policies can increase our supply of goods and services, improve our
efficiency in using the Nation’s human resources, and help people
lead more satisfying lives.

INCREASING THE RATE OF CAPITAL FORMATION
(Investment Policy Report)

To reach a number of our important economic goals, the share of
national output devoted to capital formation will have to increase in
the 1980s. Lifting the growth of productivity from the very low levels
of recent years will require an accelerated rise in the stock of capital.
Environmental and related improvements will also demand large in-
vestments. Further, as discussed earlier in this chapter, we will need
to invest very substantial sums in developing alternative sources of
energy and improving the energy efficiency of the economy. A larger
and more efficient capital stock would also help the United States to
compete in world markets, improve the foreign trade balance, and
strengthen the value of the dollar relative to other currencies in ex-
change markets.

Because of the importance of capital formation in determining the
long-run growth of the economy, the Humphrey-Hawkins Act places
considerable emphasis on the performance of business fixed invest-
ment. One of the requirements of the act is that an Investment Policy
Report be included in each Economic Report of the President. The follow-
ing section touches on the topics specified in the act; relevant mat-
ters, such as policies dealing with Federal expenditures, Federal reg-
ulation, and international trade, are discussed in more detail else-
where in this Economic Report.

THE ADEQUACY OF RECENT INVESTMENT

An examination of recent trends in investment raises a number of
questions. The fraction of GNP devoted to investment in 1978–79
has approached the shares realized in the late stages of the last two
expansions, but this proportion was relatively low during the early
stages of the recovery from the 1974–75 recession. Thus the addition
to the stock over the past 4 years has been relatively small, especially
when the depreciation of the stock during this period is taken into
account. At the same time the growth in the labor force was larger
than in earlier periods, and hence the rate of growth in the capital
stock available per worker fell substantially. Furthermore some of the
recent investment has been devoted to meeting increased energy
needs and the requirements of environmental, health, and safety reg-
ulations. While such investment is important to national goals, it
does not directly expand industrial capacity or contribute to meas-
ured productivity. Finally, the composition of investment has been more heavily weighted toward shorter-lived assets than it was in periods prior to the 1974-75 recession.

Since 1974 the share of gross business fixed investment has reached 10 percent of GNP only during the last 2 years (Chart 6). Moreover the 1979 gain occurred despite reduced growth in real investment expenditures; real GNP grew at a still lower rate.

Chart 6

Real Nonresidential Fixed Investment
as Percent of Real GNP

Historically it has not been uncommon for the share of such investment in GNP to rise as growth of the economy begins to slow. Similar behavior occurred in 1960, 1969, and again in 1974. The growth of investment does not always coincide with the overall growth of the economy because actual investment expenditures lag the planning and appropriation stages and because expenditures for ongoing projects are not necessarily curtailed in a downturn.

The composition of recent business fixed investment has been quite different from historical norms. In 1979 the share of investment in producers' durable goods in real GNP (7.0 percent) was the
second highest in the last three decades. Both motor vehicles and other equipment attained shares of GNP that approached record peaks for the year as a whole, although purchases of vehicles declined sharply during the course of 1979. In contrast the share of real GNP accounted for by business investment in structures (3.3 percent) continued to be less than that realized in every year between 1947 and 1974.

A variety of causes could be found for the changing strength of the major components of business fixed investment. One is Federal tax legislation, which since 1971 has increased the investment tax credit for equipment while giving structures only partial coverage. Another is that the higher level of inflation in recent years has increased the tax burden on long-lived assets relative to short-lived assets. Uncertainty about future economic conditions and about the outcome of various regulatory processes has intensified, and such uncertainty tends especially to penalize investments in assets with long-term payoffs.

As discussed in Chapter 2, only part of the unsatisfactory productivity of recent years can be blamed on declining rates of capital accumulation. Nevertheless there is little doubt that increased rates of capital formation will improve productivity in the future. Capital accumulation increases labor productivity directly by giving labor more to work with, and some technical advances contribute to productivity growth only when they are embodied in the capital stock.

*Investment and Innovation*

The last point made in the preceding section takes on special significance in the light of changes in the average age of the capital stock. From 1948 through 1966 the average age of producers' durable equipment and structures fell about 3 years. The average age fell by about 1 year from 1966 through 1973. Since 1973 the average age of business capital has not changed significantly. Because the gap between best-practice and average-practice technology is narrowed when innovations are put in place, modernization of the capital stock is one way to diffuse innovation that will add to productivity. Not all technical progress is embodied in capital, however, and the quality of some new capital may change little. Thus the fact that the average age of the capital stock has remained constant may account for only a small portion of the recent declines in productivity growth.

A Domestic Policy Review, initiated by the President, recently assessed the proper role of the government in fostering industrial innovation. On the basis of this review, the President sent an Industrial Innovation Message to the Congress in which he detailed a number of steps that the Administration had taken or would soon be taking.
Specifically, the President's 1981 budget proposes programs to encourage the development and transfer of technical information and to improve the patent system. The budget also contains proposals to stimulate small businesses devoted to high technology, including direct support to small research and development firms. The President has directed the Small Business Administration to increase further the availability of venture capital to these firms. Finally, also to increase the availability of venture capital, Employee Retirement Income Security Act regulations have already been changed to allow pension funds to invest in small innovative firms.

Federal support for research and development, measured in real terms, fell substantially between 1969 and 1975. In more recent years the trend has been reversed. The Nation's effort in basic research depends on the Federal Government for about two-thirds of its support. The budgets of the Administration have increased that support each year, the increase amounting to 22 percent in real terms between 1976 and 1979. The President's 1981 budget proposal continues that policy.

SPECIAL INVESTMENT NEEDS

Compliance with mandates to improve the environment, health, and safety requires substantial investment. The results of this investment—cleaner air, purer water, and a safer working environment—are not included in conventional measures of output, although they benefit everyone. Investments to meet regulatory requirements are financed from the same sources as investments that directly increase industrial capacity. Thus any given fraction of GNP devoted to investment will yield less measured gain in productivity than historical relationships would suggest. Meeting requirements of the Clean Air and Water Acts alone is estimated by the Environmental Protection Agency to have absorbed 5.6 percent of business fixed investment, or 0.6 percent of GNP, in 1977. Over the decade of the 1980s the investment required to meet existing environmental regulations alone is expected to average 0.3 to 0.6 percent of GNP. To the extent that new regulations are imposed, the share of GNP used may be larger.

The additional private investments directly attributable to increasing and diversifying our domestic energy supplies and improving energy efficiency will also be substantial. The requirements outlined earlier in this chapter, including those stemming from the national energy program, will add the equivalent of about 1 percent of GNP to investment needs. There will be other indirect investment requirements. Since rapidly rising energy costs increase the rate at which the capital stock becomes obsolete, replacement investment must also rise if a reduction in the Nation's productive capacity is to be avoided.
Even without the special investment needs of energy and the environment, it is difficult to imagine that healthy economic growth could be maintained by a ratio of business fixed investment to GNP of less than 10 percent. The direct investment requirements for increased energy supplies, plus environmental regulations currently on the books, could raise this to over 11 percent. Finally, depending upon how much investment will be required by new environmental regulations and by the need to accelerate the replacement of industrial facilities made obsolete by higher energy costs, the necessary investment ratio may be higher still. Achieving this level of investment will not be easy; the highest share attained by the economy in the postwar period was 10.8 percent in 1966.

SAVING-INVESTMENT RELATIONSHIP

The basic saving-investment relationship as measured in the national income and product accounts is presented in Table 23. The reported values represent the amount of gross saving by the household, business, and government sectors, along with gross investment by type of expenditure. Household saving equals disposable personal income less personal outlays, which consist mainly of personal consumption expenditures. Business saving is defined as retained earnings plus depreciation. The government sector’s contribution to national saving depends on the budget surpluses or deficits of Federal, State, and local governments. The government sector adds to national saving when a combined budget surplus is recorded.

Gross investment consists of domestic investment and net foreign investment. Net foreign investment is conceptually similar to the current account deficit in the balance of payments, with a surplus in the current account corresponding to positive net foreign investment. As Table 23 shows, saving and investment as fractions of GNP have increased in the last 2 years, although they remain slightly below the values of the 1965–69 period.

Whether business investment will grow enough to meet the country’s needs in the 1980s will depend on two key questions. Will investment incentives be sufficient to bring the demand for business capital goods up to the necessary level? And will the share of national saving in GNP expand to permit that investment demand to be realized without adding to inflationary pressures on the economy? While the two questions are related—since additional saving tends to lower long-term interest rates and encourage investment demand—it is useful to examine each of them separately.
TABLE 23.—Gross saving and investment as percent of GNP, 1965-79

[Percent]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross saving (^1)  (^2)</td>
<td>15.8</td>
<td>15.1</td>
<td>13.8</td>
<td>15.3</td>
</tr>
<tr>
<td>Personal</td>
<td>4.4</td>
<td>5.0</td>
<td>4.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Business</td>
<td>11.6</td>
<td>10.5</td>
<td>11.9</td>
<td>11.8</td>
</tr>
<tr>
<td>Government</td>
<td>-2</td>
<td>-5</td>
<td>-2.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Federal</td>
<td>-0.3</td>
<td>-1.2</td>
<td>-3.3</td>
<td>-0.8</td>
</tr>
<tr>
<td>State and local</td>
<td>(+)</td>
<td>0.7</td>
<td>1.0</td>
<td>1.2</td>
</tr>
<tr>
<td>Gross investment (^3)</td>
<td>15.8</td>
<td>15.3</td>
<td>14.2</td>
<td>15.5</td>
</tr>
<tr>
<td>Nonresidential fixed</td>
<td>10.5</td>
<td>10.2</td>
<td>9.8</td>
<td>10.6</td>
</tr>
<tr>
<td>Residential fixed</td>
<td>4.0</td>
<td>4.5</td>
<td>4.1</td>
<td>4.9</td>
</tr>
<tr>
<td>Change in business inventories</td>
<td>1.3</td>
<td>0.8</td>
<td>0.4</td>
<td>0.9</td>
</tr>
<tr>
<td>Net foreign</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.9</td>
</tr>
<tr>
<td>Statistical discrepancy</td>
<td>(+)</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
</tr>
</tbody>
</table>

\(^1\) Preliminary.
\(^2\) Includes net capital grants received by the United States, not shown separately.
\(^3\) Saving and investment may not be equal due to rounding.
\(^4\) Less than 0.05 percent.

Source: Department of Commerce (Bureau of Economic Analysis).

DEMAND FOR NONRESIDENTIAL FIXED CAPITAL

Future trends in capital formation will reflect both past and future investment incentives. Last year's Economic Report discussed many of the factors which appear to influence business decisions to invest. Table 24 presents data for a number of these factors.

Preliminary data for the year 1979 as a whole do not indicate a clear pattern. Two of the measures shown—capacity utilization and the rate of return on stockholders' equity—rose and were above their average levels for the 1955-69 period. The other three declined and

TABLE 24.—Determinants of business fixed investment, 1955-79

[Percent, except as noted]

<table>
<thead>
<tr>
<th>Period</th>
<th>Ratio of real capital investment to real GNP</th>
<th>Capacity utilization rate in manufacturing (^1)</th>
<th>Cash flow as percent of GNP (^2)</th>
<th>Rate of return on depreciable assets (^3)</th>
<th>Rate of return on stockholders' equity (^4)</th>
<th>Ratio of market value to replacement cost of net assets (^5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1955-69 average</td>
<td>9.5</td>
<td>84.2</td>
<td>9.4</td>
<td>12.9</td>
<td>6.4</td>
<td>1.097</td>
</tr>
<tr>
<td>1970-77 average</td>
<td>10.0</td>
<td>80.9</td>
<td>8.3</td>
<td>9.4</td>
<td>6.4</td>
<td>.917</td>
</tr>
<tr>
<td>1978</td>
<td>10.0</td>
<td>84.4</td>
<td>8.8</td>
<td>9.7</td>
<td>7.1</td>
<td>.678</td>
</tr>
<tr>
<td>1979: First 3 quarters (^6)</td>
<td>10.4</td>
<td>86.0</td>
<td>8.5</td>
<td>9.2</td>
<td>7.7</td>
<td>.654</td>
</tr>
</tbody>
</table>

\(^1\) Federal Reserve Board index.
\(^2\) Cash flow calculated as after-tax profits plus capital consumption allowance plus inventory valuation adjustment.
\(^3\) Profits before taxes plus capital consumption adjustment and inventory valuation adjustment plus net interest paid divided by the stock of depreciable assets valued at current replacement cost.
\(^4\) After-tax profits corrected for inflation effects divided by net worth (physical capital component valued at current replacement cost).
\(^5\) Equity plus interest-bearing debt divided by current replacement cost of net assets.
\(^6\) Seasonally adjusted.

Note.—For annual figures for 1955-77, see Appendix Table B-85.

Sources: Department of Commerce (Bureau of Economic Analysis), Board of Governors of the Federal Reserve System, and Council of Economic Advisers.
were below their 1955–69 averages. The steady increases in capacity utilization rates since the 1974–75 recession reflect the strength and duration of the subsequent recovery as well as the relatively slow accumulation of additional industrial capacity. The rate of return on stockholders’ equity also rose (see Table 24). However, this increase is not a good measure of the change in the rate of return available on new equity investments, because it stemmed largely from unanticipated increases in inflation which reduced the real burden of corporate debt. The slowdown in the growth of profits in 1979 contributed to the declines in the rate of corporate cash flow and the rate of return on depreciable assets. The ratio of market value to replacement cost of net assets declined even further from its low 1978 level as inflation pushed the replacement cost of physical capital well beyond the market value reflected in equity and debt prices. All of the investment determinants except the ratio of market value to replacement cost of net assets and the return to depreciable assets were above 1970–77 averages, but these averages themselves were equal to or below those of the 1955–69 period.

Federal tax policy has an important influence on business fixed investment. The Revenue Act of 1978 lowered the corporate tax rate across all income classifications. The investment tax credit was made permanent and was extended to a broader range of investment expenditures. The tax rate on capital gains was also reduced by allowing a larger proportion of capital gains to be excluded from an individual’s taxable income.

While these reductions in tax rates were occurring, the increase in inflation tended to raise the tax burden on businesses. During periods of rising inflation the real tax burden increases because depreciation allowances are based on historical costs rather than on replacement costs. Partly for this reason, the ratio of Federal corporate income taxes to profits measured on an economic basis was higher in 1979 than in 1978 despite the reduction in the corporate income tax rate which took effect in 1979. Since long-lived investment goods suffer larger declines in the real value of depreciation allowances over time, inflation distorts both the amount and composition of investment.

THE SOURCES OF SAVING

In periods of economic slack the production of additional capital goods does not require a reduction in the output of consumer goods. In fact the expansion of wage income from the increase in output of investment goods will lead to a simultaneous rise in the demand for and the production of consumer goods.
In periods of relatively high employment, however, the growth of national output is limited to the 2½ to 3 percent rate given by the growth in potential GNP. Investment can grow more rapidly only if its share in GNP rises, which in turn requires an increase in the share of GNP that is saved. In order to increase the share of investment in GNP during the 1980s, therefore, total saving will have to rise relative to GNP. Saving frees resources for use in the production of capital goods and provides the flow of funds needed to finance investment outlays. The amount of saving by governments, business firms, and individuals is thus the major determinant of the amount of total investment that can be undertaken. About one-fourth to one-third of national saving in the past has been absorbed by residential construction. The bulk of the remainder is available for business capital formation.

Recently, as the Federal Government's deficit has narrowed, Federal Government dissaving has declined. The Federal deficit (as measured in the national income and product accounts) has declined in every year since 1975 from an average of 3.3 percent of GNP in 1975-77 to 0.8 percent in 1978-79 (see Table 23).

Gross saving in the State and local government sector averaged 1.2 percent of GNP during 1978-79. The bulk of this saving was from net additions to the surpluses of social insurance and pension funds. Last year the operating budgets of State and local governments were approximately in balance. The combined budgets of Federal, State, and local governments recorded a net surplus in 1979, the first such surplus since 1973.

In contrast to the recent changes in governmental budgets toward positive net saving, the personal saving rate has declined substantially in recent years. For 1979 as a whole, the rate was 4½ percent; it was even lower by year end. A number of contributing factors have been cited as causes of the recent low saving rate. These include the high proportion of the work force consisting of younger people, the increased number of two-earner households, and—in 1979—the efforts of consumers to maintain real consumption in the face of slow growth in real income. In addition, inflationary expectations in conjunction with low rates of return on financial assets, low real borrowing costs, and the ready availability of credit may have reduced the personal saving rate by increasing the attractiveness of real assets relative to financial assets. The relative importance of these factors to the decline in the saving rate is uncertain.

Business saving—retained earnings plus depreciation—grew at a rate of 9.2 percent in 1979, down moderately from the growth of recent years. Historically the rate of growth of business saving has var-
ied substantially; the most recent figure is well within past ranges. Because business saving is an internal source of funds to finance expenditures on physical capital, policies designed to increase business saving also tend to have a direct impact on business fixed investment. The Revenue Act of 1978 strengthened this source of corporate financing by lowering the corporate income tax rate.

CAPITAL MARKETS AND THE AVAILABILITY OF CREDIT

Financial markets and institutions play a major role in linking saving and investment. The business sector finances a significant portion of its long-term investment expenditures through such financial intermediaries as insurance companies and pension funds. Direct purchases of new equities and corporate bonds by households have recently been only a minor source of financial capital for businesses. In 1978, for example, the nonfinancial corporate business sector raised $20.1 billion in the corporate bond market, while the household sector reduced its net corporate bond holdings by $1.4 billion. Indirectly, however, workers and other individuals constitute an important source of business funds through pension funds and other forms of group saving.

During most of 1979 businesses had little difficulty in obtaining credit. Total financial capital raised by the nonfinancial business sector rose by an estimated 17 percent in 1979. Short-term debt was an unusually important source of the business sector's financing. Businesses preferred shorter-term issues because it was thought throughout most of the year that longer-term rates were at or near their cyclical peaks and would decline in the near future. In fact long-term rates rose sharply during 1979, but this increase had not been widely anticipated.

To help ensure that financial capital is available to businesses in the future, the Administration is systematically reviewing Federal credit activities. In the budget for fiscal 1980 the Administration announced the development of a program to establish a credit-monitoring system which covers direct lending by agencies as well as guaranteed loan programs. The 1981 budget recommends limitations on annual appropriations for a wide range of activities involving Federal credit. This new monitoring system includes both on- and off-budget Federal loan and loan guarantee programs. Although some programs are exempt, this review will lead to a more efficient allocation of both credit and real resources.

The availability of financial capital in the future will be maintained by improving the economic environment in the United States, as outlined in this chapter, and by selective policies designed to meet the
needs of small businesses for financing. Through the continuing efforts of the Small Business Administration and the programs included in the President's proposals to foster industrial innovation, more credit will be available to small businesses. For the economy as a whole, a reduction in inflation will enable monetary policy to ease, thereby improving the flow of funds in financial markets.

SOME LIKELY PATTERNS OF NATIONAL SAVING IN THE 1980s

Table 25 illustrates a pattern for national saving that seems possible under a set of reasonable assumptions for the 5-year period 1982-86. The Federal budget is assumed to be balanced on average over the period. Continued control over spending should make it possible both to reduce taxes during the period and to have a balanced budget in most of those years. State and local governments are likely to continue, on average, the surpluses of recent years which stem from an excess of revenues over expenditures in pension and related funds for their own employees. Business saving will probably remain close to historical trends in the absence of future business tax cuts, and the personal saving rate is assumed to increase to slightly above its 1975-79 average. In sum, total domestic saving as a proportion of GNP can be expected to rise slightly in the 1982-86 period compared to recent years. But the inflow of investment from abroad, which is the financial counterpart of the U.S. current account deficit, should move toward zero as market forces bring receipts and expenditures in the current account close to balance. The share of GNP used for housing will increase slightly because of the energy requirements discussed earlier in this chapter. With inventory investment taking about the same share of saving as in the recent past, the

Table 25.—Actual and illustrative saving-investment balances

<table>
<thead>
<tr>
<th>Item</th>
<th>Actual 1975-79</th>
<th>Illustrative 1982-86</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Government surplus</td>
<td>-2.2</td>
<td>0</td>
</tr>
<tr>
<td>State and local government surplus</td>
<td>1.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Gross business saving</td>
<td>11.8</td>
<td>11.5</td>
</tr>
<tr>
<td>Personal saving</td>
<td>3.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Equals: Total saving</td>
<td>14.5</td>
<td>16.5</td>
</tr>
<tr>
<td>Less: Net foreign investment</td>
<td>-0.5</td>
<td>0</td>
</tr>
<tr>
<td>Residential fixed investment</td>
<td>4.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Inventory investment</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Equals: Saving available for business fixed capital formation</td>
<td>9.9</td>
<td>11.0</td>
</tr>
</tbody>
</table>

1 Preliminary; detail may not add to total because of rounding.

Sources: Department of Commerce (Bureau of Economic Analysis) and Council of Economic Advisers.
amount available for business fixed investment should be about 11 percent of GNP.

It was estimated earlier that to improve productivity, expand capacity, make the adjustment to higher energy costs, and meet environmental needs the ratio of business capital formation to GNP would have to rise to at least 11 percent and possibly somewhat higher. The earlier discussion of factors underlying the demand for investment goods and the analysis of saving ratios in Table 25 suggest that specific measures to increase investment and saving may be needed in later years.

THE PROSPECTIVE POLICY MIX

Inflation and economic growth tend to increase average effective tax rates and thus the share of Federal taxes in GNP. Under current inflationary conditions, and given the uncertainties in the economic outlook, the highest priority in the use of additional Federal revenues is to reduce the budget deficit. This is the policy incorporated in the President's 1981 budget proposals. However, continued control of Federal spending will make possible tax reductions in future years that are quite consistent with the maintenance of an appropriate degree of fiscal restraint. Considering the need for additional investment incentives, the design of future tax reductions should give a high priority to measures which strengthen investment.

Policies will also be needed to increase the amount of available national saving. One way to do so is to have smaller tax reductions and run a Federal budget surplus. A budget surplus would increase national saving and thereby provide additional sources of funds for investment. Alternatively, some of any potential budget surplus could be used to reduce taxes in ways which increase the after-tax return to personal saving. There is considerable uncertainty about the likely size of the response of personal saving to increased after-tax returns. It is clear, however, that each dollar of such tax reduction—which lowers the potential Federal surplus (and hence total national saving) dollar for dollar—will yield at most a small fraction of a dollar in additional personal saving.

Tax reductions devoted explicitly to business firms in the form of increased investment incentives, on the other hand, will tend to increase both business saving and investment. While some part of a business tax reduction will go toward higher dividends, a fairly large fraction of it is likely to end up as increased retained earnings.

The fact that an increase in the ratio of saving to GNP may be necessary to make possible the desired expansion of investment does not imply, of course, that increasing the saving share will itself guarantee
a rise in investment. A higher saving share will tend to reduce real interest rates and thus encourage investment. But that alone may not be sufficient. An overall economic climate with inflation being steadily reduced and output growing at a sustainable pace would be very conducive to investment. It may be necessary also, as fiscal drag allows statutory tax rates to be reduced, to provide a significant part of the reduction in forms which both raise the return to investment and increase business saving.

ADJUSTING TO EQUILIBRIUM IN AGRICULTURE

During the past decade the role of U.S. agriculture in the national and international economy changed dramatically. This change has important implications for inflation, agricultural productivity, and the long-term performance of the farm sector.

Historically agriculture’s productive capacity increased so rapidly relative to demand that national agricultural policy had to concentrate heavily on protecting farm income from the consequences of overproduction. But rising world population, increased consumption of animal products, and the improved capability of some developing nations to purchase food and feed grains—combined in the last decade with dollar devaluations and global crop shortfalls—now require nearly full use of the land, labor, and capital available to agriculture. Measured in constant dollars, this sector’s total exports have increased more than 60 percent since 1972. U.S. agriculture appears closer to resource equilibrium than it has been for many decades.

This situation is likely to persist. While year-to-year fluctuations in weather, world economic performance, or even international affairs may result in potentially troublesome periods of excess production, the longer-term outlook strongly suggests that production will more typically be at or near capacity. Growth in world population and improved economic conditions in both developed and developing countries will increase their need for and improve their capability to purchase food and feed grains.

POLICY ISSUES

The United States is now more vulnerable to agricultural price and income fluctuations arising from changes in worldwide demand for U.S. farm products than it was in the past. Sustained full use of farmland, for example, makes it more difficult to increase output in response to successive world crop shortfalls. Then too, as exports are expanded, U.S. agriculture becomes even more closely linked with