domestic farm program should be restricted. This section should be repealed. Otherwise any commitment on protection levels by the United States is of little value—certainly not enough value for other countries to negotiate reductions in their protection levels.

Similarly, the U.S. needs to relinquish its 1955 GATT waiver for Article XI. The waiver permits the use of quantitative restrictions on imports without any need to justify their use. The waiver could be voided if Section 22 were repealed. Even if Section 22 is not repealed, the waiver should be ended so that U.S. failure to live by GATT principles on agricultural imports would be subject to at least the discipline of withdrawal of concessions on our exports by other countries.

A most serious issue must be considered in evaluating the prospects of the GATT negotiations on agricultural trade. This issue is: Does either the United States or the European Community have the capacity to enter into a binding agreement to reduce protection to a given level by a specific date? What is to keep Congress, for example, from mandating price support or target prices that violate such an agreement?

If Section 22 is not repealed, Congress can force violations of any trade agreement. Similarly, under the current decision rules in the EC requiring unanimity, what is to keep one country from vetoing price reductions that would be required by a trade agreement?

It is important that the U.S. and EC enter into constructive discussions concerning how the farm price and income policies of each can be made more market-oriented over the next decade or so. As of the moment, there is no basis for saying that the U.S. policies are more market-oriented than the EC's or that the EC subsidizes its agriculture to a significantly greater extent than does the U.S. today. In the past EC's protection of agriculture was greater than in the U.S., but this is no longer the case.

The European Commission's price decisions for 1986 for the grains were more consistent with the long run required adjustments than the U.S. price decisions. Taking all the actions together including a levy of 3 percent, nominal returns to grain producers in France in 1986 may be as much as 10 percent below 1985. When inflation is taken into account, the decline in real producer returns for grain will be at least 10 percent for the entire community. ■

DISEQUILIBRIA

. . . when things don't fit and other thoughts

Andrew M. Novakovic on The Dairy Buyout

It May Work

The Food Security Act of 1985 (FSA) launched a new way to deal with the surplus milk production problem. Dairy farmers could bid for government payments in exchange for slaughtering or exporting their dairy cattle, retiring their dairy facilities, and ceasing the production of milk for five years.

During February and March 1986, bids were tendered by farmers and reviewed by USDA. By April 1 the farmers whose bids had been accepted were notified, and an 18-month phasein period began. Other dairy price support provisions of the FSA featured an assessment on dairy farmers and future cuts in the support price for milk.

Many think the dairy buyout will be a failure but there are good reasons to be more optimistic.

The Dairy Termination Program, or buyout, will significantly cut milk production and can help lead to balanced dairy markets in the future.

Detractors argue that the buyout is mostly a political gimmick having no long-run value in terms of reducing milk production. This reaction results in part from the experience with the 1984 and 1985 Milk Diversion Program (MDP)—also an experiment in voluntary supply control. Although the MDP cut production in the short run, it did not provide a long-run solution to surplus milk production. The buyout program need not and should not replicate the MDP experience. The buyout differs from the MDP in two important respects. First the programs have distinctly different requirements. Second, the profile of the buyout's participants could enhance its success; the type of farmers in the MDP worked against its chances of success (which wasn't good in any case).

The buyout required a total disposal of cattle and termination of milking. That is certainly "stiffer" than the partial reductions required by the MDP. The likelihood of positive long-run effects—participants staying out of business—is higher than what was expected and observed with the MDP. A production rebound after the MDP was a certainty. Some buyout participants—or their resources—may reenter dairying when their contracts expire, but with all their dairy animals and perhaps other dairy assets sold off, reentry is much less likely.

There are no specific data describing farmers who participated in the MDP or the buyout versus those who didn't; but from what information is available it appears that farmers were motivated in different ways by the two programs and that this affected the types of farmers who participated in these programs.

Two of the major factors which affected the profitability of participating in the MDP were (1) a farmer's current production relative to his base, and (2) the level of a farmer's fixed costs relative to his variable costs. The MDP invited what has come to be known as "selling air," i.e., farmers could cash in on prior reductions relative to their base, without doing anything new. Before the MDP began, its participants' annual production was already some 20 to 25 percent below their "base" marketings. Low fixed costs relative to total costs also encouraged participation. Farmers whose fixed costs were low relative to their total costs were penalized less for operating at less than full capacity; hence the attractiveness of the $10 per hundredweight diversion payment was greater for them than it was for producers with higher fixed costs.

In areas of the country where the fixed costs of milk production tend to be relatively high, such as the traditional milk producing regions of the Upper Midwest and Northeast, participation in the MDP was very low. In some areas, such as the Far West, fixed costs are relatively low but many farmers had expanded too much to be able to afford to cut back below their base period production. The single most important factor was probably the level of production relative to base production. For farmers in this category, the partial cutbacks required under the MDP were easy to achieve and the payments were substantial.

A different set of motives apply to the buyout. In the beginning most analysts

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suspected that the buyout would draw heavily among farmers who were near retirement or were in the worst financial shape. It is undoubtedly true that the program appealed to those two groups. However, there seems to be a large percentage of farmers in the buyout who had been in good financial shape and were operating well managed, successful farms.

Most farmers who were in poor financial shape, especially due to high debts—the primary cause of financial stress today—seemed to offer bids calculated to totally eliminate or substantially reduce their outstanding debt. That resulted in high bids that were ultimately rejected. On the other hand, profitable farmers, who may very well have been able to sustain those profits, found that if the government would pay them a lesser amount, they could do as well as or better than if they kept on milking cows.

The availability of alternative incomes also seems to have been an important factor. Participation rates by county show relatively higher participation in areas near urban centers. This suggests that participating farmers may have looked to cashing in on the residential or recreational value of their land. Low participation in the Northeast and the Midwest and high participation in the South and Far West suggests that areas having better agricultural, and possibly non-agricultural, alternatives also attracted lower bids and higher participation. The farmers who had alternatives of one sort or another were more likely to be in the buyout.

So, it seems to have proven to be cheaper to buy out profitable farmers who had alternative uses for their land and labor than to pay the debts of poorer farmers who had few viable alternatives. This is significant in at least three respects. First it suggests that the buyout resulted in farmers leaving dairying who otherwise would have continued to produce milk. Second, it means that dairy farmers who are financially weak now constitute a larger portion of the remaining farmers. Hence a larger portion of farmers are more vulnerable to potential price cuts. Third, the successful farmers who left dairying are more likely to successfully transfer their skills to another enterprise. To the extent they do, they are more likely to stay with the new enterprise they chose even after their contractual commitment expires in 1991 and 1992.

Consequently, by eliminating dairy cattle, by retiring other milk producing assets, and by attracting a different profile of participants, the buyout is more likely to have longer lasting effects in reducing milk production than did the MDP.

How great or long lasting will the effects be on milk production? That will be determined by other economic factors independent of the buyout. Short of mandatory supply controls, the key to any long-run solution is the expected and obtained profitability of dairying. If dairy farming looks sufficiently profitable five years from now, many buyout participants may be tempted to reenter dairying. Similarly, others will be encouraged to enter and nonparticipants will be encouraged to expand. If milk price is reasonable relative to the prices of milk producing inputs, then such expansion will not be encouraged and the buyout will likely be judged a success.

It could then be argued that the buyout had positive long-run effects, that these effects exceeded what could have been obtained with the same price policy without the buyout, and certainly that adjustments of production were hastened by the buyout.

What happens to the nonparticipants over the next few years, especially those poorer, struggling farmers is a nagging and troublesome question of major social and economic concern. For them the buyout is no longer an option, they are faced with the other components of the 1985 Food Security Act (FSA)—price cuts and assessments.

Price Cuts Under the FSA

With compensating adjustments in the support price and a direct farmer assessment, the FSA more or less provided a 50-cent cut in milk price supports on April 1, 1986, and sustains it through 1987. Beginning in 1988 and through 1990, the Secretary of Agriculture is permitted to reduce the support price by 50 cents per hundredweight on January 1 if he determines that annual net removals would otherwise exceed 5 billion pounds (milk equivalent) for the ensuing year. If all three optional cuts are taken, the support price could fall to $9.60 per hundredweight from its $11.60 level at the start of 1986.

The first price cut in 1988 will most likely be warranted, if current conditions continue. The justification for further price cuts depends on a host of economic factors, the future condition of which we can only guess. Chief among these are feed prices, but other input prices may also be important, particularly if they change considerably. Perhaps most notable among other input prices are interest rates, which could have important impacts on farmers whose debts are high.

Current expectations are that generally lower input prices will favor increased milk production. Feed prices will follow lower grain prices, resulting from lower loan rates for the major feed grains. Interest rates, adjusted for inflation, are currently very high. But where they will be in 1988 and beyond is anybody's guess.

A New 'Race for Base'

Another factor that seems to be leading to increased production currently is a rather perverse one that has little to do with current financial conditions. It is the belief by a sizeable portion of dairy farmers that we are a short step away from mandatory supply controls, involving in one form or another quotas based on historical production records for each farm.

Belief that such programs are not only desirable but inevitable is leading to what has been called a "race for base." By increasing production now, some farmers are hoping to create the largest possible historical base from which their quota would be calculated. There seems to be no region where sentiment in favor of mandatory controls is greater than the Upper Midwest, but support exists in all regions.

Given this, it is of considerable significance that members of Congress who have been viewed by their peers as leaders in dairy policy, have strongly denounced mandatory supply controls. Congress and the Administration show precious little interest in changing dairy policy before the FSA expires in 1991. The recent national referendum among wheat growers was taken as a key litmus test, and its results did not change the mood of policymakers. The relatively close vote and very small turnout does not make a convincing case that farmers want supply controls. Dairy farmers may have voted differently had they been asked, but the wheat referendum will nevertheless not be the new stimulus to agricultural supply controls for which some in the dairy industry had hoped. For farmers who continue to expand production without a concomitant increase in net returns, the race for base will be exceedingly costly and may hasten their involuntary retirement from dairying.

Dairy Policy Prospects

Although mandatory controls are unlikely, another round of voluntary controls is possible. The FSA permits additional buyout programs or MDP-like programs starting in 1988. Another MDP is unlikely, given the record of the last one, but if the buyout is working smoothly and seems to be holding production in check, another buyout could be viewed as a politically acceptable alternative to further price cuts.

Additional price cuts in 1989 and 1990

might well be warranted. That will depend on two major factors, the level of input prices and the prevalence and success of productivity increasing technologies. Input prices could conceivably fall dramatically under current legislation; however, practical factors, world events, and Mother Nature will likely intervene to lessen or prevent large drops. Bovine growth hormone and other productivity increasing technologies could have dramatic effects and seem to be on the horizon of commercial application. Although the expected dates of their first application continue to be postponed, such technologies will not be delayed forever, and less dramatic ones will inexorably push productivity up even if at a slower rate. Increases in dairy farm productivity will be important in the future, as it has been in the past, but new technologies may not provide any large boost to production before the FSA expires. If they do, it is quite possible that measures such as another buyout would be used to blunt the price cuts that would otherwise be required.

Barring a drastic turnabout in Congressional and administrative philosophies, the path set for dairy policy by the FSA will be adhered to at least through the end of the decade. Programs such as the buyout are an important part of the fabric of the FSA, but the long-run path for dairy policy is more than ever before defined by government's willingness to let price move in response to market conditions—even if it means moderate but persistent drops in the support price.

Even though the buyout can be expected to help in restraining production, price increases are unlikely for quite some time. But, policies such as the buyout, to augment and blunt price cuts may become increasingly important. The dairy industry faces a future of further and probably larger increases in productivity, induced by new technologies and the improved and expanded use of existing technologies; they also face a government less willing to support farm prices and incomes. In this environment the challenge for dairy policy will be to meet social goals relative to a farm and rural community that has been depressed and faces further adjustment stress rather than to focus on purely economic goals relative to supply and demand in dairy markets. C

Eugene Lamb on A New Focus on Swamp and Sodbusting

Busters Can Lose Farm Program Benefits

Two features of the 1985 Farm Bill may be the least understood provisions by CHOICES readers. One relates to "sodbusting;" the other to "swampbusting." They are especially significant because individual farmers and ranchers could lose other farm program benefits if they convert wetlands and if they cultivate highly erodible land. The 1985 farm legislation is the first time in the history of the United States that this tie has been made.

Swampbuster Provisions

Under swampbuster provisions, farmers who apply for USDA program benefits are required to certify that they are not producing any agricultural commodity on wetland converted after December 23, 1985. Further, farmers who are in violation of the Wetland Conservation provision will be ineligible for USDA farm program benefits for any crop that is produced on any land they own or operate. Except for wetlands which are determined to be of minimal value, conservation plans for farms will not be approved by the local conservation district if they include conversion of existing wetlands.

The effect of these provisions could be important because of the attractiveness of farm program payments such as deficiency payments and because of the significant amount of wetlands that could be potentially converted.

It is estimated that 76 million acres in the nation are wetlands and that 5.1 million have the potential of being converted to cropland.

Sodbuster Rules

Farmers who apply for USDA program benefits must certify that they have not broken out highly erodible land for production of agricultural commodities since December 23, 1985. If highly erodible land has been broken out for production, farmers must certify that the commodity is being produced under a conservation plan approved by the local conservation district or they become ineligible for benefits for any crop they produce on any land they own or operate. Further, producers will be encouraged to enroll eligible highly erodible lands in the Conservation Reserve.

USDA program benefits that would be denied under the regulations are USDA price and income supports, disaster payments, crop insurance, FmHA loans, Commodity Credit Corporation storage payments, farm storage facility loans, and other programs under which payments are made with respect to commodities produced by the farmer. ASCS has also indicated that ACP cost-sharing will not be allowed on lands in violation.

Perhaps the most significant provision, conservation compliance, requires that January 1, 1990, all highly erodible croplands, regardless of when they were broken out, must have an approved conservation plan for production of agricultural commodities if the producer is to remain eligible for USDA program benefits. The producer will have five years (January 1, 1995) to implement the approved conservation plan.

USDA's Soil Conservation Service in their 1982 National Resources Inventory estimates that nearly 118 million acres of cropland currently in production are classified as highly erodible. These highly erodible lands comprise 30 percent of the total cropland in the U.S., but account for nearly 60 percent of the soil erosion occurring on cropland. Another 225 million acres of agricultural lands have medium or high potential for conversion to cropland. There are over 76 million acres of wetlands in the contiguous United States, 5 million of which have either medium or high potential for conversion to cropland.

For more information about the Swamp and Sodbuster programs, write to: National Association of Conservation Districts, 1025 Vermont Avenue, NW., Suite 730, Washington, D.C. 20005 or: Soil Conservation Service USDA, Washington, D.C. 20250. C

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