A NOTE ON THE SUPPLEMENTARY MINIMUM PRICES SCHEME

INTRODUCTION

This article provides an overview of the Supplementary Minimum Price Scheme as operated by the Government since 1978. It includes a description of the scheme's short history, objectives, price levels set each season, the principles and processes by which the scheme operates and concludes with a discussion on the monetary implications of the scheme.

HISTORICAL BACKGROUND

Supplementary Minimum Prices (SMPs) were introduced in the budget of 1978. The Government at that time pledged to underwrite these minimum prices in order to supplement, if necessary, minimum prices set under the stabilisation schemes operated by the major Producer Boards. The scheme confirmed the new direction of Government's agricultural policy; with a shift evident in the type of support given from one of the general subsidisation of a range of inputs to one emphasising production-related measures which directly influence the type and volume of output generated from the agricultural sector.

Government saw that "a major factor inhibiting the achievement of the agricultural sector's potential was a lack of confidence in its future prospects and profitability".[1] Consequently, the SMP scheme was proposed to ensure that incomes would be at such a level as to assure continued development in the agricultural industry through the maintenance of the volume of inputs into the sector. With the agricultural sector accounting for over 70 percent of New Zealand's export earnings, it was considered essential that the momentum in production and exports be sustained.

The objective of the SMP scheme was to achieve this by setting supplementary prices at such a level as to provide an adequate return for farmers' reasonable requirements for living expenses, farm operating expenditure and new development expenditure. Thus "this would give farmers an assured and realistic base for forward planning".[2]

The subsequent growth in the agricultural sector in the 1978/79 and 1979/80 seasons was impressive; however, it is difficult to say to what extent the introduction of the scheme influenced this. Total stock unit numbers, which increased from 100.5 million in June 1978 to an estimated 107.1 million in June 1981 are expected to increase further to 109.4 million in June 1982, and this, combined with a general slight improvement in stock performance, has resulted in significant increases in production and the volume of goods available for export. Without doubt the very favourable climatic conditions in the 1978/79 and 1979/80 seasons contributed substantially to this growth.

1. Minister of Finance: Financial Statement, 1 June 1978.
2. Minister of Finance: Financial Statement, 1 June 1978.

The role the SMP scheme played in the first three seasons of its operation was largely to provide farmers with the assurance that they would be protected from unanticipated unfavourable market fluctuations which could threaten to undermine the financial viability of their industry and in particular of development programmes on which many were embarking. It was expected that this assurance would favourably influence investment and production decisions and in practice it would appear to have done so. In the current 1981/82 season the scheme has been called on to provide more tangible support in the face of weak market prices for meat and wool in order to maintain farmers' returns at a level deemed necessary to sustain confidence in their investment decisions.

SUPPLEMENTARY MINIMUM PRICE LEVELS

In the first three years SMPs were pitched at a level consistent with the basic function of protecting producers from any sudden decline in market realisations. For the most part market returns remained above the SMP price levels and were sufficient to maintain satisfactory levels of farm income in real terms. While a relatively small payment of $18.8 million was made under the scheme in 1978/79, no payment was made in 1979/80 and $1.9 million was paid out in 1980/81.

During the 1980/81 season, however, beef, wool and dairy prices weakened and net farm incomes in real terms declined to index levels below those of 1977/78. While the SMPs had again been set at levels which would underpin the market in the event of a substantial decline in market prices, and consequently required only minor payments under the scheme, the relatively depressed market returns coupled with rapidly rising farm input costs caused a severe cost-price squeeze for farmers. Concern was voiced that the industry would have great difficulty in maintaining farm input volumes in the 1981/82 season at a level which would enable production levels to be maintained.

The Government responded by departing from the trend of the previous three seasons and in 1981/82 pitched the SMPs at a level which was generally well in advance of market prices then ruling for wool and meat. Income adequacy appeared to have become one of the criteria used in setting the SMPs in order to protect farmers from further erosion of their real incomes by the continuing cost/price squeeze. The result has been that to date in the current season substantial supplementation has been required for the main meat products, supplementation ranging up to 25 percent of the adjusted weighted average sale price (AWASP) has been paid on wool, and it is likely that the cost of supplementation during the season will be in the range of $300 — $400 million. Income projections suggest that these relatively high SMP payments will nevertheless be sufficient only to hold net real sheep and beef farm incomes at the previous year's lower levels.

Table 1 shows the SMP levels and producer board minimum prices for major products in each of the seasons since the scheme commenced.

TABLE 1
PRODUCER BOARD MINIMUM AND SUPPLEMENTARY MINIMUM PRICES
(cents/kilogram)

Season	*1978/79*	*1979/80*	*1980/81*	*1981/82*
Wool				
SMP	205	235	235	320
Wool Board minimum	170	200	215	250
Meat				
Lamb (PM)				
SMP	70	86	110	145
Meat Board minimum	72	86	113	116
Mutton (ML1)				
SMP	30	40	43	50
Meat Board minimum	30.5	35	40	43
Beef (P1 Steer)				
SMP	80	110	120	143
Meat Board minimum	70	112	120	125
Beef (Manufacturing Cow)				
SMP	70	100	105	125
Meat Board minimum	58	100	103	100
Milkfat				
SMP	180	185	230	280
Dairy Board minimum	165.72	185	230	268

Funding

Payments made under the SMP scheme are funded initially from accounts set up at the Reserve Bank. In the case of meat and wool two special accounts, the Supplementary Minimum Meat Prices Account and Supplementary Minimum Wool Prices Account, were established with payments being administered by the respective producer boards. Drawings made on the accounts incur an interest rate of 1 percent. In the case of dairy products the funding is handled through the Dairy Industry Reserve Account again attracting an interest charge of 1 percent. Given the buoyant trading conditions for most dairy products at present, it is unlikely that any payments will be required to this sector.

The Government may reimburse the accounts for any drawings made during the season or after the season ends. The respective seasons for the dairy, wool and meat industries run to May, June and September.

Operation of the Scheme

The fundamental structure and purpose of the SMP scheme is uniform in all three industry sectors but particular arrangements apply to its operation in each because of their individual characteristics. Brief descriptions of the way the scheme operates in each sector follow.

Wool

The Government establishes an average minimum guaranteed price for wool sold in the season. In 1981/82 this is 320 c/kg. However, a number of conditions must be met before wool is covered by the scheme and can therefore qualify for supplementation:

— the wool must be being offered at its first point of sale

— the wool may be greasy or scoured shorn wool, including dead wool but slipe and dag wool are not covered

— the wool must be sold through auction, registered private buyers, co-operatives, pools wool sold in the United Kingdom or under the Board's extra choice scheme.

Supplementation is based on a percentage calculated on the difference between the AWASP for each auction sale and the SMP set for the season. For example, if the AWASP for a particular sale in 1981/82 is 280 cents/kg, the difference between that and the 320 cents/kg minimum (40 cents) is expressed as a percentage of the 280 cents/kg (i.e. 14.3 percent) and 14.3 percent is added to the price for each type of wool sold at the auction. (A supplement is only paid if the percentage exceeds 0.5 percent.)

The AWASP for any particular sale is applied to all privately sold wool from midnight on the day before that auction sale until midnight the day before the next auction sale and any percentage payable is based on that AWASP value.

The SMP scheme does not supplant the Wool Board's own minimum price scheme or the Government controlled trigger price. If prices fall below the minimum floor price (250 c/kg in the 1981/82 season) set by the Wool Board then the Board will either purchase the wool and/or supplement the prices realised at auction up to the point where Government supplementation begins. If, on the other hand, prices reach the trigger price (400 c/kg) then skimming off will take place.

Meat Scheme

For meat, supplementary minimum prices are set for specified 'benchmark' export meat grades. Payments for non-benchmark grades are calculated on a scale relative to the benchmark grades. The requirement for any supplement, and the size of it, is normally determined by the amount by which the SMP level exceeds the meat exporters schedule (as advised by the freezing companies) for the benchmark grades. Where different schemes have been offered, as in the case of beef slaughter in the South Island compared with the North Island, the supplementation has been based on the higher scheme. If supplementary payments are made, the freezing companies obtain reimbursement from the Meat Board which in turn draws on the Supplementary Minimum Meat Prices Account.

The Government SMPs again operate in tandem with the price smoothing schemes administered by the Producer Board. If schedule prices exceed the stabilisation scheme's trigger price, then half the difference will be skimmed off into the Meat Income Stabilisation Account. If schedule prices fall below the SMP levels for the benchmark grades but higher than the minimum prices established by the Meat Export Prices Committee of the Meat Board, then the Government will bear the full cost of supplementation. Finally, if schedule prices fall below the Board's minimum for the benchmark grades the Board may either supplement up to its own minimum as set by the Meat Export Prices Committee (using funds from the Meat Income Stabilisation Account) or it may issue a Board schedule and purchase the product as has been done with mutton and most recently lamb in the current season. In either case, the Government supplementation cost relates to the difference between the SMP levels and the schedule or Meat Board minimum prices, whichever are the higher.

Dairy

For the Dairy industry the Government sets a price payable per kilogram of milkfat processed (280 c/kg in 1981/82). A government supplement to bring prices up to this level is made if the combined Dairy Board basic price plus 50 percent of the forecast trading surpluses of the milkfat and solids-not-fat (SNF) accounts are less than the SMP.

The Dairy Board sets a basic payout price each season, expressed in cents per kilogram of milkfat processed. On the basis of this price payments are made to dairy companies progressively during the season in line with their production. At the end of the season an 'end-of-season payout' is made once trading results are known when a part of any surplus (generally 50 percent) in the two major trading account identities, the milkfat and solids-not-fat accounts, is paid out to the companies. The SMP price is therefore set in relation to the basic price but making allowance for the expected end-of-season payment.

Individual dairy companies are responsible for the level of payments to their suppliers. These can fluctuate around the basic price set by the Dairy Board depending on their product mix, manufacturing cost levels and other financial commitments arising out of capital works development. The SMP price is related to the basic price to companies rather than to the more diverse final payment to suppliers.

Monetary Implications

Payment of supplements under the SMP scheme in the current season is high enough to exert a significant impact on monetary conditions in the 1981/82 fiscal year. Taken on its own, an injection of funds of this magnitude coming direct from the Reserve Bank into the monetary base would be expected to contribute to a significant easing in liquidity. However, if the Government took action at the same time to withdraw funds from the monetary base, as it has been doing with its recent public debt operations, the impact will be greatly lessened. Whether the Government felt that most benefit would be gained from extra liquidity being channelled into the economy in this manner or in some other way would also affect its assessment of the payments.

The concerns which may arise from large injections of liquidity through SMP payments with regard to monetary policy stem from the fact that the addition to the monetary base may stimulate an expansion in private sector credit by the major lending institutions at a time when credit expansion is already excessive.

In terms of more general policy issues, such payments raise questions concerning the level of support which certain sectors of the economy may receive, or certain groups within a sector. Support of this kind, where it is not available to all export industries, carries with it the possibility of introducing distortions into the structure of export industry activity because it weakens the impact of market signals on the recipients. Against this can be set the benefits which are expected to stem in the form of increased production because of the heightened certainty and confidence which producers experience when short-term market fluctuations are modified in this way.

These are wider policy issues associated with the SMP scheme which have in recent months become the subject of considerable debate. The purpose of this article has been the more narrowly defined one of providing an overview of the way the scheme operates, the objectives which lay behind its establishment and a brief comment on the scheme's monetary implications. These can be significant and are therefore an element to be taken into account in any more broadly based assessment of the scheme's value.