THE AGRICULTURAL ECONOMICS RESEARCH UNIT
Lincoln College, Canterbury, N.Z.

The Agricultural Economics Research Unit (AERU) was established in 1962 at Lincoln College, University of Canterbury. The aims of the Unit are to assist by way of economic research those groups involved in the many aspects of New Zealand primary production and product processing, distribution and marketing.

Major sources of funding have been annual grants from the Department of Scientific and Industrial Research and the College. However, a substantial proportion of the Unit’s budget is derived from specific project research under contract to government departments, producer boards, farmer organisations and to commercial and industrial groups.

The Unit is involved in a wide spectrum of agricultural economics and management research, with some concentration on production economics, natural resource economics, marketing, processing and transportation. The results of research projects are published as Research Reports or Discussion Papers. (For further information regarding the Unit’s publications see the inside back cover). The Unit also sponsors periodic conferences and seminars on topics of regional and national interest, often in conjunction with other organisations.

The AERU, the Department of Agricultural Economics and Marketing, and the Department of Farm Management and Rural Valuation maintain a close working relationship on research and associated matters. The Unit is situated on the 3rd floor of the Burns Wing at the College.

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The author of this paper, Dr. Robert Bohall, works with the Economic Research Service of the U.S. Department of Agriculture (USDA). He has been recently working on an exchange basis with the Australian Bureau of Agricultural Economics in Canberra (BAE).

Dr. Bohall presented this paper while on a visit to New Zealand Universities and Government Departments in December 1982. The paper reviews the present situation regarding U.S. agricultural and macroeconomic policies with respect to their implications for the New Zealand farm sector.

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1. INTRODUCTION

The U.S.A. is an important force in world economic activity and agricultural trade. Developments in the United States impact on New Zealand farmers on both the demand and supply side. The net effect of Reaganomics depends to what degree world agricultural demand is stimulated through U.S. macroeconomic policy versus being offset through increased commodity supplies and competition for export markets from specific support for the US agricultural sector.

This paper initially reviews 'Reaganomics' and the current macroeconomic and agricultural environment in the United States. It is generally a truism that U.S. policy, as with most governments, is developed with domestic priorities taking precedence. The implications are that while international relationships are very important and there are strong ties between the U.S.A. and New Zealand, it is the political and social pressures within the U.S.A. that predominate in the development of national macroeconomic policy and agricultural legislation. It is later argued that:

(i) U.S. agricultural policy and U.S. macroeconomic policy may be of about equal importance in terms of direct implications for New Zealand farmers;

(ii) the fundamentals of commodity markets are still the primary factors influencing grower returns and profits for farmers in both New Zealand and the U.S.A.;

(iii) less support in real terms is provided under most U.S. agricultural programs than was the case five years ago;

(iv) there is the strong possibility that 'protectionism and predatory export policies' may increase in the U.S. and around the world; and

(v) the U.S. is heading toward economic recovery but --.
2. U.S. MACROECONOMIC POLICY (REAGANOMICS)

The policies of the current U.S. Administration are many and varied, are not always consistent, and certainly have evolved through political compromise and trade-offs. As originally conceived the major tenets of the Reagan program include:

(i) Slowing down the very high rate of inflation in the U.S. economy.

(ii) Cutting taxes - supply side economics.

(iii) Deregulating business - relying on the market place.

(iv) Increasing exports - improving the balance of payments.

(v) Balancing the federal budget - minimising cost exposure.

(vi) Increasing defence spending.

(vii) Maintaining or revitalising economic growth.

The concerns of New Zealand and other countries are that Reaganomics may not result in an economic recovery in the U.S.A. and that world demand and New Zealand export markets may be adversely affected to the detriment of producers. In addition as one of New Zealand's major customers and competitors, the policies of the current Administration influence agricultural export prospects to the U.S. and U.S. agricultural exports to other countries in competition for world markets.

Let us briefly review where Reaganomics is at the moment - what has occurred and what may occur with respect to the U.S. economy.

(i) Tight money policy. The U.S. Federal Reserve Board (FRB) has kept the lid on the growth in the U.S. money supply - the target for M-I (all cash plus deposits in checking accounts) has been around 5.5 per cent per year. Earlier in the year economists argued the temptation to relax monetary controls and increase the money supply in the short run would be to the detriment of longer run economic growth and renewed inflation. However in mid-October Mr Volker, Chairman of the FRB who has been a tough advocate of restraint in monetary policy indicated
a more relaxed approach. He indicated the FRB feels inflation has been largely wrung out of the U.S. economy and the forces are present that would push the U.S. toward recovery to be fueled by increased buying by consumers. While there will be no basic change in anti-inflationary policy by the Fed the policy objective should be to facilitate and sustain a U.S. economic recovery.

(ii) Lower inflation. Annual rates of inflation for the U.S. economy are now estimated at around 4-5 per cent, in contrast to around 13 per cent in 1979 and 1980. Tight money policy has been effective in cooling off the inflation rate and inflationary expectations. In March 1982, the U.S. Consumer Price Index declined for the first time since 1965 and in September the U.S. Prices Paid Index declined by 1.7 per cent. Part of the slow-down in inflation has also been a substantial cooling off in world markets of primary commodity prices, particularly for energy and agricultural crops.

(iii) High but declining interest rates. Actual rates of interest are still high by historical standards in the U.S.A. but have declined substantially since early in 1982. The U.S. prime rate in early December was 11.5 per cent (compared with 16.5 per cent in July) and the lowest in over two years. Inter company loans and the discount rate for banks were around 9 per cent and rates for Treasury bills 7-8 per cent. With nominal interest rates declining more rapidly than the rate of inflation the real rate of interest has also fallen from the extremely high levels in the first half of 1982. The impact of lower interest rates on housing starts, Christmas retail sales, business investment and the restructuring of debt remains to be seen. Automobile sales were up substantially in November. Previously analysts had argued a decline in nominal interest rates to 12-14.5 per cent (a goal which has been surpassed) would be necessary before there is such turn-around in the U.S. economy.

(iv) Decline in business investment and consumer demand. With previously high interest rates and reduced profit expectations, businesses in the U.S.A. have been postponing investments in new technology, depleting their capital stock and deferring new purchases of goods and services. This 'wait and see' attitude of running down stocks rather than investing
in new production has contributed to unemployment and slowing economic recovery. U.S. consumers have been reluctant with uncertain employment and wage prospects coupled with finance costs to purchase on credit especially for 'big ticket' items such as housing, automobiles, and appliances. However, housing starts in October were up 1 per cent over September and 31 per cent above the depressed October 1981 level.

(v) High unemployment. Unemployment rates in the world have been rising and are now close to 9 per cent overall, the highest of recent history. In the U.S.A., the November unemployment level of 10.8 per cent, equal to 12.0 million workers, is the highest since the depression years of the 1930's. The combination of uncertain economic expectations and deferred business investment and consumer expenditure has resulted in layoffs and a reduction in new employment opportunities. In September 1982, the U.S. unemployment rate for 'blue collar' workers was 15.6 per cent, blacks over 20 per cent, and construction workers 22.6 per cent. However, rates are well below the 24.9 per cent level of 1933 at the height of the depression and with some increase in the U.S. workforce participation rate (especially females), may not be exactly comparable to say the 1960's, or the depression years. The unemployment rate was a major campaign issue in the recent U.S. Congressional elections which resulted in gains in the U.S. House of Representatives and in State elections for the Democratic Party.

(vi) Recession (decline in real GNP over two quarters). In the U.S.A., real GNP declined by over 5 per cent in both the December 1981 and March 1982 quarters. The June quarter showed an increase of 2.1 per cent and the September estimate was a disappointing no change.

U.S. factories have been running at 68 per cent capacity, the lowest on record and the economy has been moving sideways. The index of industrial production in October was 8.6 per cent less than in October, 1981. Analysts are still divided on whether the recent surge in the U.S. stock market represents a real business turnaround or merely a reaction to the Federal Reserve attempts to create one. The index of leading indicators has risen in five of the last six months. Earlier OECD forecasts called for about a 2.5 per cent real gain in U.S. GNP for 1983 but cautioned this may be high. The U.S. National Association of Business economists recently projected a 3.3 per cent growth for the same period.
An interesting argument regarding recent lower interest rates and inflation is the possibility this could be evidence of falling economic activity and falling demand for funds rather than the greater availability of funds. Lord Keynes indicates there are two elements of recession:

(a) Genuinely deficient effective demand (in monetary and real terms) and,

(b) Prospective profitability of new investment so low that no matter how low interest rates fall there will be no stimulus to investment.

Therefore even if the U.S. relaxes controls and increases the money supply to decrease interest rates, it is conceivable this will not result in an increase in demand (the liquidity trap). However, other economists argue the liquidity trap is probably non-existent and that under the current situation real interest rates are still quite high (i.e. 11.5 per cent prime rate and inflation rate of less than 5 per cent). The liquidity trap might be more relevant if nominal interest rates fell to 3 per cent and inflation to zero.

(vii) Cut in taxes. A politically popular 25 per cent tax cut, estimated at US$750,000m over five years, was passed in 1981 by the U.S. Congress. By July 1982 a significant portion of the cut (15 per cent) had been implemented, and an additional 10 per cent reduction is scheduled to take place in July 1983. However in order to reduce expected 'excessive' government budget deficits legislation was passed in August 1982 which will increase U.S. taxes by an estimated US$99 billion over the next three years and partially offset the earlier tax cut.

(viii) Major budget deficits expected. To date, a record 1982 budget deficit of US$110,000m has occurred, equal to 3.6 per cent of GNP. In relative terms this is less than the 4 per cent US$66,400m previous record that occurred in 1976 but far above initial estimates. With increases in defence spending, reductions in tax revenue, and despite budget trimming in social programs, the U.S. budget deficit is currently projected by the Administration at around US$110,000m for 1983, or by the U.S. congressional Budget office at US$155,000m. With a federal
deficit as a share of the economy of 5-6 per cent, this could equal the rate of capital formation or investment in productive facilities. At an equal level, there is the danger federal financing could crowd out private investment.

Currently the U.S. administration is drafting the 1984 budget. Prospects are for a deficit well in excess of US$100,000m. Congress will likely be looking at the revenue side to increase the taxable income base by lowering tax deductions and consider further cuts in social programs (retirement, health etc.) as well as slowing down the increase in military spending.

(ix) Increased Protectionism - export subsidies. Increasingly in recent months various countries including the U.S. have been tinkering with the terms of international trade. Tariff and non-tariff barriers on imports of automobiles, steel, electrical goods, high technology products, and agricultural commodities including sugar and beef have been developed. Pressure has been exerted on U.S. trading partners including Japan to expand imports of raw products through lowering trade barriers and guaranteeing a higher degree of market access. Legislation has been enacted to subsidise U.S. exports of agricultural products to meet the competition of other countries, particularly the E.E.C., in world markets. Other legislation that would include any product or group of products has been introduced in the U.S. Congress aimed at 'reciprocity' or meeting perceived export subsidies by foreign governments. The types of trade policies being considered are reminiscent of the depression years when 'beggar thy neighbour' isolationist types of regulations contributed to the downfall in the world economic conditions. The recent 'collapse' or lack of significant progress at the GATT ministerial meetings is likely to improve the chances that some of the nearly 100 protectionist bills before Congress are enacted.

(x) Lack of major improvement in U.S. economy to date. The U.S. economy moved into a deep recession in the first half of 1982 and experienced only slight improvement in the third quarter. Some recovery in the fourth quarter is possible. The expectation is that, with inflation under control, with the 1 July tax cut, with budget deficits manageable, and with the decline in interest rates, investment will pick up, housing
starts and automobile sales will improve and the U.S. economy will rebound and Reaganomics will succeed. This scenario is not impossible, but the timing has been delayed and, as a result, U.S. economic recovery now looks more likely in 1983 as opposed to the last half of 1982.

Recession has tended to move with some lag to other countries including New Zealand. The real concern is that the U.S. recovery may be too weak and that the impacts of Reaganomics and policies of other governments including the E.E.C. and Japan may not pull the world economy out of the current recessionary period.

In the event that an economic recovery in the U.S. does occur, because of the important impact of the U.S. on the economies of all the Western industrialised nations, the demand for New Zealand agricultural products, particularly beef and wool, should strengthen. This could improve the outlook for farmers but the more fundamental problem of agricultural policy remains. Alternatively, prolonged recession or weak recovery in the developed economies will tend to exacerbate the low income prospects facing the New Zealand agricultural sector in 1982-83.
3. U.S. AGRICULTURAL POLICY

U.S. agricultural policy is determined within the constraints of the administrator's budget, which is monitored by the U.S. Congressional Budget Office, and the U.S. political environment. In the U.S. Senate the agricultural sector tends to have relatively more influence since Senators are elected on the basis of two per State. In the House of Representatives Congressmen are elected on the basis of population and urban concerns tend to overwhelm agricultural issues. Agricultural policy also reflects regional and commodity interests and coalitions with dairy and field crops are usually able to sustain strong political support. Livestock interests usually are content to benefit from, and support, programs that will result in plentiful supplies of relatively low cost feed grains. Minor commodities and other special agricultural interests rely on alliances with broader groups to achieve support. Overall the agricultural sector in the U.S. would have proportionally less influence than in New Zealand and the relative influence of the sector has been declining over time. There is a strong recognition by urban groups of the benefits of agricultural exports with regard to the U.S. balance of payments and need for foreign exchange as well as the benefits of low food prices to U.S. consumers. Within this context there are at least three major pieces of U.S. agricultural legislation that are important for New Zealand producers.

Firstly is the 1981 Agriculture and Food Act that was passed by the U.S. Congress and signed into law by President Reagan in December of last year. It is a four-year authorisation bill for many farm programs, with commodity provisions generally applying to the 1982-85 crop years. In addition P.L.-480, or foreign food assistance, and export credit programs are covered by this legislation. Secondly are the agricultural provisions of the Budget Reconciliation Act signed into law 8 September 1982. Thirdly is the U.S. Meat Import Act of 1979.

For wheat and the feed grains, the dual commodity income and price support system, is continued through the 1985 crop year. Income support is provided through the target price concept, which guarantees eligible producers a direct deficiency payment if farm prices fall below established
target prices ($4.30 on wheat and $2.86 for corn in 1983). Price support will continue through a non-recourse loan programme, with levels determined by the Secretary of Agriculture. Minimum loan rates for the 1983 crops of wheat and corn (maize) were increased to US$3.65 and US$2.65 respectively under the Budget Reconciliation Act. Grain price support measures available under the 1981 Act also include the farmer-owned reserve, set-aside and acreage-reduction programs.

For wool, the farm bill extends the U.S. National Wool Act of 1954 through to December 1985. Support rates were lowered to 77.5 per cent from 85 per cent of the formula rate. The formula rate is US$0.62¢/lb times the ratio of the parity index of prices paid by U.S. farmers during the past three years to prices paid in 1958 through to 1960. The parity index is based on prices paid by farmers for commodities and services, including interest, taxes, and farm wage rates.

Of particular interest to New Zealand are U.S. dairy programs. The dairy provisions of the 1981 Act have had to be modified because of program cost. Originally the dairy provisions called for a minimum 1983 support level of US$13.25/cwt (US$292/t) of milk. This figure was to have increased over time to US$14.00/cwt (US$309/t) for 1984 and US$14.60/cwt (US$322/t) in 1985. There were separate provisions within the Act which called for the minimum support price to be adjusted upward as a fixed percentage of parity if the net cost of the program or net government purchases were below certain limits.

However, with the continued rise in dairy production (and surplus) over the past few months coupled with indications of increases in cow numbers, herd expansion, and production per cow and with the availability of relatively low cost concentrate feed, new legislation was enacted. The Budget Reconciliation Act holds the support level for the 1983 and 1984 program years (October 1982 - September 1983, etc.) at US$13.10/cwt (US$289/t) and for 1985 at the same level of parity as represented on 1 October 1983. The bill also permits the Secretary to make a non-refundable US$0.50¢/cwt (US$11/t) assessment if purchases are expected to exceed 5 billion pounds (2268 kt) milk equivalent. This assessment was implemented effective 1 December 1982. The funds will be remitted to the Commodity Credit Corporation (CCC) to offset part of the program costs. Effective 1 April 1983 an
additional US$0.50 may be deducted if purchases are expected to exceed 7.5 billion pounds (3400kt). This second deduction would eventually be refunded to those producers who lower their output by a specified amount. In effect by April 1983 the U.S. dairy price support will likely be US$12.10 per cwt (US$267/t) or nearly 10 per cent less than what was called for in the original 1981 legislation.

The Reconciliation Act also amended previous legislation (the Agricultural Act of 1949) to allow donation of surplus dairy products through foreign governments, public, and non-profit organisations overseas.

Factors which are contributing to the U.S. dairy surplus include

(i) increased production in response to dairy support prices;

(ii) sluggish demand for dairy products domestically;

(iii) a history of support price increases at a rate greater than for most other farm commodities;

(iv) low prices for cull cows and the highest ratio of replacement heifers to cows on record;

(v) lack of off-farm job opportunities;

(vi) increased farm size and productivity increases; and

(vii) a favourable milk-to-feed price ratio close to the highs of the past 20 years.

The present U.S. dairy surplus is reflected in a 17 per cent increase in production since the mid-1970's in the face of relatively static demand for fluid milk, a slight increase in cow numbers since 1979 after an extended long term decline, and continued increases in production which has doubled output per cow over the past 25 years. The volume of manufacturing milk has increased significantly especially since 1978.

Since 1949, when the dairy support program began, large quantities of dairy products have frequently been purchased by the Government to maintain the established support prices. The milk equivalent of these purchases has varied substantially, but in the last two years has reached
historically very high levels. On average, 38 per cent of annual skim milk powder (SMP) production, 8 per cent of annual cheese production and 14 per cent of annual butter production have been removed from commercial markets under the price support program. In the 1981-82 marketing year, about 30 per cent of butter production, 67 per cent of SMP production and 14 per cent of cheese production were purchased by the Commodity Credit Corporation.

In view of these recent purchases, the level of government-owned dairy stocks has risen markedly. At 1 July 1982, government-owned stocks accounted for about 7228 kt, milk equivalent, about three times the volume held in July 1980. Butter stocks have doubled in the past two years, while cheese stocks have been substantial. In the past, most cheese stocks have been held by commercial traders; however, in the past two years the amount of American cheese (not including processed cheeses) held by the Government has increased from about 13 per cent to 60 per cent. Stocks of government-owned SMP have risen significantly since 1980. The most recently published data on stock levels held by the Commodity Credit Corporation (for 1 October 1982) are: butter, 182kt; cheese, 374kt (includes processed cheese); and SMP, 534kt.

The cost of the dairy price support program has escalated in line with government purchases of dairy products. In 1979, the net expenditure of the Commodity Credit Corporation on dairy price support was only $250.6m. The net expenditure by the Corporation in the following two years rose to $1279.8m and $1974.4m, respectively, and is projected to have reached more than $2000m in 1982. The cost of the program was a primary factor influencing the adoption of the revised dairy support program.

The combination of low feed prices, and low beef prices and/or a high level of replacement heifers, will likely result in 1983 milk production at about the same as in 1982 (61.2 Mt). While production could decline slightly by 1984, analysts indicate it would likely increase faster to 61.9 MT by 1987.

Historically, the United States has been a net importer of dairy products, particularly cheese and casein, although significant quantities of SMP (94.5 kt in 1981) have been exported as food aid under the PL 480
programs. Increasing costs of maintaining high levels of dairy stocks of butter, cheese, skim milk powder and whole milk powder at a time of high interest rates has brought increasing pressure on the U.S.A. to dispose of some of these products on overseas markets.

With limited opportunities to dispose of surplus dairy stocks on the domestic market, the United States is likely to resort to placement of these stocks on the export market in the near future. The U.S. Government is exploring several ways of clearing these products without disrupting the international dairy market. Alternatives include:

- concessional sales and donations under the PL 480 program;
- donations to foreign governments and humanitarian organisations under section 416 of the Agriculture Act of 1949 (the Corporation would be authorised to pay costs for reprocessing, packaging and handling and delivery);
- government-to-government sales;
- barter transactions such as a recent trade for bauxite with Jamaica; and
- Commodity Credit Corporation sales to private traders.

The other alternative is for the U.S. to dispose of dairy products at highly competitive or even subsidised rates in world markets. There is an obvious concern in the U.S. about the lack of progress at the recent GATT ministerial meetings. Dairy products presumably could be used in a 'trade war' with the E.E.C. which would have major indirect impacts upon New Zealand producers. The mechanisms and timing of such a 'trade war' are uncertain and given the depressed state of the world dairy market for products such as skim milk powder, butter and cheese the prospects for significant sales of these products appear limited. In any event, it is not apparent at this moment that such a 'trade war' will occur nor that if it does what the magnitude and overall impact will be.

The likely continuation of surplus milk production in the United States in the medium term will be an important influence in the international
market in the next few years. Recent OECD medium-term projections of likely production, consumption and export availability indicate that both the E.E.C. and the U.S.A., in spite of measures aimed at curbing production, will continue to produce a surplus. A corresponding growth in consumption in either the developed or developing countries is unlikely to offset these increases.

The longer term implications of U.S. dairy policy are the maintenance of relatively high stocks and their subsequent clearing on export markets. This is not only likely to depress world dairy prices, but U.S. exports could erode both New Zealand's and Australia's share of export markets. Both these countries could face increasing competition from the U.S.A. in the developing markets such as OPEC and the newly industrialised countries. Import requirements by these countries for dairy products, particularly cheese, is forecast to expand in the medium term.

The U.S. Meat Import Act of 1979 effectively limits imports of beef, veal, pork and sheepmeat to roughly 4-5 per cent of U.S. consumption. Lamb is specifically excluded from the Act. Features of the Act include the determination of a trigger level for the imposition of import quotas. The trigger level is 110 per cent of adjusted base quotas which provides an incentive among exporters for voluntary restraint to avoid quotas. The adjusted base quota is determined by formula which takes into account average U.S. imports for the 10 year period 1968-1977, increases in average commercial production of quota products versus the historical base production period, and a counter cyclical component which is designed to allow for increased imports in years of relatively low U.S. production and vice versa. The Act also allows the President to intervene to increase imports when U.S. prices have been rising rapidly if the countercyclical component is more than 1.0 (relatively low U.S. cow beef production per person). New Zealand has agreed to limit 1982 exports to the U.S. to around 155kt or slightly over 26 per cent of the estimated global total of 1.295 billion pounds (587kt). The current trigger level is 1.3 billion pounds (590kt).

I should mention at least one other provision of interest to New Zealand meat exporters - the inspection of meat imports. Basically, the 1981 Agriculture and Food Act requires that U.S. meat imports will be subject to the same inspection, sanitary, quality, species-verification and residue
standards applied to products produced in the U.S.A. This should not present a problem to New Zealand producers and does not prohibit entry of foreign meat because drugs or chemicals banned in the U.S.A. were used during the production process.

The 1981 Agriculture and Food Act extends the Agricultural Trade Development and Assistance Act of 1954, more commonly known as PL 480, until December 31 1985. It provides in addition for an export credit revolving fund to finance export sales of U.S. agricultural commodities on credit terms not to exceed three years. The fund would be used only for purposes of market development and expansion where there is substantial potential for developing or enhancing regular commercial markets.

The agricultural provisions of the Budget Reconciliation Act also mandate that for fiscal years 1983, 1984 and 1985 US$175-190 million be used annually for agricultural export promotion activities including interest buy downs, direct credits or subsidies so that 'American farmers and exporters may compete in international trade on an equal basis'. A particular concern indicated by U.S. Congressional conferees in finalising the legislation was the use of export subsidies by foreign governments in violation of obligations under trade agreements (i.e. GATT). The Conferees believed the U.S. cannot tolerate unfair trade practices and allow other countries to make use of export subsidies on agricultural products to capture markets from the U.S. On 20 October 1982 Secretary Block announced a three year US$1500 million 'blended credit' program to expand exports of U.S. agricultural products. Annually for fiscal 1983, 1984 and 1985 this will consist of US$100 million of the Reconciliation Act funds coupled with US$400 million of PL 480 direct credit authorities to expand sales in developing countries particularly those with good long-term market growth potentials.

The U.S. agricultural situation leading into 1983 indicates total 1982 wheat production at an all time high of over 76 million tonnes, 1 per cent above last year, so its likely even with near record disappearance - particularly exports - that year end stocks will continue to climb and be the highest since the early 1960's. The U.S. September crop report reinforced the outlook for a domestic feed grain production of over 250 million tonnes including record corn and soybean crops and a substantial buildup in stocks which will keep prices under pressure. Export prospects
are tempered by poor worldwide economic conditions but falling interest rates may provide a positive influence. Cattle feeding is expanding and the number of cattle on feed in 7 major States on 1 September was up 8 per cent over a year ago. Hog production is favourable but may not expand until the last half of 1983; broiler and dairy production are running 2-3 per cent ahead of last year.
4. THE IMPACTS OF U.S. MACROECONOMIC AND AGRICULTURAL POLICY ON THE NEW ZEALAND FARM SECTOR

No attempt has been made in this paper to precisely quantify the many impacts of U.S. policy on New Zealand agricultural producers. However, there are a number of observations or testable hypotheses regarding the impacts of Reaganomics that deserve emphasis in concluding.

(i) U.S. macroeconomic and monetary policy through impacts on the world international economy and particularly upon exchange and interest rates may be equally important as U.S. agricultural policy on New Zealand farmers. Given the importance of meat and dairy exports in particular and the increasing likelihood of trade conflict and subsidisation in the agricultural sector, U.S. agricultural policy can have a major impact on New Zealand farm incomes over the next two to three years and override macroeconomic events. However, the recent significant decline in interest and inflation rates and a possible turnaround in world recession should stimulate demand for New Zealand agricultural commodities such as beef, dairy products and wool. A depreciation of the U.S. dollar against the New Zealand dollar and other currencies may not strengthen New Zealand's competitive position in third countries for export markets, but stronger world economies should boost international trade overall. Conversely, failure to achieve a world economic recovery would likely result in sluggish demand for New Zealand agricultural exports in 1983 and a loss of income for farmers.

(ii) The fundamentals of commodity markets are still the primary factors influencing grower returns and the profit picture for farmers in both New Zealand and the U.S.A. With world commodity surpluses, prices will decline. Current heavy world dairy stocks will keep prices near current levels over the next few months. Similarly, for New Zealand farmers, the outlook for wool is not strong with current high stock levels in both producing and processing countries serving to overhang the market already depressed by world recession especially in the OECD countries. The outlook for meat exports in 1983 will be dampened due to the relatively high drought induced supplies in Australia and the continued uncertainty regarding world economic recovery.
(iii) The impact of the U.S. farm legislation as implemented by the Reagan Administration in 1981 and 1982 is to reduce risk, provide relatively less price protection, and help U.S. farmers maintain a minimum level of returns. As a result, U.S. agricultural production of food and feed grains, wool, cotton, rice, soybeans, dairy products and sugar will be larger than would be the case without the legislation, and world commodity markets will be impacted accordingly because of increased supplies. However, the degree of support provided under the 1981 legislation is relatively less than was the case under the 1977 U.S. farm bill. Between 1977 and 1981, the U.S. consumer price index (CPI) increased 44 per cent for food and 51 per cent for all items. The increase in target prices, loan rates or support levels for U.S. agricultural commodities between the 1977 and 1981 farm bills was generally much lower, ranging from reduced support to an increase of 37 per cent depending on the commodity. The support for grains has led to favourable input prices for the dairy and livestock sectors. As a result world markets may be sluggish for the intermediate term. In the longer run the downward adjustments made under the budget Reconciliation Bill should bring about a better balance on grains and dairy production.

(iv) The current recession is building up strong pressures for increased 'protectionism', export subsidies and the danger of trade wars most of which would be detrimental to the New Zealand agricultural sector. Be it 'protectionist' measures such as the U.S. Meat Import Act, higher tariffs, or voluntary bilateral trade constraints the political goals are to protect less efficient or noncompetitive domestic industries and employment against imports or to offset 'unfair' competition. The result is a decrease in trade, loss of income and an implicit tax on the exporter and on consumers in the importing country. To counter these measures governments have increasingly taken to directly or indirectly subsidising exports to meet the competitive terms of trade of other producers and/or to offset the impact of trade barriers.

A good example of the U.S. 'protectionist' movement is the politics of the U.S. Budget Reconciliation Act of 1982. As the bill was being developed and debated by the U.S. Congress, the U.S. Farm Bureau (the largest and probably the most influential U.S. farm lobby that
has long been an advocate of free trade and outspoken against Government intervention) called for subsidising U.S. farm products to retaliate against subsidised exports from the E.E.C. The Farm Bureau President in correspondence with the U.S. Secretary of Agriculture indicated that 'negotiations with the European Community have failed and that now is the time for the United States to get tough'. 'American farmers can not sit by and let overseas markets be taken over by E.E.C. products that are lower in price only because of Government subsidies'. It seems plausible that in the U.S. frustrations with the costs of agricultural programs especially for dairy, wheat and coarse grains, the expansion of area and production of these products by competing exporters (subsidised or not), and the pressures from important political farm groups may result in increased reliance on export credits, subsidies and incentives in the future perhaps even to the de-emphasis of loan rates and target prices. The continuation of world recession and sluggish demand for agricultural and industrial goods may inexorably lead governments down the path of predatory trade practices. Given New Zealand's reliance on agricultural exports particularly for dairy such a path would be disastrous. As one commentator indicated the thrashing of the elephants such as the U.S.A. and the E.E.C. could trample the trade ground for years to come.

It should be noted that most leading agricultural producers have a record of providing assistance to the agricultural sector. New Zealand has in place numerous assistance measures (most notably the Supplementary Minimum Price scheme) which are leading to increased production of meats, wool, dairy products, etc. For example 1981-82 SMP payments to wool producers in New Zealand totalled $185m. The problem is that the good intentions of policy officials in approving various subsidy schemes has led to oversupply in the face of world recession and slow growth rates in importing countries.

(v) The U.S. economy is very slowly starting to recover and will likely improve over the next several months into 1983. The danger is that the recovery may be too weak especially if there is a substantial lag between a turn-around in the U.S. and in other industrialised nations. New Zealand, for example, appears to have relatively high
interest rates, a high cost structure and unemployment problems which have led to the current wage and price freeze which is intended to prevent a domestically created recession that might result in future growth below capacity. Third world developing countries have been severely burdened by high interest rates and an increasing debt load. More than 40 countries are falling behind on their international debt payments with Mexico and Argentina two of the more prominent examples. The temptations by developed countries to support their domestic industries - both agricultural and manufactured goods - usually works to the detriment of developing nations and the movement toward trade protectionism and/or export subsidies exacerbates the problem.

In summary while many signs point toward world economic recovery it is not clear that the expected recovery will be all that strong nor that New Zealand will be in a position to benefit. Hopefully for the New Zealand agricultural sector CER will be successful, world markets will improve with an economic recovery, and sound domestic monetary and labour policy will prevail to avoid internal recession. U.S. macroeconomic and agricultural policies are an important part of the world picture but commodity fundamentals, continued high rates of productivity and competitiveness, New Zealand domestic policy and the trade discussions and negotiations by industrialised and developing nations will be the primary determinants of the welfare of New Zealand farmers in the next few months and years.
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