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A GOLDEN HANDSHAKE: *Decoupling With A Twist*

by Lloyd D. Teigen

New technology can be a mixed blessing for farmers. It can increase efficiency and profits. But in the long run, it can also increase commodity supplies, leading to lower prices which decrease farmers' incomes, leading ultimately to fewer farms.

Policymakers are often concerned with this chain of events, and therefore seek to control production and express great concern about declining farm numbers. Over the last 50 years, U.S. farm numbers have fallen from 6.8 million to 2.2 million and farm employment from 10 million to 3.5 million (from one-fourth of national employment to just 3 percent). This is also approximately the time period that the federal government has had farm commodity programs.

◆ Paying cash annuities to farm operators who leave farming would help those who stay in farming, as well as those who leave. Such a progrm would facilitate, rather than retard structural change in U.S. agriculture and its cost would be consideraly less than current farm programs.

Farm programs often focus on symptoms of the problem (such as prices, production, and acreage) instead of on technology and basic structural issues. Policies that seek to help producers remain in farming are often justified as efforts to save the family farm. But they often encourage more farmers to stay in farming than the market will support.

Some policies encourage financially troubled farmers to stay in farming when they might have been better off financially to quit farming. In this way, farm programs can be like "golden handcuffs," enticing farmers to stay in place, with short-term income enhancements, but without improving their longrun financial well-being. The golden handcuffs keep incomes enough above the thresholds governing technological adoption, exit, and other farm adjustments, so that change in the system is retarded. The golden handcuffs lessen the stress, but prolong the suffering of marginal farms.

Handshakes, Not Handcuffs

Another legitimate role of farm policy is to ease the adjustment process for farmers leaving the sector.

Call this approach the "golden handshake." This would consist of a cash annuity paid to farmers choosing to leave farming. Such a program would improve the long-term incomes of people remaining in farming and would cost taxpayers less than other forms of government assistance. A golden handshake program could replace the current price support program. It would increase the off-farm opportunity incomes of farmers on the margin. Although it resembles the dairy buyout program, there are important differences between retiring a cow and retiring the farmer.

Golden handshake annuities would be paid each year during the lifetime of an ex-farmer. To qualify, a farm operator would have had to produce a certain minimum level of output — perhaps $40,000 in annual commodity sales for a specified number of years. The farm assets of the handshake annuitants could be sold, leased or merged by the annuitant with the assets of any bona fide farm operator, providing that the number of commercial farm operations decreases by one for every annuity paid. Handshake annuitants could transfer resources from father to son without penalty, if the son already was a bona fide farm operator. A bona fide recipient farm operator must have sold a minimum level of products (say, $30,000 per year) in the two or three years before the program was established.

The program is targeted at a specific set of marginal farm operators. Each ex-farmer in the program would receive the same amount of money. Therefore, only operators of smaller farms would likely be interested. The amount of the payments, as set by policymakers, might be $10,000 yearly, for example.

Those continuing to farm would receive increased income because of expansion opportunities and price effects. Total output should decrease because of the smaller numbers of farms and farmers and from the diminishing marginal productivity of the remaining farms. The long-run incomes of remaining (marginal) farms would rise nearly dollar-for-dollar with the amount of the "handshake" annuity, since the annuity raises the exit threshold for all farms and exits would continue until farm profits exceeded the new threshold of opportunity.

The golden handshake program could have a price-tag substantially less than the cost of current government farm programs. For example, if all farms in the $40,000 to $100,000 sales category availed themselves of a $10,000 annuity, the Federal budget exposure would be about $3.2 billion per year. Participation would probably be less than that number.

In a simulation model, the golden handshake program costs between one-third and one-eighth the cost of various other farm programs. The model shows that government policies often delay the longterm effects of new technology. With technological advances, fewer farms can produce more at lower cost, with ultimately about the same per-farm profit.

Only the golden handshake program, among policy options examined, alters outside opportunities enough to affect the long-term profit of farms in the industry. The market's response to the departing farms will raise the profits of the remaining farms nearly dollar for dollar with the golden handshake payment. The model indicates that not all assets of departing farmers would continue to be used as intensively for farm production, because commodity price levels, determined by supply and demand, would make this uneconomical. As technology spreads, prices initially fall when supply and demand are allowed to work, but later rise after production responds to farm exits and other necessary structural changes.

Real Prices Have Declined

During most of this century, real (inflation-adjusted) prices of farm commodities have declined in the face of increasing production levels. Farm policies have been designed to counteract this trend, but have not succeeded.

The long-run income position of farmers is determined by income opportunities outside the farm sector, and these are not affected by farm policy in its current form. Whether farm-

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ers have other possibilities outside the farm sector has a lot to do with whether they stay in farming or leave and how they organize their business.

The "golden handshake" program would facilitate, rather than retard, the process of structural change in U.S. agriculture. It would increase the incomes of both departing and continuing farmers. The adoption of new technology would increase more rapidly in response to the market-oriented price and profit signals experienced by farms. Although a golden handshake program would not reverse the secular price decline, the new technologies' cost-effects would permit the remaining farms to adapt to market conditions.

A Form of Decoupling

A golden handshake program could be considered a type of decoupling, which means removing farm program payments from any tie to production. Some policy-makers have been promoting this concept as a way to end policy-induced excess production. Other decoupling proposals would pay people who remain in farming, not those who left the sector.

Adoption of the golden handshake program would continue to provide a safety net for farmers, while removing the safety net from under commodity prices. Because farmers benefit in different ways than under current programs, some people might be reluctant to endorse the golden handshake idea. Despite its redistribution of program benefits and its reduced number of active farm operators, the golden handshake would increase incomes of all marginal farmers with reduced budget exposure and permit commodity prices to seek levels that compete in world markets.

If the government pays farmers in this way, why not pay other types of workers and businessmen to change jobs? Similar kinds of retraining and adjustment assistance have been offered in the past to workers affected by trade liberalization. The primary reason to limit the handshake program to agriculture is that the adjustment costs are higher for farmers than for many others in the economy. Farmers are often at a great distance from other opportunities and find it difficult to adapt their skills to other economic pursuits.

For More Information

This discussion is based on ERS Staff Report No. AGES880810 *Agricultural Policy, Technology Adoption, and Farm Structure, October 1988.* Copies can be obtained by writing to the author at 130 New York Avenue NW, Economic Research Service, U.S. Department of Agriculture, Washington, DC 20005.

HAVE YOU HEARD...

...that the 88th Annual Meeting of the Southern Association of Agricultural Scientists will be held in Nashville, TN, February 4-8? The Southern Rural Sociological Association, the Southern Agricultural Economics Association, and other associations will all be meeting as part of this annual conference.

...that new ERS figures show lower farmland loss in urbanizing areas? The new estimates developed by Marlow Vesterby and Doug Brooks, both of the Economic Research Service, show that conversion of agricultural land to urban uses is lower than previous estimates. ERS estimated the average annual amount of conversion at 780,000 acres per year over the 1970's, substantially below the 2.9 million acres estimate in the National Agricultural Lands Study (NALS) and the 1.3 million acres estimate prepared by the Bureau of Census.

The conference, the first national conference on farmland conversion since the NALS study ended in 1981, focused on national and local concerns about urban conversion, the impacts of urbanization on agricultural investment and land values, prospects for studying the effectiveness of farmland retention programs, appropriate roles for the federal government, and small farm opportunities in urban "niche" markets. For more information, contact workshop coordinator Ralph Heimlich, ERS/USDA, Washington, DC, 20005.

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