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State Level Agricultural Policy in Minnesota:
Adjusting to Change in the 1980's

by

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A report prepared for the staff of
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Overview

This paper considers both the limits and possibilities of state agricultural policy. The limits of state policy result not only from scarce resources, but the fact that state agricultural sectors are enmeshed in national and international markets and political forces over which they have no direct control. Possibilities for state policy exist in carefully designed programs which recognize these macroeconomic constraints. While this study is intended to inform the larger Winrock effort to develop options for the State of Arkansas, its lessons are general. It seeks to illustrate by example Minnesota's policy response to the difficult agricultural environment of the 1980's. Whether these policies are adaptable to other states is a question best answered by those more familiar with these states' needs.

The particular focus is on three areas of policy with which I have been directly involved. The first is the Minnesota interest rate buydown program, developed during the winter of 1985 to relieve financially stressed farmers. This program illustrates five key lessons: the limits of state financial resources; the consequent need to shift financial risk away from state treasuries; the potential for cooperative efforts by state departments and the state university; the problems resulting from efforts to make rural financial stress a partisan political issue; and the difficulty of dismantling temporary initiatives. Given scarce resources, states must combine the efforts of various government departments, minimize conflict over bureaucratic turf, and fully utilize the knowledge base of the state university system. Partisan politics and national debate over agricultural policy should not be allowed to dominate the attention of state agricultural officials.

The second policy area is the Minnesota conservation set-aside program: Reinvest in Minnesota (RIM). RIM illustrates the need for careful targeting of state programs in the face of budget constraints. It also suggests new ways in which state universities and government departments can combine their efforts. Finally, it emphasizes the importance of working within federal programs, in this case the Conservation Reserve Program (CRP) and Acreage Reduction Program (ARP) of the U.S. Department of Agriculture.

The final policy area considered is state-level economic forecasting, with special emphasis on the agricultural sector. The distinction between agricultural forecasting and agricultural reporting is emphasized, with attention to the analytical need to integrate these two kinds of efforts. The lessons here are the problems of separating state and national economic trends; the need to coordinate state agriculture departments with other departments, such as revenue and finance; and the crucial analytical role of university and private sector economists.

Minnesota's Interest Rate Buydown Program

In January of 1985, 10,000 farmers massed in sub-zero temperatures on the steps of the state capital in St. Paul to demand relief from farm debt burdens. Remembering the populist initiatives of the 1930's, many called on the Governor to impose a moratorium on farm mortgage foreclosures. Set against this demand was wide-spread concern in the financial community that a moratorium would tie up orderly foreclosures and force reductions in the general supply of farm credit. In response to the mass rally, Governor Perpich appointed an "Economic Crisis Commission".

The Commission membership included four farmers: three activists

favoring a moratorium and the conservative President of the Minnesota Farm Bureau, who opposed it. It also included four bankers: two small town independents, a representative of the Federal Farm Credit Bank of St. Paul, and a large metropolitan bank. Finally, it included four members of the state legislature: two representing the Democratic Farm Labor (DFL) Party and two the Independent Republican (IR) party. To these twelve members I was added as chair, in part in my capacity as a faculty member in the Department of Agricultural and Applied Economics at the University of Minnesota. The Economic Crisis Commission was later enlarged to include representatives of northern Minnesota's stressed Iron Range, although the original "Farm Subcommittee" continued to meet separately and after four weeks presented its recommendations.

The two key options which the Governor requested the Commission Subcommittee to consider were a moratorium on foreclosures and an initially vague proposal for farm interest rate relief. Judging the moratorium issue to be exceedingly divisive, I proposed that the Commission develop an "interest buydown" plan first, then debate the moratorium. Meeting with staff in the State Department of Agriculture, the Commission discussions were rapidly relayed to farm groups, bankers, and the state legislature (then in session) resulting in at least one emotional visit by a legislator determined to promote the cause of a moratorium.

Despite this charged atmosphere, the group succeeded in developing a detailed proposal for an interest buydown on farm operating loans, the first such state program in the nation. The essential feature was that private banks would reduce interest charges on seasonal operating loans in return for a state commitment to share the costs of this "buydown". The

loans could be as large as \$75,000.00. Reductions in interest were initially fixed at one-third of the total interest rate reduction for banks. In return, the state would pay the remaining two-thirds of the reduction. Terms of the buydown were to be for one year. The actual buydown was calculated from the Federal Intermediate Credit Bank (FICB) rate (then about 13 percent) and averaged about 6 percent. Lenders were to submit application for the program, which was administered by the State Department of Commerce. An initial appropriation of \$25 million was to be used until exhausted. Eligibility was restricted to farmers with debt-to-asset ratios in excess of fifty percent, based on farm balance sheet records as of 1984.

While some recommendations were slightly altered in the legislature, the buy-down proposal was carried largely intact to the House and Senate. After passage in early March, 1985, the program was quickly implemented by the Commerce Department, although not in time for many farmers who had already arranged or been turned down for spring operating credit. As a result, only about ten percent of the appropriated \$25 million in program funds was expended in the first year. The program was widely considered a limited success at best, and dubbed a failure by many advocates of the "stronger medicine" of a moratorium.

The moratorium, meanwhile, had been reviewed by the Commission and held to be incompatible with an interest buydown due to its likely tightening effect on credit. This "incompatibility finding" allowed the moratorium to be rejected more easily once the interest buydown had been passed. By an 8--4 majority, the Commission voted against recommending a moratorium. The moratorium issue then moved into the legislature, where it

tied up both houses for much of the session, but was ultimately defeated in part as a result of the Commission's findings.

In the following year, in the face of revenue shortfalls, the legislature cut the appropriation for the buydown to \$5 million, slightly improved its attractiveness to lenders by reducing their share to 12.5 percent of the total buydown and raised the amount of credit available to each farmer to \$100,000.00. Ironically, now that it was familiar to both bankers and farmers, the program proved immensely popular in the face of the 80 percent funding cut. Available monies were applied for and committed within seven days, forcing the Governor to write a "blank check", indicating that all program requests up to a certain date would be honored. Ultimately, nearly \$20 million dollars was committed, creating a deficit of about \$14 million. As support for a moratorium faded (with falling interest rates), the buydown was loudly declared a success by the Governor, the Commissioner of Agriculture, and a variety of its former critics in the legislature. In 1987, despite even lower interest rates, the buydown was continued, at a level of \$17 million, in the face of public opposition by many who argued that it was no longer necessary.

What are the lessons of this experience for state agricultural policy? First, states can successfully intervene in farm financial markets, but only at the margin. The most important single feature of the interest buydown proposal was that it restricted public sector aid to eligible farmers to less than several thousand dollars each. For example, under the Commission's original proposal, on a one-year operating loan of \$75,000 at 13 percent, a six percent buydown to seven percent on one year of interest would have the state pay two percentage points, equal to \$1,500.00, while

the bank paid twice that, equal to \$3,000.00. To the farmer, total interest costs were reduced by nearly half, from \$9,750.00 to \$5,250.00 or by \$4,500.00. In effect, the state commitment of \$1,500.00 leveraged \$75,000.00 in private credit. At this level, \$20 million in state funds could leverage fifty times that much in private lending. The same principle applied even after the terms to the banks were slightly eased, since it was the banks themselves who continued to bear the risk of the loans.

Hence, risks were assumed by private lenders, not the state treasury and taxpayers. The share of public risk bearing is the second crucial lesson, since it is well documented that the agricultural sector is inherently disposed to greater variations in income than other sectors of the economy. If states provide income supplements or other forms of direct assistance, they take on a share of the risk of agriculture itself. In many cases, this risk is simply too great to bear directly. A Minnesota program of the 1970's to aid young farmers in getting established by providing direct supplemental loans in which the state in effect shared risk directly, for example, ultimately resulted in virtually every one of the several hundred aided farmers going bankrupt in the 1980's as land prices fell and their debt burdens accelerated.

Third, the Minnesota interest buydown resulted from cooperation between state government and the University, from which the program drew considerable analytical support and advice. This cooperation was not a result of a carefully planned or longstanding effort, however, and occurred almost accidentally. Indeed, because of the highly politicized nature of the state Department of Agriculture, cooperation was often hampered by

suspicion that the University was insensitive to the needs of farmers, and that it promoted technologies and policies which reduced their number. This point of view, combined with much neopopulist sympathy in the Department of Agriculture for the foreclosure moratorium proposal, made cooperation a fragile bargain. Much more could have been done to promote this cooperation if the Department of Agriculture had been less directly involved in the politics of despair which swept the farm sector in that difficult winter, and if the University had earlier extended offers of assistance in dealing with the farm credit crisis.

The issue of a "politicized" Department of Agriculture is a crucial one, especially in periods of financial stress and adjustment. Very little is gained in such periods from attempting to gain partisan support from lost farmsteads and low prices. The wrenching declines in standards of living which have characterized agriculture in the 1980's require a measured and non-partisan approach to state agricultural policy, especially because the capacity for state intervention is so limited. With such an approach, it will be far easier to develop linkages with other state departments and the University.

A final lesson of the interest buydown experience in Minnesota is that a limited intervention, once it becomes popular, is difficult to disassemble even if obsolete. As interest rates fell during 1986 and 1987, the justification for the buydown faded. However, the fact that it was a relatively successful program encouraged its continuation in spite of questions over a continuing need. Successful programs of intervention in financial markets, even if limited, are more difficult to tear down than they are to erect. Purely on economic grounds, many bankers would probably

have restructured farm debt without the buydown program, suggesting to some that it was unnecessary. Yet such economic reasoning abstracts from the fact that without the buydown, a moratorium would have been much more likely, which would have substantially increased the frictions between farmers and lenders and reduced, rather than increased, the flow of credit.

The Reinvest in Minnesota (RIM) Program

Reinvest in Minnesota began in 1986 with passage of the "RIM bill" authorizing a program of long run conservation easements and a 10-year "RIM reserve" acreage set aside. The program was the dream of a coalition of interests led by wildlife protectionists, hunters, fishermen and conservation groups. The "RIM Coalition" successfully built support for reinvestment in the land and water quality from which the state derived recreational and tourism benefits. This investment was to take the form of easements and a 10-year reserve of environmentally sensitive lands on individual farms. Over time, the coalition was joined by land preservationists such as the Nature Conservatory, and farmers who believed in the importance of land stewardship. The coalition found especially strong support among urban and suburban legislators and rural advocates of a broadened economic base. Many of these advocates were suspicious of highly intensive agriculture practices, which they viewed as a prime cause of declining wildlife habitat in rural areas. The group was also wary of use of RIM payments to farmers as a form of political pork barrel, rather than meeting environmental objectives.

The University of Minnesota, meanwhile, had been developing a targeting scheme for set aside programs which allowed lands that were low in productivity, and highly vulnerable to erosion damage, to be located on

Minnesota's soil and natural resource maps. Based on work measuring soil productivity differences in the University Department of Soils, and policy analysis in the Department of Agricultural and Applied Economics, a simple design was developed and presented to the RIM coalition as a possible basis for land retirements (see Figure 1). The design appealed to the group on both scientific and political grounds. Not only could many lands vulnerable to environmental damage be located using computerized land information inventories, but the temptation to allocate RIM funds for purely political purposes could be reduced.

In its simplest terms, the scheme divided lands into four categories based on two criteria: the productivity of soils, measured by a "productivity index" (PI), and their resistance to erosion, measured by a "resistivity index" (RI). Scaled between zero and one for each soil type based on approximately seven sampling points in each Minnesota township, these indices allowed soils to be categorized as productive/non-productive and/or resistant/non-resistant, leading to four distinct categories of land drawn from overall distributions of productivity and resistance to erosion. For simplicity, these were each divided into two categories in initial examinations of Minnesota soils data by the Soil and Water Conservation Division of the Minnesota Department of Agriculture.

In Figure 1, soils in the upper right box are both productive and resistant to erosion. It is on these lands that long term, low cost production is to be encouraged, and where the comparative advantage of U.S. agriculture lies. In the lower left box are soils which are neither productive nor resistant to erosion. These are lands which could be relatively cheaply bid out of production and into ten-year set asides.

Figure 1

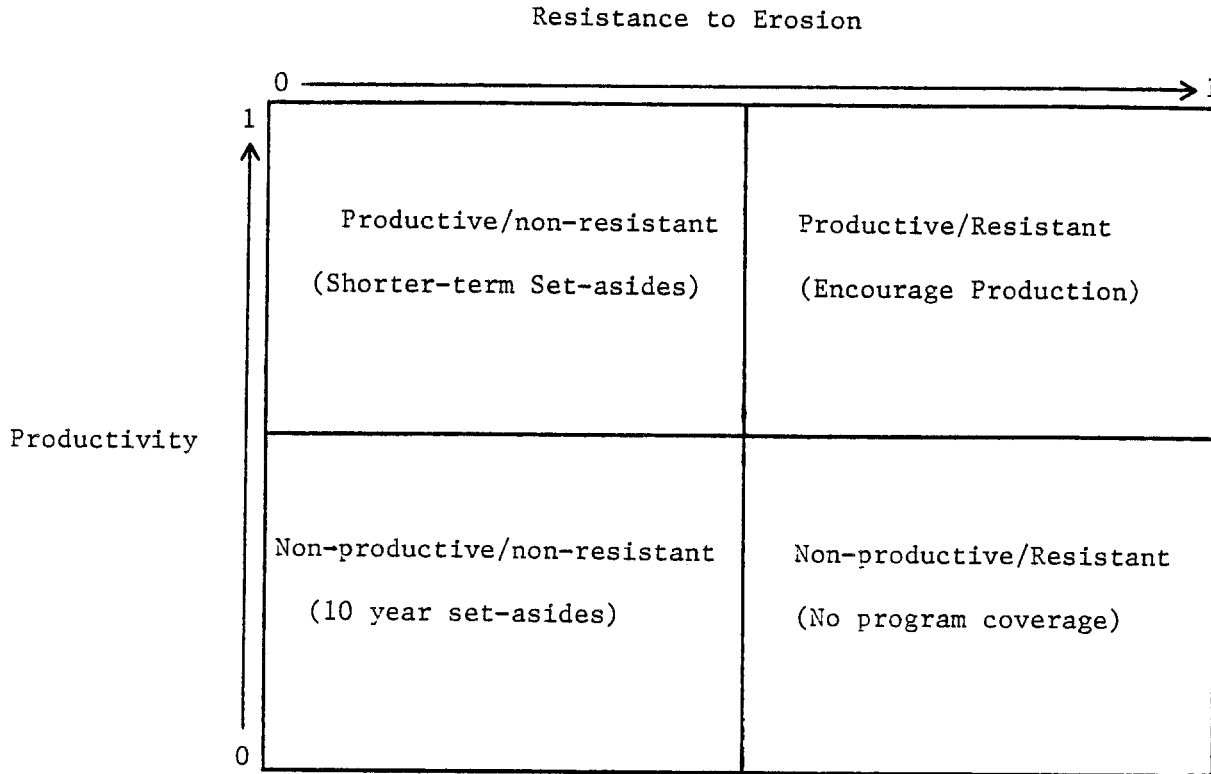


Figure 1. Mapping Soils in terms of Productivity/Resistance to Erosion

Lands in this category are ideal for the federal Conservation Reserve Program (CRP) since low bids would be sufficient to bring them out of production, lowering federal costs.

In the upper left box are productive, non-resistant soils, which if left to market forces would be cultivated, leading to excessive soil erosion. Because they are productive, however, they are expensive to "bid" out of production with programs like the CRP, which pay farmers based on the farmers' willingness to receive compensation. Hence, it was argued that they should be the first lands taken out under shorter-term mandatory federal set asides (ARPs). By restricting set asides to the upper left box, low productivity lands in the lower left and lower right boxes could no longer be set aside. This would end the frustration of supply control objectives through "slippage". Finally, soils in the lower right box, which are both non-productive and resistant to erosion, should be ineligible for program benefits of any kind.

In subsequent refinements, it was decided that the 10 years "RIM Reserve", should concentrate on lands in the lower left corner of the lower left box: the least productive, least resistant lands in the state. These lands are shown (Figure 2) by the dotted box, and were targeted for the program when it became law in 1986. Implementation of the program was shared by the Department of Agriculture and the Department of Natural Resources. Each Soil and Water Conservation District selects parcels that meet this criterion and whose retirement would enhance wildlife management and other public objectives. Landowners are then offered a take-it-or-leave-it price, paid up front, for the cropping rights to these parcels for a 10-year period.

Figure 2

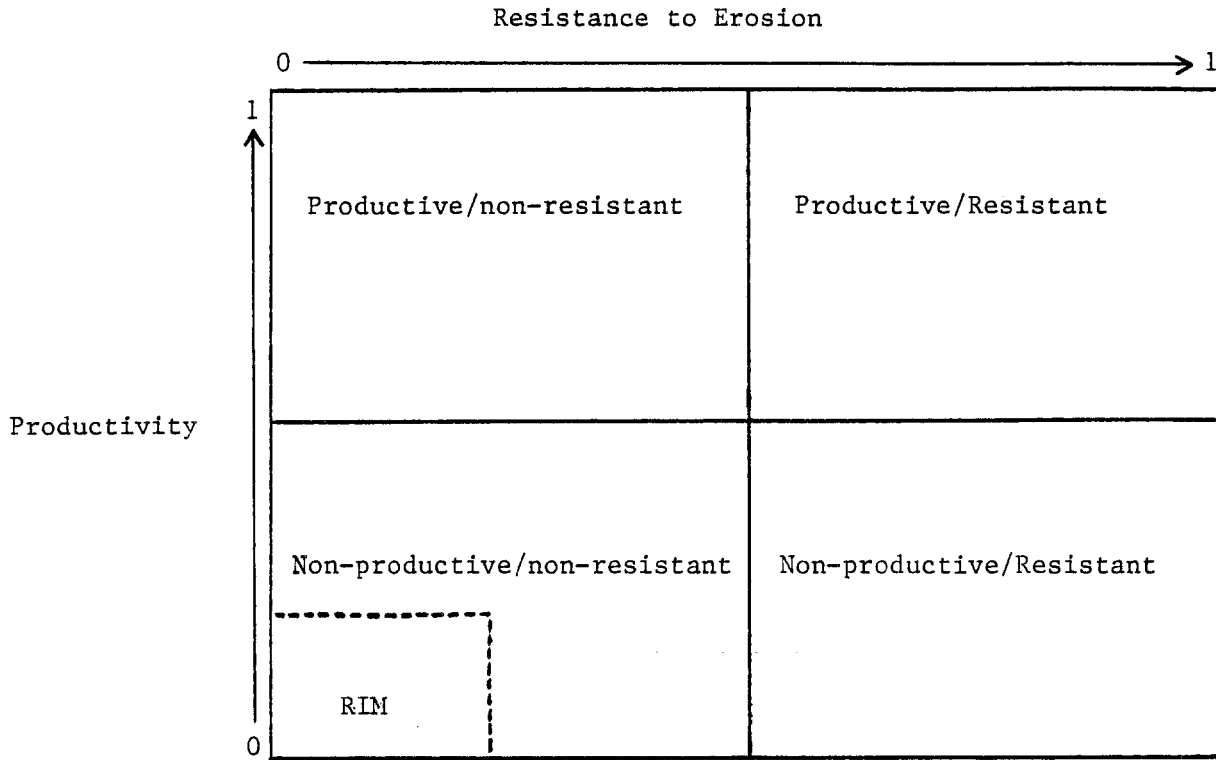


Figure 2. Mapping Soils in terms of Productive/Resistance to Erosion
RIM Targeting

The rationale behind this targeting scheme was as follows. First, the state could not afford to indiscriminately retire lands from production, whether in comparison with other states, or in relation to the federal CRP program. This targeting scheme focused RIM where it would have the most impact on environmental quality, without retiring productive acres and thus putting Minnesota farmers at a comparative disadvantage. RIM was also designed in conscious parallel to the CRP. It made use of the high visibility of the federal program, and had many of the same program features. In contrast to the CRP, however, the targeting scheme employed by RIM provides more flexibility, at the same time that it clearly distinguishes productivity from environmental considerations. The popular notion that the CRP removes environmentally fragile, non-productive lands that "shouldn't have been cropped in the first place" is belied by the fact that the bulk of the land that has entered the CRP is in Classes II and III, generally productive soils on which erosion can be controlled with proper management. RIM, by contrast, excludes productive soils with relatively high resistance to erosion.

Flexibility in targeting is retained by making RIM budget allocations to counties on the basis of the relative amount of targeted soils in each jurisdiction. The higher the legislative appropriation, the more money allocated to each county, thus allowing the program to reflect changing budget realities. Local screening committees then adjust these lists of eligible acres to reflect local knowledge of soil and terrain features, factoring in wildlife habitat and watershed management considerations. Rather than imposing inflexible criteria, the targeting scheme serves only to reduce the pool of eligible acres.

A major lesson of RIM is the importance of working within the constraints imposed by federal programs -- although it has recently been suggested that the federal CRP could usefully adopt the RIM targeting scheme itself as RIM has recently been designated model legislation by the National Conference of State Legislatures. More than any other feature, RIM's payments were set so as not to compete with the federal CRP program. For the 10 year RIM reserve lands, the state paid 90 percent of the average accepted CRP bid in the locality. The tie to the CRP payment served two purposes. First, the state had no idea how much the cropping rights to marginal land should or would cost. Hence, the CRP bids served a price discovery function for RIM. Second, the 90 percent payment level for the 10 year RIM reserve allowed the federal government to pick up its full share of land, without RIM paying for land which would otherwise come out of production at federal expense. In subsequent rounds of land enrollment, the price discovery function of the CRP has been reduced, and RIM payments have shifted to a fixed percentage of cash rental values in each county.

In summary, RIM demonstrates that states can develop acceptable, budget-conscious acreage retirement schemes, based on well-defined environmental criteria. By utilizing technical and economic information in cooperation with the University of Minnesota, RIM was able to retain flexibility while targeting key acres for retirement. To date, over \$10 million dollars has been expended to retire 22,000 Minnesota acres, about one-tenth of one percent of the state's cropland. By contrast, the federal CRP had enrolled 1.3 million Minnesota acres by February of 1987, with annual payments of more than \$83 million. By "ducking under" the CRP, and targeting those lands of particular concern to local Soil and Water

Conservation Districts, RIM has proved highly popular with farmers and state officials alike. In the recently completed session, the Legislature authorized an additional \$19 million in RIM bonding. Additional funds are now being sought from general revenues.

State Level Economic Forecasting and the Agricultural Sector

The dependence of state economies on the larger economic and political environment is especially evident in attempts to forecast state economic performance. Because agriculture is one of the leading sectors of the Minnesota economy, its performance has profound impacts on state and local revenues and expenditures, making forecasts a critical component in state economic planning. Forecast errors are also the stuff of political blame-laying, making them far more than an academic exercise.

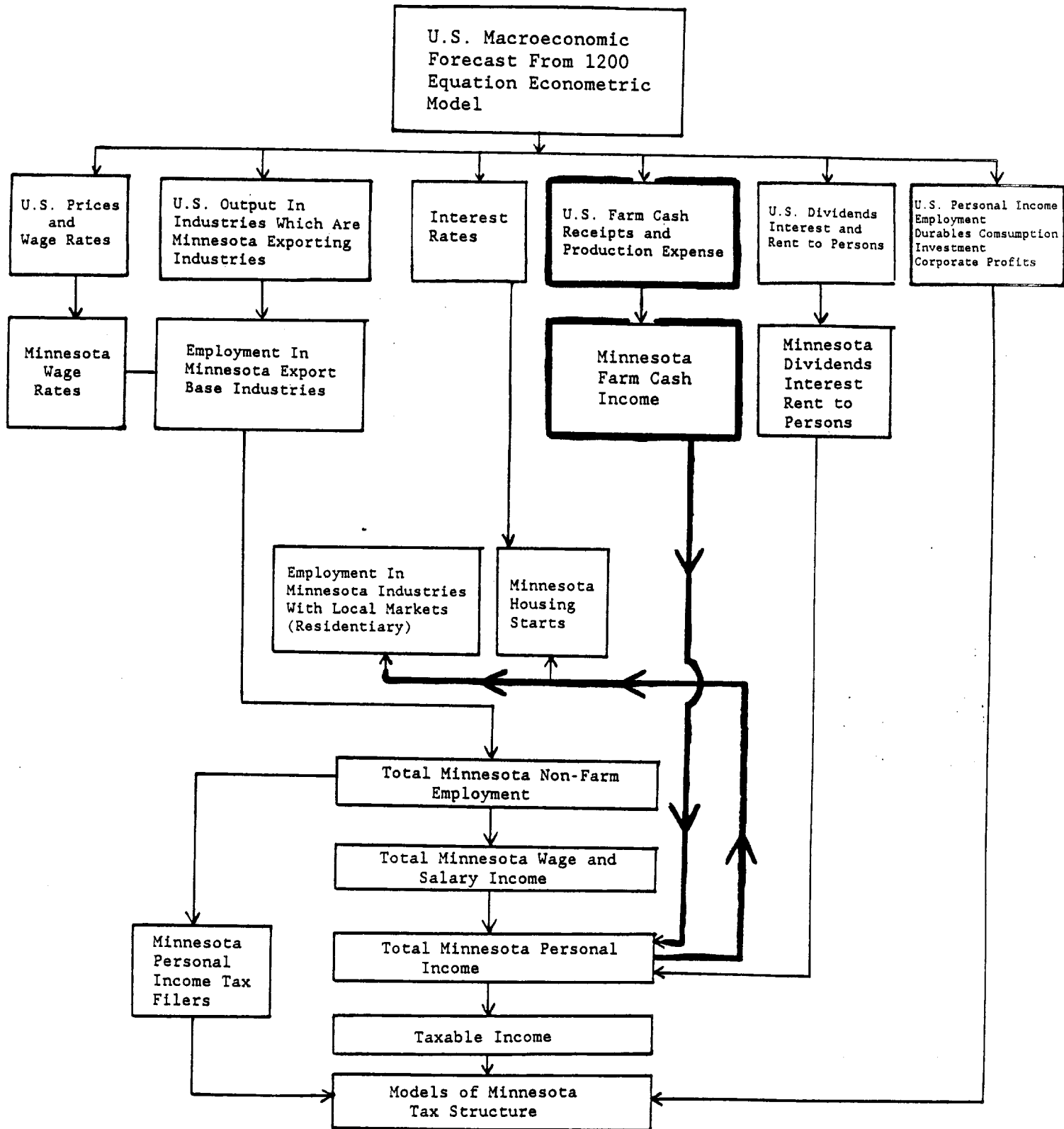
Yet Minnesota's economy is powerfully affected by regional, national and international forces. Its revenues and consequent budget constraints are largely a function of these outside forces. How much money is available for an interest buydown or RIM program, for example, will be highly sensitive to revenue forecasts, and thus will depend on larger trends entirely outside the control of state officials. While a number of key variables in Minnesota track aggregate U.S. trends, such as employment, wages and salaries, the structure of Minnesota's economy is obviously not a replica of the nation as a whole. In particular, it is more heavily dependent on the agricultural sector than the nation, as well as on mining and forestry. All of these sectors are especially sensitive to interest rates and are highly export-oriented. Changes in interest rates and/or export demand for agricultural, mining or forest products will be transmitted with greater magnitude to Minnesota than to the nation as a

whole. These interactions imply that Minnesota's economy is more volatile than the U.S. economy, and hence more difficult to forecast.

The Minnesota Department of Finance is responsible for making these forecasts, which it bases on forecasts of the national economy prepared by Data Resources, Inc. These national forecasts are then interpreted for Minnesota with the assistance of the Minnesota Council of Economic Advisors, including the State Economist. Since 1985, the Council has been composed of leading private and university economists, and the State Economist has been a one-half time faculty member in the University of Minnesota Department of Agricultural and Applied Economics. Working with the Department of Finance, this group develops a series of "scenarios" for use in state economic planning. These scenarios are less precise than point-estimated forecasts, and reflect recognition of the volatility and dependence of the Minnesota economy on factors such as exchange rates, trade deficits, and interest rates.

Unfortunately, one of the least well-understood sectors of Minnesota's economy from a forecasting perspective is agriculture. The reasons agriculture is difficult to forecast -- its interest rate sensitivity and export dependence -- make the translations from the national DRI model to Minnesota especially troublesome. The essential features of the model used to estimate Minnesota farm cash income are shown in Figure 3. They are, in turn, a function of aggregate U.S. farm cash receipts and production expenses. The actual structure underlying the agricultural economy is less well-specified than many other sectors, however, and the development of scenarios depends to an unusually large extent on the expertise of the State Council of Economic Advisors and State Economist.

Figure 3. Model of Minnesota Economy Employment and Earnings
 (Fitted to Quarterly Series, 1972-Present)



Despite these difficulties in the forecasting area, the statistical reporting services of the Minnesota Department of Agriculture are highly developed. Linked to the federal statistical reporting service of the U.S. Department of Agriculture by longstanding agreement, and 90 percent federally funded, the Minnesota Statistical Service is the Department's main data gathering service. Data are collected on both state and county levels, and include weekly crop and weather reports, crop acreage planted and harvested; crop yields, production, price and utilization; inventory numbers and prices of livestock, poultry, and dairy products; farm income figures; farm labor use and wages; pesticide use; and special surveys such as recent farm credit analysis.

In a typical year about half a million reports and publications are distributed. These reports help estimate the volume and value of agricultural products which, in turn, help producers and farm-related industries to manage their businesses and to market their products. Such reports also assist government agencies in formulating farm policy, aid agri-businesses in locating sites for agricultural enterprises, and provide data to the nation's transportation systems to prepare ways to move farm products to market. The major purpose of the reports, however, is to help farmers make production and marketing decisions. Over 80 percent of the reports distributed are sent to farmers.

The Minnesota Agricultural Statistics Service is unique in that it is located within the State Department of Agriculture, yet it is almost fully federally funded. The service works closely with the Department and, at the same time, cooperates with the USDA's National Agricultural Statistics network. Access to information and statistical expertise are two important

services often provided to other agencies in conducting surveys. The service also supplies crop and livestock statistics for departmental news releases.

The essential challenge confronting Minnesota is the integration of Agricultural forecasting with state and national agricultural statistical reporting. While the capacity to "look backward" at agricultural statistics is well developed, the capacity to look forward is limited by both knowledge of the structural causes of farm market shifts, and the dependence of state economies on national and international forces which are exceedingly difficult to forecast. To adequately integrate forecasting and reporting will depend on bringing the Department of Agriculture more closely in line with the Departments of Finance and Revenue, and the analytical work of the State Economist. Even if the ability to model these trends improves, the role of experienced economists in both the private and public sector will remain crucial to the development of policy scenarios for Minnesota. Hence the State Council of Economic Advisors will be an institution of continuing importance. In addition to their analytical skills, these groups also help to remove the forecasting and economic planning process from the political blame laying that so often accompanies a failure to predict an unpredictable future.

General Conclusions

Minnesota has established a strong reputation as a progressive, responsible state government, with considerable visibility in agricultural policy. The reasons for this success lie in the joint efforts of the Departments of Agriculture, Commerce, Finance, Natural Resources and the University of Minnesota. While these efforts have been joint, they have

not necessarily been well-coordinated. This coordination would be enhanced by the development of a less politicized, more analytically-oriented State Department of Agriculture.

Even with highly professional, well-coordinated efforts at state policy, the essence of success at the state level remains attention to the limitations imposed by resource constraints and larger economic and political forces. Each of the three programs discussed above operates within these constraints in different ways. The interest buydown seeks only to affect farm credit at the margin and over limited time periods. The RIM program works within federal crop support and conservation programs, carefully targeting its efforts where they can be most cost-effective in achieving environmental goals. Economic forecasting and agricultural reporting efforts rely heavily on outside modeling efforts and on the Crop Reporting Service of the U.S. Department of Agriculture. In developing each of these marginal interventions, the state has drawn on the expertise of the University of Minnesota, allowing its analysis to make scarce Minnesota dollars go further. This experience suggests that it is the successful melding and professionalization of state departments with the state university which provides the basis for Minnesota's modest success in formulating useful approaches to the difficult problems of agricultural adjustment.

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