand?s export earnings, that?s golden goose territory. More so because out of all the major income earning sectors in the economy, agriculture has done the best job at controlling its emissions.

You don?t hear that said much but it?s true.

The ETS cost on pastoral agriculture slide

Rural MP?s are also using the smallest denominator to lessen the ETS apparent impact. Six cents per kilogram may not sound like much, but when you are a sheep farmer making a profit of just over $9 per lamb, that adds up to $1.08 on a 18 kilogram animal.

The ETS wipes out 12 percent of our profit per lamb to achieve what, exactly?

What does success look like, please tell us, but you can?t!
There are no ETS success factors. I cannot recall the last time a major piece of public policy had so little scrutiny, by so many over so long. No one can tell us what success looks like. Is it 10-20 percent below 1990 levels? Not according to the Prime Minister who said that would be a ?hard ask.?

We?re pouring over $1.5 billion of our dollars, our estimate, into an immeasurable policy and no one overseas much cares. Those selling our agricultural products overseas tell us that international buyers don?t know about our ETS, don?t particularly care but most importantly, won?t pay a cent more.

Searching the New York Times for mention of an ETS brings up just two hits, both related to Europe. Searching the UK?s Daily Telegraph over the past four years returns three passing references to New Zealand?s ETS.

But Federated Farmers isn?t bereft of solutions. We?re taken by the recent work of the London School of Economics and the University of East Anglia. The Hartwell Paper, released in May, paints a post-Kyoto vision. Its authors are not ?deniers? but are scathing about the wasted political capital invested in Kyoto. New Zealand is seemingly heading in the wrong direction.

Kyoto lapses in 2012 and the Hartwell Paper suggests the future will likely focus on research and not emissions trading. It will focus on developing the global economy instead of keeping the poorest in shackles. It will focus on community resilience instead of trying, King Canute like, to order back an ever changing climate.

Time has come to switch-off the ETS, yet I think the most devastating commentary on the ETS comes from Monty Python.

Monty Python and the Ministry of Silly~~Walks~~Gases video

The electoral system is central to a progressive economy
So to the solutions and I cannot start without referring to our electoral system.

The Mixed Member Proportional system we have simply replaced First Past the Post?s so called, ?tyranny of the majority?, with MMPs ?tail that wags the dog?.

Supplementary Member, by contrast, means single-party Governments would be the norm because constituency results are unaffected by the allocation of list seats. Yet the check function, being no overall control, becomes more likely should Government?s lose touch. That is the vital check function. That heightened risk stops Government abuse of absolute power.

Let?s replace More MPs, as MMP abbreviates to, with Supplementary Member that blends the best points of the old system we had, with the one we currently have.

This is a capital markets hoover (slide as well)
If you want to know where our country?s capital markets are, then I suggest you mosey on down to Parliament.

Sheep v Parliament slide

In the early 1990s Government accounted for 35 percent of all economic activity. Yes these were tough times, but the fruits of reform kicked in during the late 1990s and actually carried through into the early part of this new century. Not continuing them on remains a lost opportunity.

Parliament v Sheep slide

In 2010, the Government sector has now grown to 45 percent of all economic activity.

I think the last two slides graphically show the private sector shrinking while the state has engorged itself. The state sector is now a direct competitor for capital. The challenge to Labour and National is how the two of them can pull back, because while our GDP to debt ratio is not of Greek tragedy levels, is certainly getting there.

GDP slide

What we are talking about is a $84 billion Government machine from your local council to the Office of the Race Relations Conciliator. New Zealand has embraced big Government with absolute gusto but we cannot afford it.

What would the following do for capital markets?slide

Where we will start capital market reform
So if you want to know how we can resuscitate our capital markets? How we can catch Australia by 2025? Reducing Government?s share of the economy is it.

Reducing it by ten percent, back to the levels of the early 1990s, puts $18.7 billion back into the economy each and every year. That?s more than the combined revenues of Fonterra and Contact Energy for the last financial year.

Going down to 30 percent puts $28 billion back into the hands of the private sector to invest and to grow the entire economy. That?s more than the combined revenues of the Cooperatives, Fonterra and Foodstuffs, along with NZX listed Vector and Air New Zealand.

We need a bipartisanship about the right size of Government because right now, the exchequer is like an open lolly jar on *America?s biggest loser.*

Most people work in the private sector for small and medium sized businesses but the entire policy nexus is skewed towards large and powerful corporates or the state sector, where there is a strong interrelationship. Look at the big law firms, the big accountancy firms, the big property trusts and the banks then ask yourself this, who wants to change the status quo?

Duchess of York slide

So we need to get Sarah Ferguson, the Duchess of York, down here to put Parliament on an *Economic Weight Watchers* programme. Given recent high profile business deals, I don?t even think she?d be that expensive either!

One thing is for certain, we need that fiscal diet because Government is morbidly obese.

A new prescription for capital market refurbishment
Once we trim government to size and this isn?t optional, unless we wish to become the Eastern Islands of Australia, we must have capital markets capable of doing something positive with the money available to it.

Of the NZX-15 stocks, only six, have any association to the export sector. Three are property stocks and who, incidentally, happens to be the largest tenant in New Zealand? There are three utilities, one healthcare stock and two entertainment stocks.

Does the NZX reflect the *real* economy? No it does not. Our 350,000 or so SMEs make up more than 99 percent of all businesses in New Zealand and these employ some 60 percent of the workforce.

Perhaps a more robust broking environment is part of the solution and not the problem. A robust broking environment brings forward exciting new stocks helping grow our smaller companies into larger ones.

Yet here?s blockage one. There are now about 18 broking firms but a number are either interconnected or subsidiaries.

The big two broking firms dominate by weight of numbers, with some 220 advisers between them. Esam Cushing, from May, became part of the ForBarr camp while McDouall Stuart pulled out of direct trading in March. Hamilton Hindin Greene outsourced its settlements to ANZ?s Direct Broking last year.

In 2006, First NZ Capital handled one in four trades on the NZX.

A large part of the two majors business is now in funds management. Funds management is about reputation and keeping your nose absolutely clean. When it comes to IPOs, the big broking firms will go to quality. That means ?sure fire? bets. Sure fire bets can be read as SOEs.

So let?s talk solutions

Examine possible NZX barriers to competition
Now this is likely to get me off Mark Weldon?s Christmas card list, but the Commerce Commission needs to have a very detailed look at the NZX.

Specifically to eliminate any barriers of entry for other markets.

Yes we have Unlisted, surely not the best name for a market, but it exists and struggles because to be fully functioning, it needs access to the brokers. Who is the gatekeeper and fee setter for brokers? Why the NZX.

Do you think NZX will welcome competition with open arms, well no, I don?t. This is why the Commerce Commission needs to look into the barriers for entry.

Unlisted exists, but is not pushing through as it ought to because it apparently cannot get to the brokers that promote existing stocks as well as bringing new ones forward for listing. This especially applies to the SME sector ? a sector only a couple of broking firms have any close affinity to.

The NZX has forced broker consolidation so that there are fewer companies to champion listings and of those that remain, there is a strong bias against risk inherent in the SME sector.

Are we close to a capital markets equivalent of a death spiral?

Economic development is not some pre-packaged mix you get off a supermarket shelf. It has to be specific and the NZX, right now, does not reflect an SME economy likes ours, but it needs to.

Build financial literacy
Tied to looking at barriers for entry is the need for serious financial literacy, from the very young to the very old. It is fair to say the NZX has never fully recovered from the 1980s excesses, compounded recently by the $6.8 billion lost or locked up in finance company failures or moratoria.

Education is vital but will take five years of continued work to bear fruit, but that needs to start now.

We need to empower people of all ages with the range of investment options instead of Mark Twain?s homily of buying land, as they?re not making it anymore. People need the means to adjudge risk properly. When you have half of the investment decision to place money in a finance company based upon a press advert, we must realise there is an educative issue.

Financial regulation

The regulation of financial intermediaries is an example of good legislation but like the 1980s impact upon the sharemarket, trust is a hard thing to win back. Education is key but so is confidence in the regulators. It has been suggested to me that the Securities Commission was more accurately, the Insecurities Commission.

The new Financial Markets Authority promises much and I applaud Bruce Sheppard?s appointment. He is a total breath of fresh air but of the nine members, five are lawyers by profession. You have to ask if the FMA wouldn?t benefit from more Bruce Sheppard like independence

I think a failing of the Securities Commission was the Tsar-like powers of the Chief Commissioner. The FMA instead needs to take a leaf from the Reserve Bank?s governance model for the accountability of the Chief Executive.

Yet one curly issue the FMA needs to face up to is the way broking firms are also active funds managers. To me these are separate disciplines that create conflicts of interest, Chinese walls notwithstanding. Then again, I?m just a farmer.

Access to capital

I am truly concerned that we are fast approaching a credit crunch. The mezzanine debt market has evaporated and given that?s where development funding comes from, I have no idea how to get it rolling again, but the coil is unwinding.

The picture for secured debt is equally ugly.

I can tell you as a farm leader, the calls and email I get, reinforces in me a sense the banks are skitty and risk adverse. This reflects the Basel accords that have tightened up capital adequacy ratios in response to the sub prime fiasco. Yet in dealing with the excesses in the United States, it?s affecting us back on farm.

It?s hard to get capital even though some appear to be sound businesses. The picture isn?t attractive as Europe?s banking system lurches from crisis to crisis. Given we?re dependent on those Belgium dentists and Japanese housewives, any issues up north means we?ll catch a cold.

So there is a need to diversify farm and commercial lending and that could come by a capital injection into KiwiBank to provide added competition in commercial and rural lending.

Yet the Government has KiwiBank in a corporate no-mans land. It?s unwilling to extend it capital to grow while being unwilling to cut it loose. KiwiBank is between the devil and the deep blue sea.

Well there you have it
I?d like to finish by saying that Federated Farmers is bullish about the future so long as Government gets the need for reform. That depends on Government finding a backbone and conviction to make public opinion rather than bending to it. The mining backdown saw it fail a vital conviction test, so we need that vision and we need it now.

Thank you.

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