LETTERS

. . . From you

From: *Howard E. Conklin*
Emeritus Professor
Cornell University
Re: *Supreme Court's Decision on Land Use*

The recent Supreme Court decision relative to land use controls has met a barrage of criticism from environmentalists and planners. I agree that it probably will reduce, quite sharply, the extent to which urban groups can force rural people to maintain an enjoyable countryside for non-rural use.

My first report on rural zoning was published by the U.S. Department of Agriculture in California in 1941. Since then I have watched non-rural people gradually gain more and more control over farmers, ranchers, forest producers, and other rural people. In land tenure terms, this has been a creeping expropriation of rural property rights. The Supreme Court has finally seen what my research began to reveal over 40 years ago.

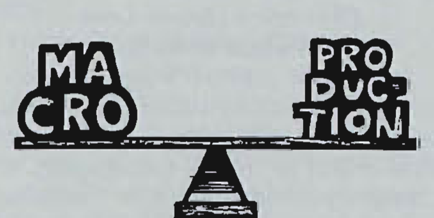
The ultimate so far in expropriation was the creation of the New York Adirondack Park Agency with sweeping power over private property. This was forced on the people of the Adirondack region by an urban-dominated legislature. Shortly before this agency was created, a major effort was made to impose the same kind of controls on all of rural New York (Study Bill 9028 of 1970). That effort failed because it involved state zoning that could have superceded local zoning in the suburbs as well as in rural areas. I was working with a commission at that time that was pushing for agricultural district enabling legislation—a "positive" approach that was supported by Governor Rockefeller after 9028 was turned back.

It is natural for various groups to attempt to gain more and more control over rural property. Society is competitive and property is a coveted item in our lifestyle. But our forefathers long ago set down a set of rules—the Constitution—for distributing and redistributing property.

These rules have been fundamental to our great prosperity and freedom. Our forefathers also created the Supreme Court to see that these rules are followed. I have been discouraged at times, over the past 40 odd years, about the trend toward permitting powerful non-rural groups increasing control over rural lands and over rural people as the primary users of these lands. I now feel reassured. The Supreme Court has performed its appointed function very well.

Incidently, urban and suburban people clearly have no need to worry about the constitutionality of most of their local zoning ordinances. City and suburban zoning increases property values. Such actions as keeping trailers and low incomes out of exclusive residential areas benefits every one in those areas, and the Supreme Court did not say that excluded people must be paid.

In my judgment, the Supreme Court in effect has said that if non-rural people want to take over rural land they will pay for it.



From: *Roger B. Long*
Professor, University of Idaho
Re: ***Kenneth Robinson's Commentary article (CHOICES, Second Quarter, 1987)***

I was recently astounded by differences in the conclusions of two people (both professional economists) about the impacts of monetary policy on agriculture. Kenneth Robinson in his Commentary article (CHOICES, Second Quarter, 1987) and Paul Craig Roberts, *Business Week* June 15, 1987, could not be further apart. Robinson stated that "the current agricultural depression is only weakly related to changes in conventional monetary and fiscal policies." On the other hand, Roberts stated that: "the dramatic speed with which Volker shifted the economy from low to high interest rates" did the following:

—The U.S. budget and the President's fiscal program were wrecked.

—U.S. agriculture has not experienced such suffering since dust bowl times.

—Manufacturers lost long-accustomed markets.

—Hundreds of financial institutions were destroyed.

—The Third World has been thrown into the worst debt crisis since the depression.

—Premier financial institutions were left dangerously exposed.

Even if there is some truth to Robinson's point of view, if Roberts is essentially correct, then Robinson appears to be the proverbial ostrich with his head in the sand. Robinson focuses on only three variables—technology, weather, and agricultural policy of three countries in his analysis.

Unfortunately, the disparity between Robinson and Roberts represents a general rift between economists who focus only on microeconomic analysis (especially production theory) to solve macroeconomic problems, and economists with a much broader point of view.

It seems obvious that the tight monetary policy of the early 1980's did at least three things that impacted agriculture:

—It made the value of the dollar higher abroad, reducing the buying power or income and therefore the demand of importers.

—It increased production costs of U.S. farmers who borrowed money.

—It redistributed income from the poor to the rich—those with savings benefited and those who borrowed lost.

To make the comment that the current agricultural depression is only "weakly related to monetary and fiscal policy" is not only unrealistic but is based on totally inadequate analysis. Could it be that a tight monetary policy does not:

—Increase the value of the dollar abroad?

—Increase production costs?

—Reallocate income from the poor to the rich?

Unfortunately, the nature of Robinson's narrow thinking represents many in the agricultural economics profession, or else they would not continue to try to solve macroeconomic-type problems with partial, inadequate microeconomic analysis. It appears to me that just the opposite of what Robinson says is true; that the most important variables are macroeconomic, not microeconomic. Of course, partial production, technology, weather, and policy are important variables. These three variables, however, are too narrow to analyze the scope of world trade in grain. It would seem more reasonable to analyze world grain trade problems in terms of aggregate world supply and demand conditions. We tend to forget that in the past, microeconomics, even with the invisible hand of the free enterprise system, never could solve economic problems created by the roller coaster swings of the business cycle. Similarly, a partially specified model of world trade in grain cannot explain shifts in supply and demand. Certainly there is more to trade in grain on a worldwide basis than just those factors that affect the United States.

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From: ***Kenneth L. Robinson***
Professor, Cornell University
Re: ***The Author Responds***

Unfortunately, my attempt to redress what I had thought was a swing in the pendulum too much in one direction has been misinterpreted by Professor Long as a rejection of macroeconomics. I share his view that we need to look at both macroeconomic variables and what I refer to as the more traditional supply and demand shifters. I cannot agree, however, with his statement that "the most important variables are macroeconomic." My plea to him and to others is to look at the facts before prejudging the issue. Macroeconomic variables can, at best, account for only a small part of the loss in U.S. grain exports to such countries as China and the USSR since 1983. Such variables also fail to explain why European Commodity (EC) exports have risen so dramatically. Nor can U.S. monetary and fiscal policies explain the divergent behavior of soybean and cotton exports over the past 18 months.

The quotation from Paul Craig Roberts also deserves a comment. Roberts apparently believes that most of the world's ills stem from decisions made by Mr. Volcker. I note that Roberts accepts no responsibility for his disastrous tax recommendations that contributed to one of the consequences he lists (wrecking the U.S. budget). I would urge Roberts (if he were listening) to heed Long's advice and avoid narrow thinking. A much broader range of variables needs to be examined in attempting to explain why agriculture is experiencing the greatest "suffering since dust bowl times." He might even discover that increased production, both at home and abroad, has had more to do with U.S. grain surpluses and the loss of export markets since 1983 than the policies of the Fed. One might have found a better informed witness to testify for the prosecution.

From: ***John T. Scott, Jr.***
Professor of Land Economics
University of Illinois
Re: ***Reply to Swackhamer's Comments on "One Way to Bail Out the Farm Credit System" (CHOICES, Third Quarter, 1987)***

I appreciate the comments of Mr. Swackhamer, President of the Farm Credit Banks of Baltimore that were included in "Letters" in the Third Quarter 1987 issue of CHOICES. He knows what the present accounting limitations of Zero Coupon Bonds are in the Farm Credit System and how the system views "Zeros" as they have traditionally been used.

However, I think these are not traditional or ordinary times for Farm Credit and new innovative approaches are going to be necessary perhaps not in Baltimore, but certainly in the country as a whole in order to keep the Farm Credit System viable. So we need to approach such ideas from the standpoint of how can they be used rather than why they cannot be used!

Accounting systems can be changed; and there was even a recent change in Farm Credit System (FCS) accounting, as we all know. The land and accounting could be transferred to a separate corporation. The word equity in the name "equity zero coupon bonds" is the clue. Part of my proposal, apparently overlooked by Swackhamer, is that the zero coupon bonds become equity shares at maturity if land values and accumulated rent is not sufficient to call and pay off the bonds before or at maturity.

From: ***Ray Hill***
Washington State Grange
Seattle, Washington
Re: ***Agricultural Policy articles (CHOICES, Third Quarter, 1987)***

One long-range solution to American agriculture's problems which needs more attention by farm bill writers is market development in the Third World. Studies have shown that our exports of farm products to these countries will increase if their standard of living and income are improved. We need to boost economic and agricultural assistance overseas first in order to have customers for our products later.

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From: ***Thomas R. McKinney***
Director, Agriculture Program
Rocky Mountain Institute
Re: ***Agricultural Policy articles (CHOICES, Third Quarter, 1987)***

I am struck by the lack of consideration of the long-term consequences of high levels of agricultural production in the Agricultural Policy articles in the third quarter 1987 issue of CHOICES.

Current agricultural policy—and those alternatives mentioned in the three policy articles—deals with the relatively short-term problems of trade, subsidies, and production without addressing the more fundamental question of whether agriculture as practiced by the majority of U.S. farmers is sustainable. A timeline for depletion can be argued but oil and natural gas resources are finite. Where will our synthetic fertilizers and pesticides come from in the future, and what alternatives exist? How will future production be affected by current erosion levels (in part due to high levels of production aimed at the export market)?

Admittedly, current and short-term financial, trade and production problems do need to be solved. However, the long-term issue of whether current agricultural practices are sustainable and the development of alternatives to current practices also need to be addressed in any comprehensive agricultural policy.

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From: ***Rudy Boschwitz***
United States Senate
Re: ***An Author Responds***

Mr. Thomas McKinney correctly points out that I did not discuss the environmental consequences of "decoupling" in the CHOICES article.

Basically, I believe farmers should be *allowed* to practice "sustainable" agricultural practices. Our present policy locks them into very strict cropping and farming practices. It is very difficult for them to change without losing subsidies. Further, by forcing farmers to idle, on an annual basis, shifting portions of their acreage devoted to wheat, feed grains, cotton, and rice, farmers must farm their "permitted" acres more intensively to make up for the income they have lost from being forced to idle other acres.

To make matters worse, we have encouraged and rewarded ever higher yields by basing subsidies on the amount of bushels, bales, and pounds a farmer could produce. Why not pour on the inputs if the government rewards higher yields with higher subsidies?

Under decoupling, farmers would be free to farm the way they want and would not have their subsidies linked to yields. American agriculture would be free to farm *more extensively and less intensively.*

"Decoupling" would do nothing but encourage sustainable agricultural practices and, as a consequence, be beneficial to the environment.

From: ***Wilbur H. Wuertz***
Chairman
National Extension Committee of the Joint Council on Food and Agricultural Sciences and Cotton Producer
Casa Grande, Arizona
Re: ***Cochrane's "Modest-Sized, Part-Time" (CHOICES, Second Quarter, 1987)***

Cochrane argues that the Extension Service and the Farmers Home Administration "would undertake new programs to work with part-time farmers reluctantly, hence ineffectively."

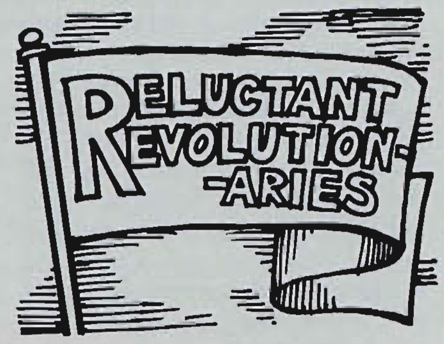
This view is cause for concern, particularly when over the past year the Extension System has embarked on an ambitious effort that is defining and developing eight national initiatives to deal with current issues faced by clientele. One of these initiatives, Alternative Agricultural Opportunities, addresses three critical issues relevant to the modest-sized part-time farmers. These issues highlight: (1) the need of the agricultural sector for flexible innovative approaches in marketing, producing, managing and utilizing traditional crop and livestock products; (2) the need for the sector to acquire knowledge and develop capabilities in marketing, producing, managing and utilizing new products, services and enterprises; and (3) farm families' need for help in developing income-generating opportunities in off-farm employment and nonfarm entrepreneurial management.

Goals of the initiative are to meet these needs through educational programs that help maintain the economic viability of the agricultural resource base. They include programs to help individuals or groups in the assessment and development of markets and new market alternatives; development of new agricultural products and services; identification and assistance in implementing alternative production systems, adopting cost beneficial practices; and assistance for farm families in analyzing/entering the nonfarm labor force or engaging in other entrepreneurial endeavors.

The Alternative Agricultural Opportunities initiative has developed since late 1986 through the efforts of a task force composed of Extension staff. Input has been received from external and internal groups. A wealth of information in this area has been collected with reports containing model programs and implementation recommendations scheduled for completion in early 1988. Other task forces are producing similar results. Those working with initiatives on Competitiveness and Profitability of American Agriculture, Revitalizing Rural America, and Family and Economic Well Being are also addressing dimensions of the area that Cochrane has delineated.

At this point in time, one cannot predict with certainty the consequences or relative merits of the three approaches to problems of modest-sized part-time farmers that Cochrane has outlined. One can argue, however, that the initiatives that the Extension System has underway are not symptomatic of an agency that is "old and tired." The Extension System, with its network reaching into every county in the nation, is positioned to deliver educational services that can enhance business management and technical production capabilities of farmers, including those who operate modest-sized farms on a part-time basis.

Cochrane argues for a new agency to address the problems of these farm families on the basis of the "verve" and enthusiasm that a new entity could bring to bear. One should recognize, as well, that when leadership and enthusiasm are focused within an established entity such as Extension, they provide impetus for the total System in directing resources toward issues such as those faced by the modest-sized part-time farmers.



From: ***Mike Sager***
Woodford County Cooperative Extension Service
Eureka, Illinois
Re: ***Vernon W. Ruttan's "Viewpoint" (CHOICES, Third Quarter, 1987)***

Ruttan states that agricultural researchers are reluctant revolutionaries who "prefer to neglect the revolutionary impact of technology on society" and "they often react with shock and anger when confronted with charges of responsibility for institutional changes. . . . "

All true from my perspective of thirty-six years in the Land Grant system. But why?

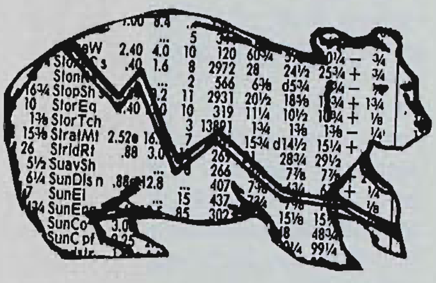
Is it possible that researchers have developed an attitude that research is an end unto itself and society is simply there to pick up the tab? Do they hold an inbred perspective of the real world? They talk mostly to each other and are motivated to a great degree by a desire to impress peers. This is a corollary to the publish-or-perish evil which dominates our universities.

Researchers look down upon teachers and extension workers as underclasses . . . which indeed they are, according to the way Land Grant Colleges of Agriculture are now administered. The current thrust of these colleges is to compete with each other for "star" researchers and research funds. This is the required route for deans to become chancellors. It is probably not bad as long as it is kept in proper perspective. Unfortunately, however, it has contributed to the growth and development of researchers as a self-annointed upperclass which appears to prefer to be responsible only to themselves. The protective shield of tenure and the perceived purity and infallability of research are convenient places to hide from the harsh reality of difficult problems. Further, the notion that research is the only source of relevant knowledge and wisdom is a bit elitist.

Researchers do not want to be involved with the messy business of working with people because status and monetary rewards are found elsewhere. Furthermore, it does not fit with their "academic" opinions of themselves. For example, why would a rural sociologist, although partially paid with extension funds, want to be actively involved in helping farm families through the financial crunch. To be involved actively in helping people is "*only extension*." By observing from the sidelines and waiting until it is all over . . . then to dissect it, will be known as "scholarly research" with higher status and material reward.

Currently, in the Land Grant system, the highest status and the greatest rewards go to those researchers who distance themselves the farthest from students and general society. Is not this a strange situation for a Land Grant institution? Does it not trample upon the intent of the Land Grant mission? Does it not create the kind of system that brought the Land Grant system into being in the first place? Should not the tripartite mission of teaching, research and extension have stronger linkages?

It is my view that too many agricultural researchers, especially at Land Grant institutions, have lost their way and the institutions aid and abet their wandering. Unless the system examines the researchers' role in light of the total Land Grant mission and ultimate impact on society, they may have problems ahead. Those who toil in the Land Grant system must never forget who they are working for.



From: ***Richard J. Sexton***
University of California, Davis
Re: ***Scruggs' Agricultural Capitalism***

Charles Scruggs gave farmers a bum steer for two reasons when he suggested they invest in the stock of the marketing and processing firms that handle their raw products. The first reason is that if stock markets are efficient, the current share price accurately reflects a stock's value, so these agribusiness stocks are no better buys than any other.

Of course, not everyone agrees that stock markets are efficient. The main detractors, not surprisingly, are those who make money selling stock market advice. Nonetheless, the logic behind the market efficiency hypothesis is compelling: if agribusiness stocks are known to be good investments, their price should be bid up quickly by buyers until no special profit opportunity exists.

Scruggs' advice could be countenanced if overselling the profit potential of agribusiness stocks was its only deficiency. After all, these stocks should be as profitable as any other. However, a second problem with the advice is that following it will exacerbate the considerable risk to which farmers are already exposed. The reason is that fluctuations in income from producing any farm product will usually be highly and positively correlated with fluctuations in the earnings (and, hence, the value of the stock) of firms that market the farm product.

As an illustration, if demand for grain and grain products increases due to improved export opportunities, this will increase prices and earnings for both grain farmers and companies that process and market grain. Similarly, earnings for both would diminish as demand declined. In a nutshell, Scruggs' advice increases farmers' exposure to risk.

If farmers want to invest in agribusiness, they would be well advised to look in the direction of the market chain opposite to that suggested by Scruggs. By investing upstream in the companies that sell them petroleum, chemicals, fertilizer, and other inputs, farmers may be able to diversify risk. The reason is that external demand or supply shocks that raise the prices for these inputs will simultaneously increase profits and stock values for the supplying companies and reduce income for the farmer buyers. The fluctuations offset each other. In other words, the income streams are inversely correlated which is what most people want to attain in their investment portfolios.

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From: ***Charles G. Scruggs***
Southern Progress Corporation
Re: ***The Author Responds***

Tyson Food's stock price increased 1,746 percent from 1982 to end of 1986. (Forbes Magazine, 12 January, 1987). That's no bum steer! That's a strong bull!

I doubt that the farmers who raised the poultry and pork for Tyson reaped that kind of return on their labor and investment. Indeed, I doubt that any farmer did that well in that period.

However, I regret Professor Sexton did not comment on my main thesis: Farmers and ranchers—agricultural capitalists—must become as aggressive and skilled in marketing, adding value, planning for a profit, and capital management as they are in producing raw generic products. We need constructive, innovative thinking of every kind to help ag producers earn the returns to management and investment that they deserve.

From: ***Earl A. Stennis***
Mississippi State University
Re: ***Carter and Pick "Centerfold" (CHOICES, Third Quarter 1987)***

For the record, we would like to note what we assume to be a typographical error in the third paragraph of the article. With a \$/Yen nominal exchange rate of 1/200, 500,000 Yen would not translate into a U.S. cost of \$10,000. Given current automobile prices, the authors probably intended for the sentence in question to read "Therefore, a Japanese car price tag of 2,000,000 Yen cost the U.S. consumer \$10,000."

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From: ***Lyle P. Schertz***
Re: ***The Editor Replies***

You're correct. The error was mine. I inserted the sentence when editing and somehow came up with the wrong number.

From: ***Michael Hanthorn***
Economic Research Service, USDA
Re: ***Kennedy's "Generic Commodity Certificates"***

To read the article entitled "Generic Commodity Certificates: How They Affect Markets and the Federal Budget," (CHOICES, Third Quarter, 1987) without any knowledge of generic certificates would leave one wondering whether USDA policymakers have a clue as to how to properly use this new farm program feature. In my view, just the opposite is true.

Generic certificates were first issued in April 1986, and after some adjustments to accommodate them, USDA policymakers have managed their issuance and use effectively. The author's suggestions that, ". . . issues surrounding these certificates have been largely ignored . . . ," that ". . . few detailed studies have been published . . . ," and that ". . . policymakers do not have a clear idea of what they can do or want to accomplish with certificates . . . " at best are unfair and at worst are false.

Issues surrounding certificates may have been ignored elsewhere in Washington, but they certainly have not been at USDA. A significant effort has been made to assess the appropriate level and timing of issuances, to provide weekly updates on exchange activity and monthly updates on issuances, and to assess the impact of certificates on program commodity markets. This effort has been carried out to effectively manage certificates and to keep the public informed.

To date, three major USDA Agricultural Outlook (AO) articles have been published that describe generic certificates, present the effects of certificates on farm prices, and compare use options available to farmers. Since April 1987, issuance and exchange data have been updated monthly in the AO. Special articles dealing with how certificates have affected the corn market and how wheat farmers can use certificates have been published in the Feed and Wheat Situation & Outlook reports, respectively, in May 1987. And, since late 1986, updates on issuances and exchanges have been presented in various Situation & Outlook reports.

In addition, the Secretary of Agriculture sent a report to Congress in July 1987 explaining why USDA has not implemented marketing loans for wheat, feed grains, and soybeans. A major conclusion of the report was that certificates lowered farm prices for corn and wheat in 1986/87 by as much as marketing loans would have.

Given the fact that USDA has been very active in managing and assessing generic certificates, it is difficult to accept the author's suggestion that USDA does not know what it wants to accomplish with them. A major objective of the 1985 Farm Act was to redirect U.S. agriculture down a more market-oriented path. This is being achieved through the lowering of loan rates and target prices, implementation of marketing loans and export promotions, and issuance of generic certificates, all of which are helping to price U.S. program commodities more competitively here and abroad.

Certificates provide farmers with greater marketing flexibility, while maintaining their price support protection, by freeing commodities that otherwise would not be available to the market at prices below loan rates. Because certificates are generic, their use is determined by market conditions, including farm prices, posted county prices (PCPs), loan rates, storage costs, and certificate premiums. This flexibility is one of the most attractive features of certificates; they move to and are used by farmers who have commodities under loan for which supply/demand imbalances are greatest.

The author is correct in stating that it is not easy to assess how certificates are used and how they affect markets, but he is wrong in saying that this has not been done and that there is little understanding of how they are affecting the commodity markets. ERS has been accurately assessing the use of certificates and their impact on prices since the Fall of 1986. It is estimated that 1986/87 farm prices would have been 15 to 20 cents higher for corn and 2 to 8 cents higher for wheat without certificates. Certificate use has had little effect on prices for other program commodities.

With respect to why certificates sell at a premium, the author states that people are willing to buy certificates above par because of the way USDA manages their use. Certificate use has been significantly affected by changes in the setting of PCPs, but the primary reason certificates sell at a premium is the advantage they afford holders, most of which are farmers who use them in conjunction with the placing of commodities under loan.

Farmers can place crops under loan, therefore can obtain price support, then use certificates to immediately reacquire part or all of the loan collateral and either sell or use it. In so doing, farmers forego any storage costs that otherwise would have accrued over the 9 months of their loans. In addition, the further PCPs are below the loan rate, the more commodity can be acquired with certificates, since they have a fixed value. In a nutshell, this describes both the advantage to farmers in using certificates at the time of placement and explains why virtually all corn and most wheat re-acquired from loan positions since late 1986 has been obtained through certificate exchanges. By design, farmers are encouraged to market their crops rather than to forfeit them to CCC.

Whether this has encouraged additional loan activity is a major point of debate with respect to the cost of issuing certificates. The author contends that many farmers placed additional crops under loan in 1986/87 to capitalize on certificate gains. Placement of 1986 crop wheat, soybeans, and cotton fell 39, 36, and 15 percent, respectively, from a year earlier. Placements of grain sorghum, barley, and oats were up slightly. Rice placements rose 75 percent, but this was more a reflection of the heavy participation in the marketing loan program.

One could argue that wheat placements in 1986/87 were higher than they would have been without certificates. But, statistical analysis of 1982/83-1986/87 data shows that virtually all of the variation in placements can be explained by the September-December average farm price as a percent of the loan rate. Based on this relationship, estimated wheat placements for 1986/87 were within 1 percent of actual placements, suggesting that farmers were not encouraged to place additional wheat under loan because of certificates.

For corn, placements in 1986/87 were up 55 percent from 1985/86 to 4.87 billion bushels, but again much of the increase can be explained by very heavy program participation and post-harvest farm prices significantly below the loan rate. Certificates are estimated to have reduced the farm price for corn by 5 cents or less during the September-November quarter, but prices would have been well below loan rates without certificates because of the record carryin, huge crop, and the sharply declining loan rate. About 90 percent of the variation in corn placements can be explained by the October-January average farm price as a percent of the loan rate. Corn placements for 1986/87 were estimated to be close to the 6.25 billion bushels eligible for loan. Therefore, placements likely would have been very large without certificates.

A final point of difference deals with whether generic certificates would be more effective than marketing loans for wheat, feed grains, and soybeans. Given market conditions in 1986/87, it is estimated that marketing loans for corn and wheat would not have lowered farm prices any more than did certificate exchanges, and marketing loan outlays would have been much higher. For soybeans and the other feed grains, marketing loans could have lowered prices more, but at a substantial cost. The idea for generic certificates may have originated in USDA, but the suggestion that this warrants Congressional skepticism over USDA's ability to run the farm programs in a cost-effective manner is unfounded. Marketing loans have not been implemented for wheat, feed grains, and soybeans primarily because of the prohibitively high cost of doing so.

OMB has requested that an economic analysis of generic certificates be conducted to determine the costs and benefits. ERS will conduct this study and release its findings in 1988. I am inclined to think that costing out certificates, albeit a difficult undertaking, is just a further complication in estimating the annual cost of the farm programs. Admittedly, USDA does not have a good track record in costing out such programs, but given the tremendously complex nature of the commodity programs and markets, neither has any other entity. Regardless, the author's suggestion that ". . . the federal budget effects of certificates are outside the generally accepted budgetary procedures for federal programs . . . " seems unjustified.

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From: *Chuck Lambert*
Assistant Professor
Central Missouri State University
Re: *Joseph V. Kennedy's "Generic Commodity Certificates"*

I cannot agree with Joseph Kennedy's statement "Policymakers do not have a clear idea of what they can do or want to accomplish with (generic commodity) certificates." This statement may be true for some Congressional policymakers and certain watchdog agencies including OMB as Mr. Kennedy alludes. It would take a total lack of confidence in the political system to assume that Dr. Robert Thompson and other policymakers in the U.S. Department of Agriculture did not realize the potential for PIK certificates during mark-up of the Food Security Act of 1985.

The current administration has taken the lead in turning the focus 180 degrees from traditional farm program objectives. The new emphasis is on: (1) stocks management—reducing government grain stocks from recent levels; (2) international competition—reducing price to be competitive in international markets; and (3) government expenditures—reducing expenditures (at least visible budget line items for deficiency payments viewed by some as direct farm subsidies).

These new objectives are obviously not consistent with traditional farm program objectives of (1) price stabilization and in some cases increased prices, and later (2) stabilized and increased farm incomes.

Perhaps the main peculiarity about the management of PIK certificates is that the administration has stated its policy objectives and developed the means for accomplishing those ends. We may have grown so accustomed to hearing idle political rhetoric and unfulfilled campaign promises that it is indeed unusual for an administration to do what it says it intends to do.

To date, the administration has employed the use of PIK strategies for corn and other feed grains with resulting lower U.S. domestic prices. This strategy may have been adopted to pacify the political interests of the U.S. livestock and poultry industries following impacts of the early buyout program in the short term. In the longer run—as production in the meats sector responds to increased profitability from subsidized feed costs—total domestic food costs would be expected to decline.

In the wheat sector the administration has chosen to use the Export Enhancement Program (EEP) to lower prices of U.S. wheat in international markets while domestic prices are not directly reduced. This strategy may be a direct slap at the subsidized European Community for exports of wheat but also has major impacts on Canada and other primary wheat exporters.

Another consideration in the use of PIK strategies in feed grains, vis-a-vis the EEP for wheat, may be that the U.S. enjoys a relatively large share of international trade in corn and feed grains. On the other hand, the U.S. share of international trade is relatively less for wheat—and has been declining because of increased foreign competition.

The PIK stocks management strategy may very well achieve the administration's primary objectives. However, producers, some policymakers, and many economists and other participants in the policymaking process (possibly including Mr. Kennedy) may have failed to realize that primary policy objectives for farm policy have changed. Potential impacts on other more traditional farm program objectives including farm income and price stability may not be understood by the public at large or some policymaking participants.

As Mr. Kennedy stated, Posted County Prices (PCPs) determine whether stocks enter CCC inventory or remain as free stocks. PCP levels, relative to the loan rate, determine which commodity loans are redeemed with PIK certificates and the rate at which stocks are released from government inventory. However, Kennedy helps perpetuate the myth that PCPs are a function of reported terminal market prices (2 of 11 terminal locations are assigned to each county) and "periodically determined differentials between local warehouses and the two nearest terminals."

CCC had "adjusted" terminal prices and differentials without establishing published guidelines for conditions leading to, or procedures for the adjustment of, terminal prices or terminal market/county location differentials. Even if these "adjustments" are consistent with the three primary objectives, listed at the start of this letter, they may lead to the perception of market manipulation and timing of adjustments for political gains.

For example, some have claimed that terminal price and PCP adjustments led to increased wheat supplies in commercial channels prior to the recent subsidized Soviet wheat deal. If this is true, then by managing the increase of market "free stocks" and driving cash market prices lower, the administration was able to reduce the amount of subsidy on wheat sold to the Russians—at the expense of U.S. producers who sold wheat at those artificially manipulated low prices.

Perhaps the irony of the entire generic commodity certificate program has been that it has led to increased market management by an administration ostensibly devoted to deregulation and decreased government involvement in the marketplace. Market intervention has taken place within bounds of discretionary authority granted the Secretary by the Food Security Act of 1985. Apparently this market management has come with the blessings of special interest groups professing a "free market" philosophy (at least in public rhetoric and as long as it serves the vested interests of the interest group membership.)

The Reagan Administration has shown that "where there's a will there's a way" in accomplishing stated foreign policy objectives—even if some members of Congress and certain government oversight agencies do not concur with the appropriateness of those objectives. It should come as no small surprise to Mr. Kennedy, and others who have not had a full chance to dissect and analyze all aspects of generic commodity certificates, that the administration has been willing to proceed in attaining altered agricultural policy objectives without the full sanctions of academia and government oversight agencies.

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From: ***Joseph V. Kennedy***
Bishop, Cook, Purcell & Reynolds
Re: ***The Author Responds***

I want to thank Mr. Hanthorn for pointing out a flaw in my article. I did not mean to imply that no research is being done on the issue of generic certificates or that the research was not detailed or competent. As Mr. Hanthorn states, ERS and others have performed valuable studies. What I meant to emphasize is that none of this research was available until well after generic certificates hit the market. This lack of pre-analysis resulted in most, if not all, policymakers, myself included, believing that certificates would trade at a discount to compensate the warehouse for its transaction costs. We failed to see the impact certificates would have on the way farmers used the loan program. It also explains the failure of USDA to anticipate the widespread use of certificates to take advantage of cross-country disparities in the PCP to market-price spread.

This lack of pre-analysis ties into a second point. Most of the analysis so far has examined the effect certificates *have had* in the market. Little has been done to develop a sound philosophy for issuing certificates in the future. If USDA has such a philosophy for what it wants to accomplish with certificates beyond the general goal of lower prices and greater fluidity, it has not announced it to the public. Certificates give USDA potentially broad powers to influence market prices and supplies. The price level and supply which USDA deems ideal will have significant impact on the market. Yet the determination of these levels has not been broadly discussed. We should devote serious discussion to issues such as the appropriate quantity of certificates to be issued, the proper recipients of these certificates, the proper relationship of the PCP to the loan rate and market price, the amount of revolving of CCC stocks we are willing to tolerate, and, finally, the wisdom of maintaining a certificate program which disproportionately affects the corn market at the expense of wheat and soybeans.

In saying this, I do not mean to imply that USDA has neglected its duties. The staff I have dealt with has invariably been highly competent and motivated. But there are limited resources to devote to sound analysis and, as important as they are, certificates are still a minor part of the federal commodities program. This in itself says something about the complexity of modern farm programs and the difficulty of coordinating their various parts.

I agree with Mr. Hanthorn's conclusion that the main motivation for using certificates has been the ability of farmers to take full advantage of the loan program without paying storage costs. I believe my article states this agreement.

I am not sure I understand Mr. Hanthorn's point regarding loan placements. But if he is saying that certificates have significantly reduced commodity prices and that loan placements are highly correlated with the average farm price as a percent of the loan rate, then I do not see how he can escape the conclusion that certificates have produced higher loan activity, even if this year's level is lower than the previous year. This implies that much of the additional redemptions of commodity loans have merely replaced other supplies, forcing them into the loan program. Additional redemptions save the government money only if they are used to meet additional demand.

I agree with Mr. Hanthorn that a marketing loan for corn and wheat is unwise. I merely raise the question of why we seek to achieve only half the effects of the marketing loan program through a program that disproportionately affects the corn market as opposed to that of wheat and soybeans. For that matter, why do we issue certificates to cotton and rice farmers who are already benefitting from market loans? Why don't we move the programs for these to crops to certificates? I have little doubt that the growers of these crops have reasons for continuing current practices. I am not sure those reasons are economically valid from a public standpoint.

Finally, I do believe that certificates are outside of the generally accepted budgetary procedures for federal programs. Even normal entitlement programs are subject to some restraints. There are many programs such as the Export Enhancement Program and the Targeted Export Assistance Program which, if paid in cash would be subject to normal appropriation controls. By making the payments in certificates, USDA avoids these controls since the cost of the certificates shows up in the Commodity Credit Corporation account, an entitlement program with looser budgetary restraints.

With regard to Mr. Lambert's statements, I do not suffer from any lack of respect for or confidence in Robert Thompson when I say that policymakers failed to realize the true nature of PIK certificates until well after their release.

More importantly, I believe that much of the inconsistency pointed out by Mr. Lambert between competitiveness and budget restraints on the one hand and higher prices and farm incomes on the other is an inevitable fact of life, at least in the short run. I believe that the administration has attempted to pursue both goals. This has met with disapproval from proponents of the two extremes but that is politics. I believe the two programs Mr. Lambert mentions, generic certificates and the Export Enhancement Program, have generally been used to subsidize farm income at the expense of the Treasury.

While I agree with Mr. Lambert that the power given to USDA as a result of certificates is somewhat strange for an administration devoted to free markets, I do not agree that the administration has not announced to the public the general goals it intends to pursue in the farm sector. I would, however, urge it to go further by spelling out the specific price and quantity goals it intends to pursue through certificates.

As a final comment to his reply, I agree that USDA needs to communicate more effectively with academia and the broader policy community. I do not believe this reflects an unwillingness on USDA's part to engage the public in a policy discussion. I believe that if better communication is to be arrived at, it will have to come from individual academics and others offering their services to government policymakers as advisors and sources of information. C