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FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

ISSN 0002 - 1512

April 17, 1981 Number 1549

THE AGRICULTURAL POLICY ARENA has become very active recently in what promises to be an interesting year. Legislation halting the scheduled April 1 increase in the support price of milk was enacted in late March. The Administration recently announced the loan rates and target prices for 1981 crops and presented its proposed legislation to the Congress for the basic commodity programs starting in 1982. Other bills for this purpose have also been introduced, many with features considerably different than the Administration's. These developments represent only the beginning of the policy-making process that will formulate new legislation to replace the omnibus Food and Agricultural Act of 1977, which expires this year.

Dairy support prices have been adjusted semiannually since the 1977 act. Adjustments at the beginning of the dairy marketing year (October 1) reflect the statutory requirement that the support price be set at 80 percent of parity. Mandatory adjustments on April 1—until overridden by the recent legislation—reflected increases in the index of prices paid by farmers during the preceding six months.

Since the summer of 1979, the dairy industry has been burdened by surplus milk production. Commercial disappearance of milk has leveled off while production continues on the upswing. To maintain support prices during this period of surplus, the federal government, through the Commodity Credit Corporation, has purchased huge amounts of manufactured dairy products. During the 12 months ending in March, for instance, the CCC purchased the equivalent of 9 percent of all milk marketed by farmers at a net cost of over $1.5 billion. Increases in support prices tend to exacerbate an oversupply problem. The higher prices encourage more production while discouraging consumption because of the impact on retail prices. Therefore, Congress decided to override what otherwise would have been a 6 percent boost in the support price on April 1. Even so, the support price of $13.10 per hundredweight is still 6 percent higher than a year ago.

Boosts in loan rates and target prices for applicable 1981 crops of food grains, feed grains, cotton, and soybeans were announced March 31. As required by legislation enacted in late 1980, dual loan rates apply for crops that are eligible to enter the three-year grain reserve. The reserve loan rate exceeds the regular loan rate as an added incentive to encourage participation in the reserve.

Loan rates represent the amount an eligible farmer can borrow from the CCC by pledging the grain as collateral for the loan. In years when no acreage restrictions are imposed—such as 1980 and 1981—virtually all producers are eligible for the loan benefits. The interest rate on CCC loans was recently raised from 11½ percent to 14½ percent. In addition, it was announced that rates on CCC loans made after April 1 will "float" with the government's cost of funds, with adjustments made October 1 and April 1. Current statutes waive the interest charges on 1981 grains that enter the reserve.

Target prices are used to determine deficiency and disaster payments. Disaster payments are available to eligible producers whose yields fall below 60 percent of normal because of a natural hazard. Deficiency payments are made to eligible producers when the average market price received by farmers during the first five months of the marketing year falls below the target price. The payment rate per bushel is equal to the difference between the target price and the higher of the five-month average price received by farmers or the loan rate. The total payment is equal to the payment rate times the farmer's normal yield per acre, times the number of acres planted.

Loan rates and target prices for 1981 crops

	Wheat	Corn	Sorghum	Barley	Oats	Soybeans
			(dollars per bushel)			
Loan rates						
1980 crops						
regular	3.00	2.25	2.14	1.83	1.16	5.02
reserve	3.30	2.40	2.28	1.95	1.23	n.a.
1981 crops						
regular	3.20	2.40	2.28	1.95	1.24	5.02
reserve	3.50	2.55	2.42	2.07	1.31	n.a.
Target prices						
1980 crops	3.63	2.35	2.50	2.60	n.a.	n.a.
1981 crops	3.81	2.40	2.55	2.55	n.a.	n.a.

The Administration's proposals, if enacted, would alter several features of the dairy and crops programs. For the dairy marketing year that begins in October, the Administration is seeking legislation that would permit the dairy support price to be set in a range of 70 to 90 percent of parity and permit adjustments as needed. This contrasts with the current legislation that mandates 80 percent of parity and a semiannual adjustment. The intent is to make the program more flexible so that government costs can be more easily controlled during periods of surplus production.

Starting with 1982 crops, the Administration is seeking legislation that would retain the loan program while eliminating target prices. Dismantlement of target prices, in turn, would eliminate deficiency and disaster payments. Elimination of disaster payments is consistent with the congressional intent of legislation enacted last year to expand the Federal Crop Insurance Corporation so that its programs would serve as the primary relief for producers of basic commodities that suffer losses from natural disasters.

The Administration is also seeking legislation that would alter the mechanics of the grain reserve program. It would like to extend the higher loan rate for grain that enters the three-year reserve program, but would eliminate the first-year waiver of interest charges. The Administration would limit the size of the feed grain reserve to 12 to 15 percent of annual production and limit the wheat reserve to 18 to 20 percent of annual production. Current statutes limit the wheat reserve to 700 million bushels, but leave the size of the feed grain reserve to the discretion of the Secretary of Agriculture. The current "release" and "call" provisions of the reserve program—which are established as a multiple of the regular loan rate—would be replaced by a single trigger price that is annually set equal to the full cost of production, including land charges. The Administration's proposal would immediately halt all storage payments and end all subsidies on interest charges once the trigger price is reached, but would not force reserve participants to repay their CCC loans.

Many of the Administration's proposals will likely run into strong opposition. Greater flexibility in establishing dairy support prices is likely to receive considerable support in the Congress. But there will be much opposition to extending that flexibility as low as 70 percent of parity. Likewise, the Congress will be reluctant to dismantle target prices. Many Congressmen are having second thoughts about replacing disaster payments with FCIC programs as the primary form of disaster relief. The convictions of the Congress that deficiency payments are a necessary backstop for low commodity prices are even more strongly held. During the past four crop years, disaster payments to feed grain and wheat producers ranged from $113 million in 1979 to an estimated $750 million last year. Deficiency payments to wheat and feed grain producers ranged from nothing in 1980 to more than $1.2 billion in 1977.

The Administration's farm commodity program proposals are generally in line with its overall desire to cut government expenditures and to reduce the government's role in the private sector. But getting congressional acceptance of the Administration's proposals will encounter rough sledding. The Congress will be particularly reluctant to accept the Administration's package as long as the Soviet grain embargo remains intact. The embargo and last year's low farm earnings provide the political pressure groups a great deal of leverage for maintaining a broad safety net of costly government programs to protect the farm sector.

Gary L. Benjamin

RETAIL FOOD PRICES rose 0.8 percent in both January and February. Declining prices for meats, eggs, and sugar somewhat offset higher prices in most food categories. Larger month-to-month increases, however, are likely later in the year as the farm values of meats and some other products increase and food marketing costs continue to escalate. But overall, the early-year developments portend an average annual increase in retail food prices below the USDA's current estimate of 12 percent.

Increases in retail prices of cereals and bakery products, fats and oils, fruits and vegetables, and the cost of eating away from home paced the rise in food prices during the first two months of this year. Retail cereal and bakery product prices, which account for almost a tenth of the consumer price index for food, rose 2.6 percent from December to February. Fats and oils, although a small portion of the consumer price index for food, were up 6.1 percent in February from December, nearly equaling their increase for all of 1980. Products derived from peanuts contributed to this surge as last year's peanut crop fell far short of previous levels and prices subsequently rose sharply.

Fruit and vegetable prices in February were 4.6 percent higher than in December, reflecting a strong gain in fresh produce prices. Although normal seasonal patterns accounted for most of the increase, reduced acreage for some vegetables and the damaging January freeze in Florida lowered production and contributed markedly to the upturn in fresh fruit and vegetable prices.

Prices of food eaten away from home in February were 2.5 percent above December's value, marking a much faster rate of gain than in 1980. Upward adjustments in the minimum wage and employer contributions to social security taxes probably provided most of the pressure, since labor is the major cost component for eating establishments.

Retail prices of red meats, eggs, and sugars and sweetners fell in January and February. Meat prices, which make up almost a fifth of the retail food price index, were weaker than expected as large numbers of cattle and hogs continued to be marketed. Commercial beef production in January and February was considerably above year-ago levels, while pork production was down slightly. However, the cutback in pork production was less than had been anticipated earlier. Retail prices of beef and pork were down nominally from December, but red meat prices at retail were the lowest they have been since last summer.

Retail egg prices showed the sharpest downturn. In February the retail price of eggs was 9 percent below December's level. However, eggs account for a nominal part of the consumer price index for food. Retail prices of sugars and sweetners were unchanged in February from January's level but were down slightly from December's level. This represented the first month-to-month decline in the retail price of sugar and sweetners since September 1978. Nevertheless, the retail prices of sugars and related products remain substantially above year-ago levels.

Food marketing costs accelerated in the first two months of 1981, owing to sharp increases in the transportation and fuel and power components. Transportation costs were up 6 percent from December to February and fuel and power costs rose 7 percent. Freight rate boosts by railroads and price increases for fuel, all of which were likely as a result of the deregulation of these industries, have occurred recently. Reflecting the revisions to wage and benefit costs around the first of the year, the labor cost component for distribution and processing costs was also up considerably from December to February.

The USDA has estimated the average annual increase for retail food prices in 1981 at about 12 percent, up substantially from 8.6 percent in 1980. Though developments thus far do not fully support this estimate for 1981, higher month-to-month gains are likely ahead because of upward pressures on some food items and the continued rise in food marketing costs.

Meat production may decline seasonally this spring and could remain below year-earlier levels throughout the rest of this year. Smaller inventories of hogs and indications of a cutback in farrowings point to lower pork production. Anticipated cutbacks in the flow of cow and forage-fed cattle to slaughter would also slow beef production. As a result, livestock prices could rise considerably over first-quarter levels causing higher retail meat prices. Because of reduced meat supplies, retail meat prices will climb much higher this year than was the case in 1980. Last year, the meat price component of the retail food index had an average annual increase of only 3.5 percent. Substantial retail poultry and egg price increases may also accompany the increase in red meat prices.

The retail price of fats and oils may show further strength as peanut supplies dwindle. By summer, stocks of peanuts could be at their lowest level in 31 years. Smaller canned and frozen vegetable supplies and the likelihood of increased marketing costs could keep these prices substantially above a year ago. But further advances in the price of fresh fruits and vegetables will depend on later weather developments. Sugars and sweetners, on the other hand, may not rise nearly as fast as they did in 1980. Wholesale sugar prices have declined recently and production levels may improve this year over last year. Last year's annual increase in the retail prices of sugars and sweetners was 22 percent.

Food marketing costs, which tend to follow the general rate of inflation, are expected to increase about 10 percent to 12 percent this year. Labor costs—which account for half of the marketing costs—have already come under pressure from adjustments in the minimum wage and social security tax payments. But pending cost-of-living adjustments for some workers and new contracts for others mean further increases in payroll costs.

Packaging and container costs may increase less rapidly than overall food marketing costs. Prices of principal packaging materials are expected to moderate as a sluggish economy prevails. Energy costs, which have risen sharply recently, may slow their advance somewhat. Still, however, the annual increase for energy costs in food marketing may be a fifth or more. In turn, transportation costs will reflect these higher fuel costs as well as other costs. Transportation costs may increase a sixth or more this year.

Jeffrey Miller

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from Prior period	Percent change from Year ago
Index of prices received by farmers	1967=100	March	258	– 1.9	+10
Crops	1967=100	March	274	– 0.7	+25
Livestock	1967=100	March	246	– 2.4	0
Index of prices paid by farmers	1967=100	March	302	+ 0.7	+ 9
Production items	1967=100	March	296	+ 0.7	+ 9
Producer price index* *(finished goods)*	1967=100	March	265	+ 1.1	+11
Foods	1967=100	March	252	+ 0.4	+ 8
Processed foods and feeds	1967=100	March	248	– 0.8	+ 7
Agricultural chemicals	1967=100	March	275	+ 1.3	+ 7
Agricultural machinery and equipment	1967=100	March	279	+ 0.5	+11
Consumer price index** *(all items)*	1967=100	February	263	+ 1.0	+11
Food at home	1967=100	February	267	+ 0.6	+11
Cash prices received by farmers					
Corn	dol. per bu.	March	3.16	– 1.9	+32
Soybeans	dol. per bu.	March	7.10	– 5.3	+20
Wheat	dol. per bu.	March	3.93	– 5.8	+ 8
Sorghum	dol. per cwt.	March	5.14	– 3.6	+27
Oats	dol. per bu.	March	2.03	+ 1.0	+51
Steers and heifers	dol. per cwt.	March	61.40	– 1.9	–10
Hogs	dol. per cwt.	March	38.10	– 7.7	+14
Milk, all sold to plants	dol. per cwt.	March	13.90	– 0.7	+ 9
Broilers	cents per lb.	March	29.7	– 2.3	+23
Eggs	cents per doz.	March	60.8	– 2.9	+11
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	4th Quarter	146	+ 2.0	+ 8
Net farm income	bil. dol.	4th Quarter	22	+ 1.4	–26
Nonagricultural personal income	bil. dol.	February	2,266	+ 0.7	+11

*Formerly called wholesale price index.

**For all urban consumers.

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