Letters

GATT Compromise (Second Quarter 1992)

■ I disagree with Heather Field's rejection of public choice theory as a useful tool to explain the EC's resistance to agricultural policy reform at the Community and international level as I argued in my comments on Fred Sanderson's "GATT Compromise," (Second Quarter 1992).

The public choice paradigm states that pressure groups will mobilize resources in direct proportion to their perceived welfare gains or losses. COPA, the federation of Community farm organizations, mobilizes lobbying efforts to protect rents derived from the CAP. National farm organizations also lobby their national governments, EC officials, and their affiliated Community organizations for the same reasons. French farmers loudly protested the U.S.-EC GATT agreement in Paris, Brussels, and elsewhere. Subsequent actions by France confirms the fact that the political strength of Community farmers is well understood at both the national and supranational level.

The structure and function of EC institutions establishes the framework within which the bargaining process operates. Politicians, farm lobbyists, and bureaucrats commit resources to influence policy debates in direct proportion to their perceived welfare gains or losses. Public choice theory allows us to predict potential outcomes of the negotiating process with some reliability. The essential bargaining process at the Community level takes place between countries, as Heather Field argues, but when the decision-making process shifts upward from the Council of Agriculture Ministers to the European Council, then the bargaining process involves more of the traditional taxpayer-producer dichotomy of political economy.

Glenn W. Ames
University of Georgia

Agricultural policy reform (First Quarter 1993)

■ Harrington and Doering (H&D) step bravely forward to restructure commodity programs. They do not, however, consider why we have a commodity oriented agricultural policy. Nor do they show why it would be better to accept their program. They suggest that current programs are based on the 1933 Agricultural Adjustment Act which they contend was designed to meet other needs. However, we should remember that the Agricultural Adjustment Act of 1933 was to be a self-financing supply control program, paid for by processor taxes. It was to put a floor under prices at a safety-net level. In the beginning, loans were made to producers at rates that were expected to be below longrun market prices. We should also remember that, by 1938, commodity interests had gained sufficient support in the "farm bloc" to institutionalize parity prices and nonrecourse loans for price support with the goal of longrun income enhancement.

H&D ask us to believe that "the public does seem willing to support revenue stabilization to cushion market price variability and the yield variability that nature brings to agriculture." When we try to convince others, it is often comforting to refer to the ambiguous public. The "public" seldom says anything as a group. Perhaps they are referring to some elements of the public, some agricultural economists, some lobbyists, some journalists. I would suggest that there may be as many as 51 percent with an opposing view. I wonder if they consulted Gallup or Harris.

As the cornerstones of their program, H&D suggest that all risk crop insurance and commodity price stabilization linked to cost of production provides a market-oriented nondistorting program. Although limited risk insurance for wind and hail comes close to meeting the criteria for actuarial soundness, coverage for floods, frost, or drought results in production occurring in regions that are high risk, the events that occur on one farm are not independent of those on another, and it is not feasible to pool the risk across those areas that are unaffected. Moral hazard and adverse selection result in the inability of all risk crop insurance to pay for itself. (The issues concerning moral hazard vary among the Canadian provinces.)

There is no justification for a generalized income stabilization scheme. Income stabilization schemes that do not recognize the source of the variation in income are likely to result in distortions because they tend to hide the cause of the problem. They are like the doctor telling the patient to take two aspirin and go to bed. They leave the patient without a diagnosis of the problem or a means to a cure. When tried, income stabilization has been quick-ly converted to income enhancement, just as drug therapy may be converted to drug dependency.

Just as H&D don't tell us how they determined that the public supports revenue stabilization, or why revenue stabilization is necessary, they fail to show how all risk crop insurance or income insurance can be "actuarially sound." The Canadian National Tripartite Stabilization Program (CNTSP) and the Western Grain Stabilization Programs (WSG) have historically had payouts exceeding contributions over the longrun. Farmers contributed about $1.0 billion (Canadian) towards the WSG from 1976 to 1990/91. During the same period payouts totaled $4.5 billion (Canadian). The Gross Revenue Insurance Plan (GRIP) and the provincial plans that spring from it, such as the Ontario Market Revenue Program (OMRP) all have participation by the Federal and Provincial governments and the producer. For example, the Saskatchewan plan has the producer paying 33.333 percent of the premium, the Province 25 percent and Ottawa 41.667

percent. These three premium payments may or may not cover the payments to producers. The material that I have from Ontario only shows the producers payment not those of the Province or the Federal government.

Revenue insurance has never been demonstrated to be actuarially sound because it is not clear what is being insured against. If the source of the problem is not determined, then providing insurance is not a realistic economic alternative. The premiums received by the insurer must exceed the payout to those insured to cover the cost of management. The participants in the program must be independently affected by the risk factor and the probability of being affected should be small relative to the size of the insured pool in order to keep the premium reasonable. Broad-based income schemes fail on several counts.

It has been clearly demonstrated by our past program excesses that "parity" is an inappropriate concept to apply to farm commodity prices and it is surprising that H&D suggest that it might have a place in future programs. Teigen's "modernized parity" is, after all is said, still a parity concept that has no basis in economic theory.

Our experience with cost of production indexing in the 1970's ought to be sufficient evidence to dissuade us from matching our support to the maintenance of the current production technology.

Although they suggest that their program would have cost $1.1 billion less in 1992 than the current program, the components of that estimate are not clear, other than they have assumed "actuarially sound" crop insurance.

Relative to the environmental issue, Canadian economists from Saskatchewan and Manitoba have expressed concern that the program will result in the breakup of marginal land to enroll it in the program. They have suggested the need for sodbuster and swampbuster programs to protect the environment from the excesses of the GRIP.

As a purely technical point, any procedure that uses a 10 or 15 year average yield or a 10 or 15 year average price is going to lag the real forces in the market. If yields are trending up at one half bushel per year and longrun prices are trending down, then their combined effect will create a substantial error in any forward price scheme. Production based on these averages would lead to substantial subsidies and create long adjustment delays.

The current U.S. commodity program, with all of its problems, gets us much closer to a market oriented policy that will let prices signal the real need for resources and allow U.S producers to sell in the world market. And, it keeps the dependency limited rather than broadening programs to include other groups.

We had better test the H&D assumptions carefully before we jump on the revenue insurance band wagon. A careful review of the Western Grain Stabilization Program, the GRIP, or ORMRP might show that these programs have not yet demonstrated their ability to operate without producing a subsidy.

Robert D. Reinsel
Agricultural and Trade Analysis Division/ERS

The authors respond:

■ We're glad we have stimulated debate on new approaches to US commodity programs and that Robert Reinsel has come to the defense of the current programs. He raises some valid questions, to which we have given considerable thought. From his comments, however, it looks as though he is bogged down by the status quo. If Congress retains the current programs, it should be by conscious decision after seriously evaluating alternative programs.

Reinsel correctly dates current policies to the Agricultural Adjustment Act of 1938. We mentioned the '33 Act because it was the first step in our government's direct involvement in farm production and income through benefit payments and controlled production. In the 1930s there was strong justification made for generalized income stabilization through the "ever normal granary." This was an important selling point to the general public on the basis of price variability between harvests. Once sold, however, then Congress willingly fostered income enhancement through the stabilization schemes to get cash into rural areas and to address the great disparity between farm and non-farm income at that time.

But what does the public support today? The fact that current commodity programs were one of a small handful of programs suffering actual budget cuts in the '90 budget resolution and that similar deep cuts appear in the Clinton budget are strong evidence to us that politicians feel they face a public increasingly unwilling to continue with the status quo and just tinker with the old agricultural programs. Bruce Gardner's excellent article, "Demythologizing farm income," in the last issue of *CHOICES* shows both the reason for income enhancement sixty years ago *and* the reason the public is skeptical about it today. It also shows the income variability problem as we moved closer to world market prices.

We recognize the tendency for income stabilization to be converted to income enhancement and have designed our proposal to introduce automatic adjusting mechanisms for yields, target prices, and prices paid indices to reduce market distortion and eliminate income enhancement transfers. If Congress deems some level of income enhancement necessary under our plan, it can provide it in a minimally distorting manner by sharing the premiums between producers and taxpayers. The dollar amounts of Canadian support are only relevant to show possible budgetary exposure if Congress decides to underwrite some of the program.

Reinsel's conception of revenue stabilization is narrower than ours. Ours encompasses both a yield insurance component and a price stabilization component.

Reinsel decries the feasibility of a multiple peril crop insurance, citing problems of risk pooling, the lack of independence of risks, moral hazard, and adverse selection. While it is true that multiple peril crop insurance, as it is currently administered in the US, has experienced problems from each of these, we do not believe that this fact renders the concept unfeasible. We recognize the problem of determining commodities and areas of homogeneous risk for pooling. The insurance industry has devised ways to cover risks that are not strictly independent—how else could homeowners' policies have storm and weather damage coverage? Adverse selection quickly becomes a non-issue if participation rates are high, as has been the Ontario experience. While no plan is completely free of moral hazard, our plan is structured to provide specific disincentives to "farming the program." To do so would rapidly reduce a producer's future coverage. In our plan, the current income equivalent of future coverage provides a positive marginal revenue to salvaging damaged or low-yielding crops, which current programs do not.

In looking at our price stabilization component, Reinsel has apparently misconstrued Teigen's analysis of parity. Teigen's "modernized parity" is essentially a moving average price of a commodity over the preceding 10 years, indexed for changes in input prices over the same period—unrelated to the 1910–1914 base period of traditional parity. If weights are periodically updated in the prices-paid index, the Teigen index can automatically adjust for changing technology and input use. Thus, it is not a captive of cost of production or current technology, but eliminates the variation or random noise without masking the underlying market price signal. The 10 to 15 year moving averages are necessary to allow forward prices to reflect long-term market trends. Any lags in them can be corrected for in the estimation of the RHO parameter that equates forward prices to indexed moving average prices (IMAPS).

Reinsel's assertions that current programs are more market-oriented, that they let prices signal real needs for resources, allow world market trading, and limit dependency just do not hold water. Mainstream policy and trade economists (including Reinsel) have been citing the distortionary effects of our agricultural programs on product and factor markets and on input usage for nearly a generation.

Reinsel's comments regarding environmental concerns and compliance are critically important. We believe that our program will have more perceived value to farmers than the existing programs with no budget to support them. Thus, cross-compliance can be legislated and continue to operate in our plan. However, if society wants to greatly change the way farmers farm or change the utilization of the landscape, perhaps society should pay for this directly, rather than distort farm incomes and commodity prices to gain those different ends through high payments and increasingly complex and strictured cross compliance.

We certainly agree with Reinsel's last point. Analysis of the advantages and disadvantages of this and other policy proposals for US agriculture is both necessary and desirable. Careful review of our current policies and the policies of others is an essential part of that process.

David Harrington
Agriculture and Rural Economy
Division/ERS

Otto Doering
Purdue University

The great deficit debate (*First Quarter 1993*)

■ In the First Quarter 1993 issue, *CHOICES* did a service to its readers by highlighting the great deficit debate. This reader is of the opinion that the growing deficit is a very serious matter.

Figgie says that in 1991 the interest charge on the official debt was the largest single item in the federal budget. This charge has continued to grow, and unless the deficit is brought down it will increase further.

Interest costs on the national debt, which run around 7 percent, are more than twice as great as the historic real rate of economic growth, which is about 3 percent. Economic growth is the product not only of capital but also of land, labor, and management.

The only methods by which an economy with a heavy debt load and a low rate of economic growth can pay a high percentage return on capital are these:

1. Transfer some of the social dividend away from those who produce the country's goods and services, diverting this reward to those whose contribution to their country consists of collecting interest. This process already penalizes the productive sectors of the society; a growing debt would aggravate the problem.

2. Reduce the real rate of interest and the real burden of debt by inflation and so diminish the twin burdens of interest and repayment. This is already happening and is a subtle form of repudiation.

With rising debt, one or the other or both of these forms of predatory behavior will escalate. This stern lesson many debt-ridden countries are now learning and the United States may still learn.

Don Paarlberg
Purdue University