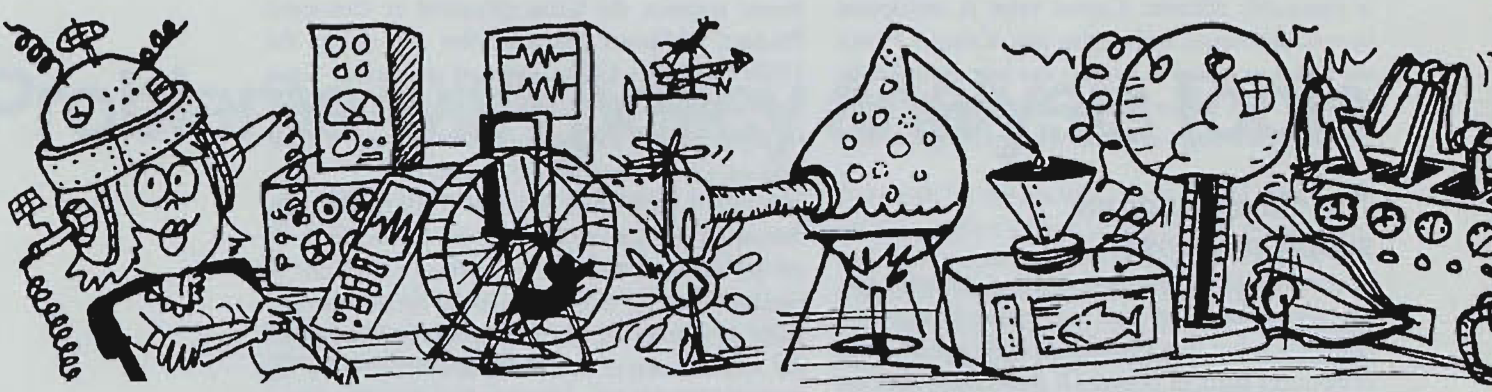
Letters



Ag policy reform: response to a reply

■ Harrington and Doering in their reply (Second Quarter '93) seem to have intentionally misunderstood my comments on their proposal in the First Quarter '93 edition of *CHOICES* or they did not consider the provisions of the 1990 Act.

The Food, Agriculture, Conservation and Trade Act of 1990 is really not a "status quo" program when compared to the legislation prior to 1985. Under the Act the nonrecourse loan provides a flexible low level basic support at 85 percent of a 5 year moving average of market prices (minus the high and low price). This loan rate may be reduced further given certain stocks to use ratios and at the discretion of the Secretary. In addition, the base acreage and yield for deficiency payments are fixed and the acreage on which payments are calculated is reduced by the mandatory normal 15 percent flex. The implications of these provisions are that; (I) income payments are separated from current production decisions; (2) loan rates are normally below the world price and thus are a safety net that support prices and income only in years of extreme over production, (3) grain can be sold by the farmer or the government any time it is deemed profitable to sell (there is no release price for grain under loan) and the CCC may sell grain at 115 percent of the basic loan rate; (4) the United States is no longer the residual supplier of grain to the world market because stocks are not accumulated to raise income; and (5) income enhancement is from direct payments from the treasury rather than though supported prices.

The 1990 program meets the market orientation provisions of the Uruguay round GATT negotiators. We can thus conclude that current programs have evolved to a much different form than those in place from 1938 to 1985. Although the 1990 Act may not be ideal, it offers a substantial degree of protection to farmers without substantially altering or distorting market prices. And, if we did not choose to use export subsidies to meet certain objectives relative to the EC, the program would not have much of an impact on trade.

Relative to their argument on "modernized parity," the fact remains that it attempts to link the prices of output to the prices of inputs. This would seem to limit the effectiveness of commodity prices in signaling the need for re-source adjustment. Maintaining a purchasing power relationship between input and output prices seems at odds with market orientation and with the direction of program evolution.

Relative to their remarks on insurance programs, we should note that the risk pool for storm and weather damage is very large and the probability of any one building being damaged is very low. Thus, the premium is small relative to the potential loss.

Concerning the Ontario program, its hardly surprising that participation rates are high. The producers only pay one-third of the cost of the premium.

In their comment relative to the program development process of the 1930s Harrington and Doering seem to argue against themselves. They point to the willingness of the Congress to convert stabilization schemes into income enhancement schemes.

It is dangerous to second guess the motives of the Clinton Administration but their budget does not offer program cuts until after the next farm bill. The Administration seems to have decided not to get involved in a debate with the commodity interest groups to achieve a needed immediate reduction in spending. Perhaps the level of support for change in programs is not so large as Harrington and Doering suggest.

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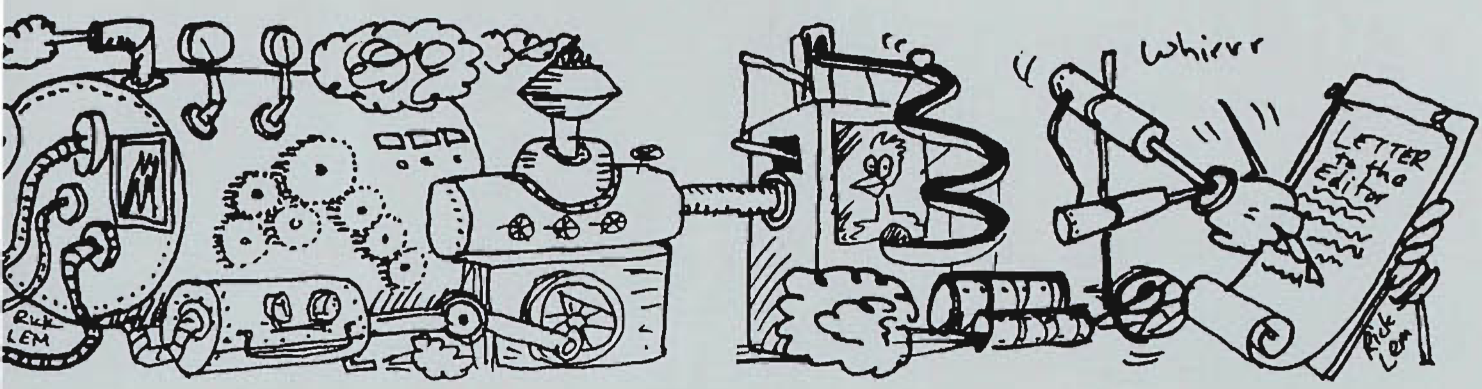
Financial institutions for agriculture: a comment

■ Duncan and Taylor (2nd Quarter 1993) present a coherent perspective on a possible future for financial intermediation in U.S. agriculture. We agree that the financial environment facing farmers and lenders in the future will differ from that of the past. And, we agree that the appropriate framework for thinking about



the environment is one of supply and demand relationships. However, we also have a different perspective on the supply of funds for agriculture and how lenders may allocate these funds.

In an aggregate sense we are somewhat less sanguine about the future supply of agricultural credit. Duncan and Taylor suggest that lenders have a large supply of credit that they wish to place in agriculture, as evidenced by low loan-to-deposit ratios in rural banks. But, taking this data out of context can be misleading. As agricultural credit decisions by lenders are fully integrated into larger financial markets, it makes less sense to look at fund availability in financial institutions in rural areas and say these are funds for farmers. Unless agriculture provides risk-adjusted rates of return that are competitive with other sectors, commercial banks will place their deposits elsewhere.

Duncan and Taylor note this issue in their discussion of changes in regulation, but it goes beyond regulation to the basic lending strategy of institutions. Capital is expensive for banks. New capital requirements will make commercial banks look very carefully at how their capital is deployed by line of business. It is not clear how agriculture will fare in this environment. The trend toward larger banks noted by Duncan and Taylor could actually reduce the supply of agricultural credit, if large banks cut back on farm lending due to relatively low rates of return and high delivery and servicing costs. Similarly, while small farm banks have fewer alternative lending opportunities, they can place funds with larger banks or buy government securities.

Our second point concerns who will receive credit. In the future the farmer and the lender face interesting risk/return trade-off choices. Large farms that are able to reap size and scale production efficiencies may be riskier. Smaller more-diversified enterprises whose on-farm activities appear less efficient may have greater stability.

One could argue that in the slow growth environment for agriculture postulated by Duncan and Taylor, lenders might be more willing to fund enterprises with diversified income sources rather than specialized producers, especially if government price supports are less generous in the future. We do not dispute the tendency for most agricultural production to come from a small number of large farms, or Duncan and Taylor's analysis of the financial implications for full-time farms, but we believe that they gloss over the implications of the diversified sources of farm family income for agricultural credit markets.

Most farms today rely on some form of off-farm income and the financial arrangements of these enterprises are based upon all sources of income. To buttress their argument for larger size farms, Duncan and Taylor note that family living should not exceed more than 10 to 15 percent of gross receipts. We would submit it can also be seen as arguing for greater off-farm diversification of income sources.

We believe that the changing environment could lead to more difficult financing decisions for specialized, full-time farmers, who may be pushed toward non-traditional credit sources by the reluctance of commercial banks to advance funds. Conversely, we believe that the flow of funds to smaller farms with demonstrated sources of off-farm income will continue to ensure that these farms remain a dominant force in terms of number of farms and credit used, even as their share of output declines. At present two-thirds of credit goes to farms with sales less than $250,000. Finally, Duncan and Taylor provide an important service by noting the growing role played by the financial activities of non-finance corporations. Traditional input-side dealer credit and the growing use of credit by marketing and processing firms are clearly going to be important for larger producers. But one might ask whether there is a price to be paid by farmers who become bound to a single firm for multiple services.

In conclusion, while we agree with the specifics of the ten points set out by Duncan and Taylor in their conclusion, we would draw somewhat different general implications for agricultural credit markets.

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