THE FARMING DOWNTURN

This article discusses recent and prospective future developments regarding the New Zealand agricultural industry. Comment on the two farm packages announced in December 1985 and July 1986 is also included.

Introduction

Most farmers are now faced with a major adverse change in their financial circumstances. Although an assessment of the scale of the overall problem is plagued with difficulties, it has been estimated that by mid-1986 around 10 per cent of all farmers were in a critical financial position, with few prospects of trading their way out of difficulty. Moreover, it was thought that there were a further 30 per cent involved in traditional pastoral farming activities or in horticultural operations who would have difficulty surviving unless market conditions improved within three years.

This article begins with a discussion of developments in the farm sector over the last decade, giving some emphasis to the most significant factors contributing to the present plight of farmers. A discussion of the objectives and rationale underpinning the farm policy packages announced in December 1985 and subsequently in early July 1986 follows. To conclude there are some thoughts about the future prospects for farming.

Farming Trends Over the Last Decade

Perhaps the most fundamental factor affecting New Zealand farming is that trends in international agricultural product markets have been developing adversely for many years. One consequence is that New Zealand has been operating within the constraint of a long-term trend decline in its terms of trade. As table 1 demonstrates, the terms of trade (average export prices divided by average import prices) have generally moved up and down in line with recessions and recoveries in the world economy, but these cyclical fluctuations have been superimposed on an overall downward trend. The terms of trade trough reached in the early sixties was relatively more favourable than the trough reached later in the decade, which in turn was a better position than the low point reached in the mid-seventies. The current situation is even more unfavourable as the terms of trade have continued to decline through the first half of the current decade — despite a sustained recovery in the world economy since the end of 1982 which might have been expected to lift our export returns.

Moreover, the terms of trade are not a good measure of international trading conditions specific to the farm sector, since they include non-farm exports which have accounted for an increasing proportion of the measure. Table 1 also shows estimates of the terms of trade for agricultural products for the world as a whole. Since 1960 average prices for all goods rose by around 8 per cent on average each year, but the average price rise for agricultural production amounted to only 3 per cent per year. The net effect of this has been that the relative price of agricultural output has now been reduced to around one-third of its 1960 level. Although these figures apply to agriculture in the world as a whole rather than to New Zealand specifically, they are nevertheless indicative of the deteriorating market environment faced by the New Zealand agricultural sector.

The consequences for New Zealand have been exacerbated by protectionist measures in many of New Zealand's potentially most lucrative markets. Quantitative restrictions have been widespread, while the increasing reliance on agricultural price support mechanisms — in particular in Europe and in North America — has artificially stimulated farm output. An additional negative influence may have been a shift in tastes in the industrial countries from red meats to white meats.

Following the especially marked turndown in the terms of trade during the mid-seventies the country was faced with a policy choice. The export sector could have been left alone to adapt to the tougher trading environment as best it could. But at the time there was a widely held view that the only way growth could be sustained was by consciously adopting policies which would increase the volume of traditional exports. Also, although there was a recognition that the terms of trade had been declining progressively over an extended period, at least a partial terms of trade recovery was anticipated. Accordingly, though there were costs to the taxpayer involved, the Government introduced various schemes designed to promote traditional forms of pastoral farm output, and hence export receipts.

Initially the Livestock Incentive Scheme and Land Development Encouragement Loans were introduced. More recently in 1981/82 Supplementary Minimum

Table 1
International Trade Prices

	1. New Zealand Terms of Trade[1] (Year ended June)	2. World Wholesale Price for Agricultural Materials[2] (Calendar Years)	3. World GDP Deflator[2] (Calendar Years)	4. Implied Terms of Trade for World Agriculture (Column 2 divided by column 3)
1960	96	41	24	171
1961	90	38	25	152
1962	94	36	26	138
1963	99	37	26	142
1964	111	37	28	132
1965	108	36	29	124
1966	107	37	30	123
1967	101	34	31	110
1968	89	33	33	100
1969	88	35	34	103
1970	87	32	36	89
1971	83	32	38	84
1972	93	41	41	100
1973	113	74	45	164
1974	112	71	52	137
1975	78	57	58	98
1976	72	71	64	111
1977	79	73	71	103
1978	78	79	78	101
1979	86	96	87	110
1980	82	100	100	100
1981	76	85	113	75
1982	77	81	127	64
1983	74	84	145	58
1984	75	88	152[3]	58[3]
1985	73	77	159[3]	48[3]

1 Department of Statistics, series S5T95.
2 International Monetary Fund; International Financial Statistics, series 76 bx and 001.
3 Reserve Bank estimates.

Table 2[1]
Index Of Volume Of Production

Commodity	Year Ended June 1977–78	1978–79	1979–80	1980–81	1981–82	1982–83	1983–84	1984–85
Wool	1000	1032	1161	1247	1187	1183	1176	1254
Sheep	1000	982	1162	1178	1153	1270	1207	1334
Cattle	1000	966	980	958	1000	1026	872	1003
Pigs	1000	896	878	865	878	888	966	1050
Dairy Products	1000	1082	1136	1092	1088	1113	1230	1259
Poultry Products	1000	1011	1049	1120	1144	1251	1211	1356
Crops And Seeds	1000	1019	980	961	1003	1094	1266	1306
Fruit, Nuts And Oilseeds	1000	1163	1236	1339	1638	1532	1892	2249
Vegetables	1000	937	997	933	1034	1048	1060	983
Other Horticultural Products	1000	1213	1585	1782	1901	1852	2230	2230
Other Farm Products N.E.C.	1000	1186	1601	1847	2070	2543	2996	3551
TOTAL – All Farm Products	1000	1025	1115	1132	1147	1181	1218	1307

1 Figures for 1982–83, 1983–84 and 1984–85 are provisional
Source: Department of Statistics; Infos database system.

Table 3
Contribution to Gross Domestic Product (March years)[1]

	1975–76	1976–77	1977–78	1978–79	1979–80	1980–81	1981–82	1982–83	1983–84	1984–85
					$ million					
Agriculture	1071	1405	1340	1422	2139	2161	2248	2117	2413	3542
(as percent of total)	(9.2)	(10.0)	(8.7)	(8.1)	(10.1)	(8.8)	(7.7)	(6.7)	(7.0)	(8.8)
					in constant 1977–78 prices. $ million					
Agriculture	—	—	1340	1252	1424	1601	1559	1659	1684	n.a.
Total			15424	15454	15835	15932	16674	16752	17218	18308

1 Figure for 1981-82 to 1984-85 are provisional.
Source: Department of Statistics, Infos database system.

Prices became a major form of Government assistance to the industry, and in 1982/83 the Meat Board started to borrow heavily in order to sustain meat prices at levels above those justified by world market conditions.

Between 1977/78 and 1984/85 wool production rose by 25 per cent in volume terms, while the production indices for sheep and dairy production increased by 33 per cent and 26 per cent respectively (table 2). But these gains were only achieved at a significant cost to taxpayers. Supplementary Minimum Price payments totalled around $1 billion in the three years to 1984/85 when they were phased out; the Meat Board's cumulative meat trading losses, which eventually will be funded by the public, also amounted to nearly $1 billion between 1981/82 and mid-1985/86 when meat marketing reverted to the meat companies; and interest rate concessions for the farm sector were widespread.

At the same time the production of non-traditional agriculture was growing even more strongly in response to newly developed markets and the emerging awareness of alternative profit opportunities. The 'fruits, nuts and oil seeds' category of farm production which includes kiwifruit, rose by 125 per cent between 1977/78 and 1984/85, while over the same period the 'other farm products' category, which includes venison, velvet and mohair, increased by 255 per cent — albeit from a low base.

Overall agricultural production rose by 31 per cent in the seven years to 1984/85, significantly faster than the 19 per cent gain obtained in total production for the economy as a whole, as measured by Gross Domestic Product (GDP) in constant price terms (table 3). But irrespective of the faster than average output growth in the agricultural sector, agriculture's relative importance to the economy has not been growing. In 1975/76 agriculture accounted for 9.2 per cent of GDP but by 1984/85 — a good year for farming — its relative share of GDP was little different.

This apparent dichotomy is fully accounted for by the declining relative value of agricultural output. The Department of Statistics prepares GDP estimates in both current price and constant price terms. The constant price estimates based on prices prevailing during the year ended March 1978 show that agriculture's contribution to this measure of GDP, which removes the effect of relative price changes, has been rising at least as fast as agricultural production levels. Since these GDP estimates reflect agriculture's contribution after farm inputs have been netted off, there is an implication that farm input volumes have risen no more than proportionately with production levels. Moreover, as table 4 demonstrates the agricultural sector's input price rises have been no faster than for the economy generally. This leaves the declining relative price of agricultural output as the only possible explanation for agriculture's failure to increase its relative contribution to the economy in line with its faster than average output growth.

Table 4
Producer Price Indices
(December quarter 1982 = 1000)

	All Industry	Agriculture		
June Year	Inputs[1]	Inputs[1]	Outputs[2]	Implied Terms of Exchange (Outputs/Inputs)
1978–79	532	564	653	1158
1979–80	652	692	770	1113
1980–81	776	794	802	1010
1981–82	907	917	919	1002
1982–83	1003	1000	1008	1008
1983–84	1038	1048	1104	1053
1984–85	1187	1188	1294	1089
1985–86	1296	1283	1231	959

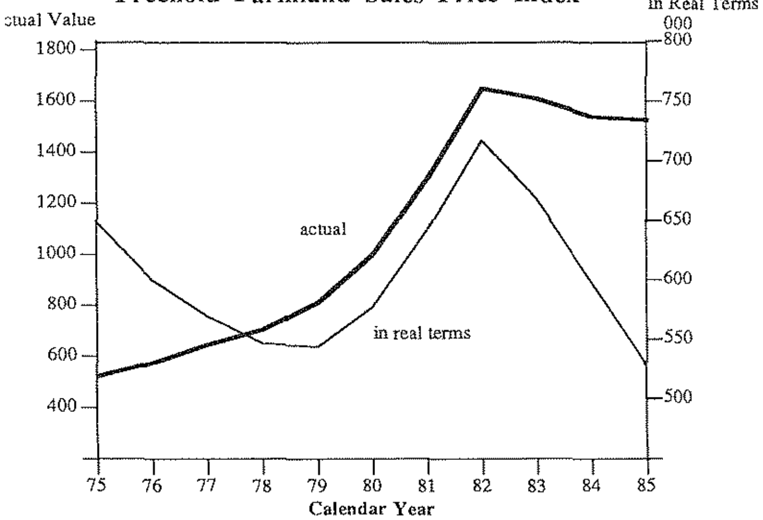
1 Input prices are producer's prices and include commodity taxes paid and subsidies received by the producer.
2 Output prices are farm-gate prices before addition of commodity taxes or deduction of producer subsidies.
Source: Department of Statistics, Infos database system.

Despite this, a rapid farmland price inflation occurred. The Valuation Department's freehold sales index shows that average farmland sale prices rose very rapidly through 1980, 1981 and 1982. The cumulative increase over this period exceeded average price rises in the economy generally by around 32 per cent, making it difficult to avoid the conclusion that farmland prices lost touch with the underlying earning potential of farmland during this period.

Although the advent of large producer subsidies is likely to have contributed to the land-price inflation, subsidies do not provide a complete explanation, since much of the farmland price inflation preceded the major broadening in farm subsidies in 1981/82. Speculative influences appear to have had a role to play; as did the taxation system which, when combined with the belief that inflation would continue, meant that farming for capital gains was an attractive proposition. Irrespective of its cause, the land-price inflation of the early eighties is now of some significance, since many, though by no means all, of those farmers currently in the greatest difficulty purchased their farms either at or near the peak of the boom in farmland prices. Other more established farmers are now in financial difficulty because they borrowed to fund the push for the extra production the Government sought to encourage.

The period since the mid-seventies has thus been one when agricultural output gains were encouraged, and when the sector was at least in part shielded from the income consequences of progressively deteriorating international trading conditions for farm produce. Also, the early eighties was a period notable for rising farm prices unrelated to the fundamental underlying health of the industry.

Freehold Farmland Sales Price Index[1]



1. The nominal value figures are taken from the Valuation Department's Research paper 86/2; while the real term data use Reserve Bank GDP deflator estimates to adjust the nominal value figures

The Rural Policy Measures

The Policy Background

Although problems with traditional forms of pastoral agriculture have been developing for a number of years, they did not manifest themselves fully in terms of farmers' cash flows until towards the end of 1985. Most major components of government assistance to agriculture were withdrawn in the 1984 Budget, but the negative impact of this on agricultural incomes was initially offset because the exchange rate was devalued by 20 per cent at around the same time.

Moreover, insofar as the meat industry is concerned, the Meat Board continued to market the bulk of New Zealand's meat production at a significant loss until September 1985, effectively driving a wedge between trading conditions in the world meat market and meat producers' incomes. Thereafter meat producers were faced with significantly reduced schedule prices reflecting returns actually being achieved in export markets. Throughout this period interest rates were rising, and in an associated development the exchange rate, which had been floated in March 1985, strengthened through to October 1985.

The downturn in farm incomes so soon after most farm subsidies had been removed, and at a time when the exchange rate had appreciated considerably, contributed to the sentiment held in some quarters that the Government should ease the situation with urgent action to reduce the exchange rate together with a return to cash assistance for the agricultural sector. But the Government rejected these options for the following reasons.

Although by October 1985 there is little doubt that the dollar had risen to an uncomfortable level for exporters, the deterioration in underlying farming conditions over the past year has a more fundamental origin, as demonstrated in table 5. Export prices for agricultural production fell by 9.1 per cent in the year following the dollar float in March 1985. Yet over the same period the trade weighted exchange rate appreciated by only a little over 3 per cent — implying that world agricultural price levels were a much greater threat to farming than was the exchange rate. Furthermore, since March 1986 the exchange rate has declined to its current level some way beneath its pre-float level, yet a farming profitability difficulty, although reduced, still exists.

Table 5
Price Indices For Exports
(Year ended June 1982 = 1000)

June Year	*Agricultural Production*	*Manufacturing*	*All Exports*[1]
1975-76	426	460	431
1976-77	537	540	534
1977-78	562	587	561
1978-79	659	653	647
1979-80	804	756	786
1980-81	878	840	873
1981-82	1000	1000	1000
1982-83	1040	1114	1057
1983-84	1087	1212	1125
1984-85	1306	1492	1376
1985-86	1202[2]	1472[2]	1283[2]
Quarterly			
1984 Sep	1213	1406	1286
Dec	1330	1486	1396
1985 Mar	1340	1559	1410
Jun	1321	1527	1396
Sep	1256	1479	1327
Dec	1178	1421	1250
1986 Mar	1217[2]	1510[2]	1301[2]
Jun	1176[2]	1492[2]	1262[2]

1 Includes fisheries, forestry, fuel and power, and mineral resourcer industries together with agricultural production and manufacturing.
2 Provisional
Source: Monthly Abstract of Statistics, table 21.10

One of the main reasons sustaining the continued perception in some quarters that the exchange rate is imposing an intolerable restraint on farm incomes is that while the exchange rate has moved down beneath its pre-float level, domestic price rises have continued to exceed those of New Zealand's trading partners. In other words, the fact that the real exchange rate remains higher than it was immediately after the 20 per cent devaluation of mid-1984 is due to relatively high domestic inflation rather than to a higher nominal exchange rate.

It would be possible to intervene in the exchange markets in an attempt to reduce the exchange rate. However, overseas experience suggests that action of this kind carries no assurance of success, unless the authorities are prepared to relax domestic monetary conditions. But if easier monetary conditions are permitted, any immediate benefit to farmers in terms of a lower nominal exchange rate would be short-lived, since in time it would simply lead to both higher inflation and higher domestic interest rates. It is difficult to judge whether these latter consequences would fully offset the initial income gains to the farming community, but certainly to the extent that higher inflation and higher interest rates would ultimately be involved, the option of a deliberate easing in domestic monetary conditions would prolong rather than cure farmers' difficulties.

The alternative approach being pursued involves a trend reduction in the fiscal deficit together with the retention of firm monetary conditions designed to bear down on inflation in the medium term. As these policies succeed in lowering inflation expectations the general level of interest rates is likely to fall progressively.

These policies are supported by the many measures that have been taken to remove artificial incentives and pricing distortions throughout the economy and so expose domestic producers to the disciplines of competitive market forces. The essential goal is to make the economy adapt and be responsive to changing economic conditions, so that domestic resources are applied to areas where they can be used most profitably.

The Government's reluctance to resurrect product price assistance in response to the recent downturn in agricultural returns has to be viewed within the context of the general policy framework. Apart from the fiscal cost implicit in subsidies for agriculture, there was also a concern about the way in which the large product price subsidy payments of recent years have significantly distorted farm production patterns.

Quantitatively, the most assistance was directed to farming activities with the biggest problems. Originally this was done with the intention of temporarily cushioning the most hard-pressed farming activities, pending a return to better international trading conditions. But now that the anticipated price turnaround has not occurred it is apparent that the overall effect of the subsidies was to delay the process of adjustment. In effect the subsidies were forestalling the changes in production patterns which are needed to redress the long-term problems facing the farm sector.

Moreover, the subsidies had started to attract international attention, particularly within the United States, where countervailing duties on lamb were imposed. To the extent that this occurred New Zealand farmers gained no income benefit, since the New Zealand subsidy was simply offset by reduced product prices and hence reduced export returns from the United States market. In effect, the subsidy itself was exported — to the benefit of taxpayers in the United States.

It was against this background that the Government released two statements affecting the agricultural sector — the first in December 1985 and the second in early July 1986.

The December 1985 Statement

The specific measures announced in the December statement were of three types. Some farm specific measures were designed to remove restrictions restraining the demand for rural land, which by then had begun to fall in price rather alarmingly. Some other farm specific measures were designed to bring about a better match between the return on farm investment accruing to individual farmers, compared to the return on the same investment obtained by the nation. The third group sought to improve efficiency and to reduce cost pressures throughout the economy generally.

In the farm specific category, the rule restricting absentee owners to a $10,000 maximum annual loss offset against their other income was removed in those cases (involving livestock and arable farming). The Income Tax Act provision whereby interest deductions were clawed back when they related to borrowing used to finance an agricultural asset sold within a 10 year period was also removed, though this affected a broader range of agricultural activity than just livestock and arable farming. It was felt that the existing legislation had been discouraging the change of land ownership, and hence inhibiting farm diversification, depressing the potential sale price of rural land. For the same reasons it was announced that the Government intended to repeal the legislation restricting the aggregation of farmland.

Changes to the tax treatment of farm livestock and development expenditure were also announced. The intention was to move towards a tax system which would not discriminate between farming and other forms of business activity. Historically, the farm sector has had access to concessional tax arrangements which effectively permitted income tax to be deferred, and which had the effect of creating a distinction between tax efficient on-farm investment decisions and sensible investment decisions for the country as a whole.

The broader economy-wide measures announced included an accelerated programme of import protection reform involving inter alia, immediate tariff reductions affecting several hundred tariff categories. The Minister of Finance also announced that the Government intended to press ahead with its programme designed to ease domestic cost pressures emanating both from the public sector and from New Zealand's system of industrial relations.

The July 1986 Farm Package

In the six month period following the publication of the December statement, the current and prospective cash flow situation on grazing farms and on some horticultural properties continued to deteriorate. It was also realised that many in the dairy farming industry would be in difficulty once the Dairy Board reduced its payments for dairy products to a level consistent with international dairy market price trends. Against this background of eroding income prospects farmland prices were continuing to fall, leaving a number of farmers with no equity and few prospects of avoiding bankruptcy and mortgagee sales. Others with greatly reduced equity levels were in no position to offer adequate security for seasonal finance: in some cases their ability to survive was in doubt, even though they may have been involved in viable farming operations if judged from a medium-term perspective. The potential volume of mortgagee sales involved was such that there was a significant risk of a disorderly rural land market, with land prices falling unnecessarily steeply, and of needless dislocation for both farmers themselves and the provincial towns.

In July the Minister of Agriculture and Fisheries announced jointly with the Minister of Finance a further rural policy package. Its main features were a discount scheme for farm borrowings from the Rural Bank and for loans taken out through the Department of Maori Affairs, a conditional seasonal finance guarantee scheme, and extended social welfare assistance for farm families in distress.

With overall lending of around $2.8 billion as at March 1986 — much of it at concessional rates of interest — the Rural Bank is the agricultural sector's largest individual creditor. The discount scheme was designed to enhance the equity position for some of its clients unable to meet their debt servicing obligations. Under certain conditions clients in financial trouble and with loans from the Rural Bank at concessional rates of interest will be able to take up the option of paying a market-related rate of interest (currently 17.5 per cent) in return for a reduced debt obligation to the Rural Bank. Under this option the scheduled total of quarterly interest payments combined with capital repayments will be maintained at an unchanged rate.

In itself this does nothing to redress farmers' cash flow difficulties, but it does enhance their equity position. Typically a borrower's debt to the Rural Bank can be reduced by 20 — 25 per cent by these means. The offer is conditional on the farmer first rationalising his or her on and off-farm resources, and also on other lenders making sufficient concessions with respect to the farmer's cash flow position to return the farm to a viable financial condition on the basis of expected 1986/87 farmgate prices. The inducement for private sector lenders to do this is the farmer's improved equity position associated with the Rural Bank's discount offer, which increases the security available to support other loans.

The conditional seasonal finance guarantee scheme is intended to tide farmers over for the period until their debt restructuring has been completed. It therefore applies to the period to June 1987. Inevitably farm debt restructuring will take some time to complete, and in the interim some farmers will experience difficulty in gaining access to the seasonal finance needed to maintain production. The guarantee is being made available by the Rural Bank, which will bear 50 per cent of the risk with the other 50 per cent being borne by other creditors. Limits tailored to individual farm circumstances apply, and the guarantee is to be given only in those cases where there is a reasonable prospect of the farmer and his or her creditors reaching an agreement on debt restructuring.

It is certainly true that these farm packages offered less in the form of direct assistance than some farmers would have wished. On the other hand, the discounting offer — along with the limited seasonal finance guarantee — does have features which will permit many farmers to survive when otherwise they would not have. Moreover, the judgment concerning future farm viability allows for planned changes involving different techniques and products. The discounting scheme therefore not only addresses the debt issue, but it also encourages restructuring as more generally defined.

The package integrates dispensations from the private sector with public sector concessions, and in doing so makes farm debt restructuring a co-operative exercise. This is an appropriate response, since both the public and the private sector have an interest in minimising needless mortgagee sales and individual farmer bankruptcies, which have the potential to force rural land prices down beneath the levels which would otherwise be justified in the market place. In this sense the Rural Bank's discounting offer is in their own best commercial interest. In addition a deliberate design feature of the discount scheme is that New Zealand's foreign competitors cannot claim that a further subsidy for farming is involved — in those cases where discounts are agreed, the Rural Bank will have no fewer cash flow receipts than previously. While its capital repayment receipts will in effect be reduced, that reduction will be matched exactly by an increase in interest receipts.

Future Prospects

Perhaps the most fundamental factor affecting the current health of farming is the long-term trend decline in agricultural product prices. In part, this trend reflects rapid technological gains in growing techniques, and there are those who believe that technological change in agriculture will, if anything, accelerate in future. Quite simply the world is becoming increasingly accomplished in providing for its food and other agricultural product needs. Given that the numbers actively engaged in the agriculture sector have not declined in line with their rising productivity levels, world markets for many agricultural products are oversupplied.

As noted earlier, although farm product returns have been falling relative to other prices, typically there have been movements above and beneath this trend in sympathy with cyclical fluctuations in the world economy. But the severity of the current situation is in part due to the fact that, unlike past experience, prices for agricultural products have not recovered after four years of sustained — albeit moderate — world growth. Although this has been beneficial in reducing inflationary pressures throughout the world, it also means that agriculture is in trouble in most producing nations.

In a totally free market environment this situation would tend to be self correcting — market price signals would in time encourage resources out of agriculture into alternative activities, leaving those remaining within the agricultural sector with satisfactory income levels. But over time the advent of progressively more determined protection together with more generous subsidies — in Europe, in North America, and in other countries including New Zealand — has tended to forestall this mechanism.

On the face of it, the future for agriculture does not seem to be promising. Unless something dramatic happens, continued technological gains coupled with the existence of a set of protected producers insulated from the usual market price signals, imply a world where agricultural markets are likely to continue to be dominated by substantial excess capacity and large surplus stocks.

Yet on the positive side there are some signs that agricultural protectionism and its associated subsidies may now begin to reduce. The problems it has caused are now widely recognised. The United States and the European Community seem to be threatening to engage in what is colloquially known as a 'trade war' on the matter. Also, there is a growing political resistance within these groups to the budgetary cost of agricultural product price support programmes. Finally, both the United States and the European Community have recently introduced schemes designed to restrict the production of dairy products. Of course this is exacerbating some New Zealand farmers' present difficulties, since one consequence is an artificial level of cow slaughtering in the United States which has affected world beef prices. But in due course this effect will unwind, at which point there is the prospect of firming beef prices together with a better balanced world market for dairy products.

Turning to a broader arena, there is now a developing initiative to integrate agriculture fully within the General Agreement on Tariffs and Trade (GATT) framework. In the past this agreement has delivered generally declining levels of protection for manufactured goods, but historically agriculture has in the main been left on one side. While there are no guarantees of any real progress on these issues, there are at least some hopeful signs that the world may now be entering a phase of declining agricultural protectionism.

While the problems inherent in agricultural protection are not of New Zealand's making, our past failure to adjust to deteriorating market conditions has exacerbated what would in any case have been difficult times. Now that the policy setting is one where the farm sector is fully exposed to market realities, the process of diversification both with respect to products and markets is likely to bring about a progressive improvement in the match between production patterns and market opportunities. Increasingly production is likely to be better linked with real markets, rather than with markets which are simply assumed to exist.

To the extent that this occurs there are likely to be concomitant benefits to agricultural earnings. Accordingly, in our non-traditional markets there is no reason why agriculture should not flourish. Agriculture within New Zealand has a history of efficiency resulting in part from the widespread application of advanced technology; and provided that the industry remains responsive to international trading conditions, there is little doubt that New Zealand's traditional advantages will continue to provide profitable opportunities which can be exploited.

In our more traditional markets the situation is more ambiguous, since in a number of respects the world market for some of New Zealand's traditional agricultural products is an administered market. Markets of this type are notoriously difficult to predict and it is not possible to reach any confident conclusion about the future. It is likely that production technology will improve apace; but ultimately, it will be beyond New Zealand's control as to whether the country benefits from this because of lower cost production, or alternatively continues to suffer from protected and subsidised production in competing nations. A continued diplomatic effort in this area appears warranted. The costs involved in attempting to bring all possible influence to bear on developments are likely to be insignificant compared with the potential benefits implicit in a system of freer world trade in agricultural products.

Insofar as agricultural product prices are concerned there appears to be no better option other than to expose the agriculture sector to the consequences of world price levels. This of course does not guarantee buoyant trading conditions, particularly in New Zealand's traditional meat and dairy markets, where future price levels will be dependent on decisions taken elsewhere. Nevertheless, agricultural profitability is not dependent on output prices alone, since input costs are equally relevant, and to some extent the latter are amenable to official influence. It is in this area that much has been done:

— in many cases the recent farm package will lead to more manageable debt servicing burdens;

— domestic monetary and fiscal policies are unambiguously directed at improving New Zealand's inflation performance, which is the key to reduced interest rates;

— many forms of protection, which have in the past added to cost pressures within the economy, have been scaled back and others have been removed altogether — the economy is being made more competitive;

— though reform of the labour market has been slower in coming, the initial stages of the review process have taken place, and shortly the Government's proposals improve the functioning of the labour market are to be made public.

None of this means that there is not some way to go, but to date significant progress in redressing the cost pressures facing farmers has been obtained, and further progress seems likely to follow. The present stance of policy affecting agriculture does not, nor could it, guarantee the farming community a prosperous future. Ultimately, the returns to domestic agriculture have to be firmly embedded within the constraint of international trading conditions — if for no reason other than agriculture's importance to the New Zealand economy. Its relative size means that subsidies designed to sustain product prices above world levels over anything other than the short term — and on a sufficient scale to make any significant difference to farm incomes — would by reintroducing distorted production patterns, lower New Zealand's overall productive capacity, to say nothing of the fiscal cost involved. Instead the Government has done much to reduce inflation on a sustainable basis, and to improve the efficiency of the economy generally. Ultimately, these offer the farming community the best hope of being able to cope in what clearly are difficult times.