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PRIORITY ISSUES FOR A NEW FARM BILL

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The Food Security Act of 1985, the principal legislative authorization for current farm policy, expires at the end of the 1990 crop year. Debate over replacement legislation is already beginning and will intensify early next year. The possibility that this authority will be amended in 1989, a year ahead of schedule, is attracting early attention to the topic.

An Assessment of Current Farm Policy

The Food Security Act

The 1985 legislation was enacted in what bordered on a crisis atmosphere. The economic problems besetting agriculture in 1984 and 1985 were not uniformly distributed throughout the sector, though treatment by the mass media might have led much of the public to that conclusion. Still, the farm economy was in turmoil and calls for a change in policy direction were coming from practically every quarter. Furthermore, few of the calls were for a diminished federal role. Notably absent were recommendations for a return to the "free market."

At the risk of oversimplifying the 1985 debate, three competing objectives dominated the choices then confronting policymakers:

1. Support and stabilize farm income.
2. Promote U.S. competitiveness in world markets.
3. Restrain budget expenditures.

It quickly became evident that at least one of these objectives would have to be slighted if the others were to be achieved. It wasn't possible to pursue a farm policy that would simultaneously result in low commodity prices (required for competitiveness in the world market), high deficiency payments (to support farm income) and low budget costs. This dilemma was resolved early in the debate when the Administration signaled that it would accept a substantially high-

er cost than it had initially proposed. From that point on budget cost was of secondary concern and it became a foregone conclusion that the policy that was ultimately adopted would be a costly one. It was viewed as a transitional policy, however, and provided for a gradual reduction in the level of income support and budget cost. As shall be noted later, the conflict among these three competing objectives is still very much at the center of debate over farm policy.

The Food Security Act of 1985, while retaining most of the traditional program components, applied them in a different way. To achieve a more competitive position in international markets and, at the same time, to allow market forces greater influence over resource allocation, loan rates were sharply lowered and their future levels tied to market prices. Target prices of wheat and feed grains were frozen at prevailing levels for two years then gradually reduced. Market loans were applied to rice and cotton. In combination, the lowering of loan rates and the freezing of target prices had the effect of substituting much higher deficiency payments for sharply lower market prices. To suppress production while excessive stocks were being worked down, the 1985 bill retained the authority for voluntary and paid acreage diversion and added authority for a 40- to 45-million-acre long-term conservation reserve.

Performance of Current Policy

Having passed the halfway point in the life of the 1985 farm bill, it is possible to begin judging performance. The bill's overall performance, as measured against most of the traditional yardsticks, is reasonably good. In fact, it is notably better than was at first expected. Still, the policy is not without its shortcomings.

Farm Income. From the standpoint of the agricultural community, farm income is probably the single most important barometer of performance. It is important not only to the farm households that receive this income, but to the many other economic interests that are dependent on a prosperous farm sector. As can be seen from Table 1, in the aggregate, net cash farm income has remained strong. In fact, it now appears that 1988 will be the first year in the last five that farm income has not risen both in terms of current dollars and constant dollars. Between 1983 and 1987, real farm income rose by one-third. It is the strength of this flow of income through this period that enabled the sector to accomplish without greater difficulty what was in retrospect a rather remarkable economic transition.

There is also a worrisome dimension to the farm income picture, however. Much of the recent strength in farm income is attributable to sharply higher government payments. In 1987, these payments were equivalent to 30 percent of net farm income. While this increased dependence on payments was by design, it was also intended that it be temporary. In effect, it was felt that the farm

Table 1. Farm Income and Direct Government Payments

Year	1978-1988			Government Payments as Percent of Net Cash Farm Income (percent)
	<u>Net Cash Farm Income</u>		Government Payments	
	Current Dollars	1982/84 Dollars		
	----- (billion dollars) -----			
1978	33.1	50.8	3.0	9
1979	33.4	46.0	1.4	4
1980	34.2	41.5	1.3	4
1981	32.8	36.1	1.9	6
1982	38.1	39.5	3.5	9
1983	37.1	37.2	9.3	25
1984	38.8	37.3	8.4	22
1985	47.3	44.0	7.7	16
1986	52.0	47.4	11.8	23
1987(est.)	56.0	49.3	17.0	30
1988(forecast)	56.0	47.0	13.0	23

Source: U.S. Department of Agriculture, Economic Research Service.

economy was too fragile in 1985 to weather the full brunt of the adjustment that lay ahead. Thus, a substantial infusion of cash assistance, largely in the form of deficiency payments, was provided to cushion the economic shock that would accompany the sharp drop in market prices. Beginning with the 1988/89 crop, the Food Security Act provided for a modest drop in target prices for the grain crops. Yet the fall in loan rates authorized by the measure has more than kept pace with the decline in target prices, thereby keeping the potential deficiency payment rate near the level at which it was initially set. The reduction in payments that is now forecast for 1988 is due largely though not entirely to the effects of the drought.

Thus, while current policy has protected farm income as was intended, it has left open the question of how the sizeable government payments that were initially required are to be scaled back. Higher crop prices in 1988/89 will tend to obscure the issue temporarily, though it will eventually have to be addressed.

Agricultural Exports. Beyond the need to support farm income, the other driving force behind adoption of the present policy was the desire to make the United States more competitive in world agricultural markets. While advocates of the 1985 farm bill might have been overly optimistic in their assessment of the pace at which an improvement in the U.S. trade balance would follow the drop in market prices, a substantial improvement in the trade situation has occurred. As shown in Table 2, whether it is measured in terms of value, volume or market share, there has been a marked improvement in the U.S. trade position since 1986. This improvement is not entirely due to the effects of the current farm policy, of course. It has been aided by a decline in the value of the dollar and a generally robust world market. Still, current policy has set the stage that has made this turnaround possible.

Table 2. Indicators of U.S. Agricultural Trade

Fiscal Year	1979-1988			U.S. Agri. Export Volume	U.S. Share of World Trade in:	
	Value of U.S. Agricultural Trade				Wheat	Coarse Grains
	Exports	Imports	Balance			
	----- (billion dollars) -----			(mmt)	----- (percent) -----	
1979	32.0	16.2	15.8	137.4	45	65
1980	40.5	17.3	23.2	163.5	43	72
1981	43.8	17.2	26.6	162.3	44	64
1982	39.1	15.5	23.6	157.9	48	61
1983	34.8	16.3	18.5	144.8	40	60
1984	38.0	18.9	19.1	143.6	38	61
1985	31.2	19.7	11.5	125.8	39	55
1986	26.3	20.9	5.4	109.5	30	44
1987	27.9	20.7	7.2	129.2	31	57
1988(est.)	33.5	21.0	12.5	145.5	42	62

Source: U.S. Department of Agriculture, Economic Research Service.

This improvement notwithstanding, there are two aspects of the present export situation that signal a need for attention. First, while U.S. farm exports are expected to remain strong through fiscal year 1988, sharply lower stocks and higher prices are expected to result in a slight drop in U.S. market share over the next two or three years. While this is due in large measure to the 1988 drought, the problem is aggravated by the construction of the current farm program authorities. As presently authorized, the only significant means of administrative control over the cost of the program is through the annual decision regarding the share of base acreage to be idled. And even this discretionary authority is constrained to some extent by current law on the basis of ending stock levels. By withholding acreage from production through higher acreage reduction requirements, the U.S. Department of Agriculture (USDA) can exert significant upward pressure on crop prices. This, in turn, results in lower deficiency payments and reduced budget costs. Unpublished analyses conducted by Abel, Daft & Earley prior to the drought indicated a potential annual budget savings for grains of \$2.7 billion by pursuing a "restricted plantings" approach to program administration.

Yet, such an approach represents a two-edge sword. While the higher market prices result in significant budget savings, they also undercut U.S. competitiveness in world markets. Looking at the period 1988-90, the analysis cited above estimated that the "restricted plantings" approach would result in annual U.S. exports of grain and oilseeds about 8 percent below levels resulting from a substantially less restrictive approach. Thus, under the constraints of existing authority, the Secretary of Agriculture is confronted with the dilemma of choosing between lower budget costs and lower exports or the opposite combination, neither of which is an attractive option.

This dilemma was only beginning to become evident in early 1988. The accelerated drawdown in grain and oilseed stocks that resulted

from the drought of 1988 will tend to obscure this dilemma and the need to correct it.

Another aspect of current policy that affects export performance and is in need of attention in the next farm bill is the treatment of soybeans in relation to the other major field crops. For a variety of historical, economic and political reasons, soybeans have been treated differently. There is no base acreage for soybeans. Non-recourse loans are available but deficiency payments are not. Accordingly, soybean producers are not required to idle acreage. Neither is there a reserve program for soybeans.

These distinctions were less important when deficiency payments played a substantially smaller role and loan rates were the central mechanism for both price and income support. But with the reversal of these roles in 1985, and with soybean producers unable to agree on a program consistent with the other crops, there could be little hope that soybeans would participate in the improved trade picture. By lowering loan rates only modestly, market prices were held above those of competing feedstuffs and other export sources, thus discouraging demand for U.S. output. On the supply side, the absence of a deficiency payment commensurate with the other major field crops discouraged producers from shifting acreage into soybean production. As a result, the turnaround in U.S. exports experienced in the grain sector was not shared by soybeans. And the outlook is for a continued erosion in U.S. market share.

There is one other significant limitation of present policy as it relates to the objective of achieving increased exports. If U.S. agricultural policy is to be based on an active and competitive involvement in world markets, it must continue to move toward greater market orientation. Although current U.S. farm policy is not as protectionistic as the policies of some nations, it is not without limitations in this regard. Restraints on the importation of sugar, meat and dairy products and the use of deficiency payments are notable examples. While the move toward freer world agricultural trade is likely to be incremental with the pace and scope determined more by domestic economic and political considerations than by anything else, the relationship of farm policy and trade policy remains an important consideration in the development of domestic farm policy.

Farm Finance. The financial condition of American agriculture has improved dramatically since the early 1980s. Although this improvement was forced on the sector and was accompanied by substantial economic and social dislocation and upheaval, the rapidity with which this adjustment was achieved is impressive. After being cut almost exactly in half, real farm asset values appear to have nearly bottomed-out, as can be seen from Table 3. Farm debt has been reduced nearly in proportion to the fall in farm asset values. As a result, the relationship of farm debt to assets has returned to traditional levels of less than 20 percent while the relationship of farm

Table 3. Farm Financial Indicators

Year	1970-1988				
	Total Farm Assets		Total Farm Debt		Farm Debt as % of Net Cash Income
	Current Dollars	1967 Dollars	Current Dollars	1967 Dollars	
1970	280.2	240.9	50.5	43.4	279
1971	303.1	249.9	55.3	45.6	312
1972	341.4	272.5	60.2	48.0	265
1973	418.9	314.7	68.1	51.2	216
1974	442.3	299.5	76.0	51.5	222
1975	510.1	316.4	85.2	52.9	294
1976	590.4	346.3	97.0	56.9	330
1977	651.6	359.0	110.9	61.1	397
1978	777.2	397.7	127.4	65.2	385
1979	907.8	417.6	151.6	69.7	454
1980	996.1	403.6	166.8	67.6	488
1981	996.7	365.9	182.3	66.9	556
1982	961.0	332.4	189.5	65.5	497
1983	945.0	316.7	192.7	64.6	519
1984	848.5	272.7	190.8	61.3	492
1985	750.1	232.8	175.2	54.4	370
1986	691.6	210.6	155.0	47.2	298
1987	714.0	209.2	143.0	41.9	255
1988(forecast)	730.0	204.7	137.0	38.4	245

Source: U.S. Department of Agriculture, Economic Research Service.

debt to cash income has retreated to levels approaching those of the early 1970s.

Though financial distress remains a feature of the farm sector, aggravated in some measure by effects of the drought, the required restructuring of farm debt is well underway. As a result, the overall farm financial situation is looking better than it has for several years. And while the Food Security Act alone is not responsible for the improvement, the large measure of income support that it provided deserves major credit for sustaining the recovery.

Ending Stocks. At the time of enactment of the present policy, stocks of most commodities were at extremely high levels and trending higher. Thanks to a combination of the aggressive use of acreage reduction authorities contained in the 1985 farm bill and the 1988 drought, stock levels will be sharply lower by the end of the 1988/89 crop year. Ending stocks of wheat in 1985/86 were nearly as large as total disappearance that year. At the end of 1988/89 they are forecast to have been worked down to approximately 19 percent of disappearance. For both corn and rice the ratio of stocks to disappearance are forecast to have been reduced from 62 percent to 21 percent. With normal yields next year, stocks will begin rebuilding in 1989/90, though not to burdensome levels (Table 4).

Farm Program Cost. As I have already indicated, it was recognized at the time of its adoption that the Food Security Act would be expensive. Farm program outlays reached a record high of \$25.8 billion in FY1986, the year in which the present policy was adopted.

Table 4. Ending Stocks of Selected Crops

Year	Wheat	Corn	Soybeans	Rice	Cotton
	1981/82-1988/89				
		---(mil.bu.)---		(mil. cwt)	(mil. bales)
1981/82	1,159	2,537	254	49.0	6.6
1982/83	1,515	3,523	345	71.5	7.9
1983/84	1,399	1,006	176	46.9	2.8
1984/85	1,425	1,648	316	64.7	4.1
1985/86	1,905	4,040	536	77.3	9.4
1986/87	1,821	4,882	436	51.6	5.0
1987/88(est.)	1,266	4,352	300	31.5	5.6
1988/89(proj.)	502	1,526	150	28.8	8.9

Source: Abel, Daft & Earley

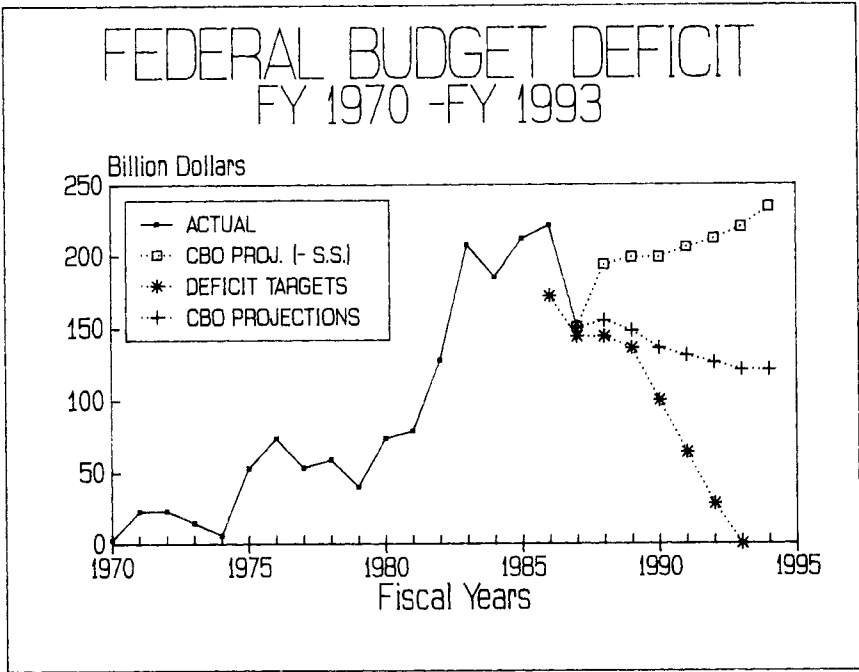
While outlays fell the following year, they remained high by historical standards. By comparison, farm program costs had averaged only \$3 billion per year during the 1970s. At a time when the nation was struggling to bring a record high budget deficit under control, farm program costs of this magnitude were a source of major concern both within the agricultural community and outside it.

Estimates of sharply lower budget costs as a result of higher commodity prices have allayed these concerns, at least temporarily. Even with an additional cost of \$4 billion for a special drought assistance package, Commercial Credit Corporation (CCC) outlays are forecast to be cut nearly in half in FY1988. While this level of expenditure is still likely to be considered excessive by most policy makers, a reduction of this magnitude will result in a far lower profile for farm program costs and a reduced likelihood that they will be singled out for special budgetary treatment.

Despite the much improved budgetary situation for the farm program, prospects for the overall budget deficit remain ominous. Having achieved a sizeable reduction in the deficit in FY1987, it appears likely that the FY1988 deficit will remain at or slightly above the 1987 level with only a modest reduction forecast for the following year. But these levels tell only part of the story. Under the Gramm-Rudman legislation that specified the procedures to be followed in achieving a balanced budget by 1993, it was required that net additions or withdrawals from the Social Security Trust Fund be included in calculating the deficit. This was required even though Social Security is now off-budget. Since the Social Security Trust Fund is presently running a large and rapidly growing surplus, its inclusion in the calculation has the effect of exaggerating progress made in reducing the deficit among the on-budget expenditure categories. In FY1988, Social Security experienced a surplus of \$39 billion and this is expected to rise to \$113 billion by 1994. Thus, the magnitude of the exaggeration is considerable, as can be seen from Figure 1.

As the disparity between the Gramm-Rudman deficit targets and the actual on-budget deficit grows ever wider, attention to the prob-

Figure 1. Federal Budget Deficit



Source: Congressional Budget Office

lem is expected to intensify. Although tax increases are a likely part of the eventual solution, so too are further expenditure cuts. When this occurs, all programs including the farm programs can be expected to sustain further cuts in their budgets.

Future Farm Policy Issues

On the whole, as the foregoing review indicates, the performance of the 1985 farm bill has been favorable. Still, the present policy has not accomplished all that it set out to and several new problems have been encountered along the way. Furthermore, at the time of its adoption, the present policy was seen as a transition to a more market-oriented, more international-trade-oriented policy. But only the first stage of the transition (and perhaps the least controversial) was defined in the policy that was adopted in 1985. Achieving consensus on the next stage could prove to be somewhat more demanding.

The issues to be debated will come from many quarters, some from within the traditional agricultural community but some from outside it as well. The list that follows is suggestive of the types of issues that are likely to be encountered.

Farm Policy Objectives

Perhaps the most important issue is also the most basic. Namely, what are the objectives of the next farm bill? As noted earlier, current policy is primarily based on the achievement of increased U.S. competitiveness in international markets through use of more market-oriented program tools. Companion objectives are to protect the economic health and viability of the agricultural sector while reducing associated federal costs. Current policy and, presumably, its objectives enjoy widespread support throughout the agricultural sector.

In retrospect, this degree of support is understandable, given that the policy has been relatively painless from the standpoint of its effects on the farm sector. The brunt of the cost thus far has been borne by the taxpayer. While a strong case can be made for “staying the course” and for reaffirming support for the objectives of the present farm policy, it is important to recognize that the economic adjustment implicit in the transition to a more market-oriented farm economy is not yet complete and that reductions in income to the sector can be expected before it is. Financially, the sector is now much better able to accommodate the impact of reduced income support than it was three or four years ago. But until this result is accepted, these objectives stand little likelihood of ever being achieved.

Reduced Budget Cost

The need to achieve very large budget reductions in farm policy appears to have receded, at least temporarily. As a result, drastic changes in program authority probably won't be required. But the need for modest reductions in program cost will persist into the foreseeable future. To a large extent the magnitude and timing of these reductions will be determined by the Congressional budget process, not by the agenda of the agricultural community. It will therefore be in the interest of agriculture to anticipate the need to achieve cost savings and to design the new farm bill in such a way that required savings can be realized without disrupting the integrity of the policy.

As noted earlier, to reduce budget cost under current policy it is necessary to restrict plantings in order to force market prices higher. However, higher prices have an adverse effect on exports as well as leaving an increased share of our productive capacity standing idle. Thus, it will be necessary to devise a means of reducing cost without undermining our position in the export markets. There are several ways of doing this, though most will involve a decline in the flow of benefits, mainly in the form of deficiency payments, to farmers.

There is also the issue of whether increased budgetary control should be exercised over farm program costs. Most farm program expenditures are considered “uncontrollable” in the sense that all

farmers who meet the eligibility requirements are entitled to receive program benefits. They are entitled to these benefits in the same way that households qualifying for food stamps are entitled to receive the benefits of that program. As a result of its "entitlement" status, actual farm program expenditures are determined by a combination of the level of participation in the program and market conditions, neither of which can be predicted with great accuracy. It is not surprising, therefore, that farm program costs have been one of the most volatile components of the federal budget over the past several years and one of the most difficult to accurately forecast.

This could be corrected by partially or completely disassociating the level of program benefits from market conditions. In other words, a fixed level of funding could be budgeted for the commodity programs, with the allocation of benefits among farmers still determined by such conventional guidelines as base acreage. This would have the effect of shifting part of the uncertainty that is now associated with the budget making process to the agricultural economy. It would also have the effect of shifting control over farm program budgets away from the authorizing process and toward the budget process which is another reason its adoption would be fiercely debated.

Flexibility in Resource Allocation

Inherent in the process of governmental involvement in the farm sector are rules that impede the allocation of resources in response to market signals. The search for policy and program tools that can accomplish their purposes without interfering in the functioning of markets is central to the design of farm policy.

Experience with the Food Security Act indicates that, in some important respects, it is excessively rigid. The most notable shortcoming in this regard is the treatment of soybeans relative to the other major field crops. The general nature of this problem and its effect on exports were discussed earlier. This will not be an easy problem to resolve; it has resisted solution for the past two years. But it will have to be addressed if the United States is to maintain its competitive position in world oilseed markets.

Distribution of Program Benefits

The distribution of program benefits is a perennial farm policy issue. With program cost falling it will be a less pressing issue but it is not likely to go away either. The payment limits now in effect appear to have limited the incidence of very large payments. A recent Government Accounting Office (GAO) study indicates that two-thirds of all farms participating in payment programs received payments of less than \$10,000 in 1985, though 23.5 percent of the value of the payments went to farms receiving \$50,000 or more (General Accounting Office, p. 71).

A more pressing topic for the next farm bill could be the way in which benefits are distributed among commodities. With the increased use of deficiency payments, benefits have become increasingly more concentrated in the feed grain sector. In FY1987, feed grains accounted for 62 percent of all CCC outlays and the share is expected to be slightly higher in FY1988. While this result was largely unintentional, a comparison of the relationship of average cost of production to target prices and loan rates for wheat and corn (Figure 2) suggests a possible need to realign target prices in particular.

The costs displayed here represent the upper and lower limits of the four alternative cost of production measures estimated annually by the Economic Research Service. For all their shortcomings, these measures provide a generally valid picture of the level and trend in per unit production cost. The data for 1984-86 indicate that the magnitude of the benefits going to corn producers in relation to their cost of production is substantially larger than that going to wheat producers.

Another implication of the present distribution of program benefits is that, however cost savings are achieved, the adverse effect will fall disproportionately on producers of feed grains.

Production vs. Conservation and Environment

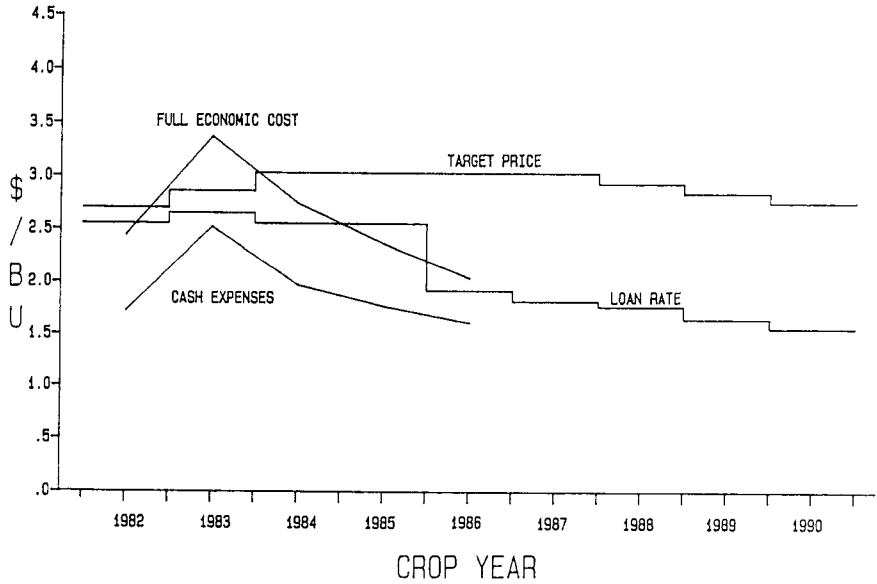
The Food Security Act of 1985 contains a number of authorities aimed at furthering conservation objectives. For the first time, commodity program benefits were made contingent on the adoption of prescribed conservation practices on land classified as highly erodible. A conservation reserve that would ultimately contain 40 to 45 million acres of highly erodible cropland was established. And a provision that prohibited the payment of program benefits to producers who converted wetlands to cropland after 23 December 1985 was included.

Surprisingly, these provisions attracted relatively little attention or debate. That is not likely to be the case with the next farm bill. The agricultural community has discovered that these provisions can directly affect their production practices and ultimately add to their costs of operation. At the same time, the environmental community feels that it has found an effective mechanism for promoting improved land and water use practices and is now identifying other environmental problems such as water quality that might be addressed in the same way.

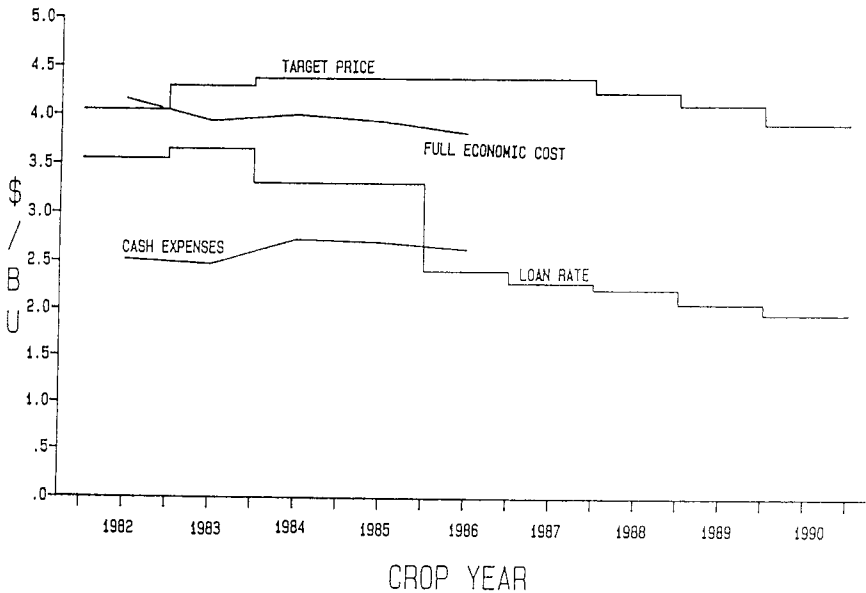
Administration of the conservation compliance provisions of the 1985 act will probably attract the most attention. Producer interests will be arguing for a relaxation of these provisions while conservationists will seek to reverse USDA decisions that they believe have already gone too far in easing compliance requirements. There will

Figure 2. A Comparison of the Cost, Price Support, and Income Support Measures for Wheat and Corn, 1982-88

CORN: PRICE SUPPORT AND INCOME SUPPORT MEASURES



WHEAT: PRICE SUPPORT AND INCOME SUPPORT MEASURES



Source: U.S. Department of Agriculture, Economic Research Service

also be issues concerning the conservation reserve. Should land be enrolled in the reserve on the basis of other environmental problems such as water quality? Should there be a linkage between the annual acreage reduction requirements and acreage enrolled in the conservation reserve? What is to happen to the land enrolled in the conservation reserve when the ten-year contracts begin to expire in 1995?

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***Opportunities for Joint Public Policy
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