FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

April 7, 1978 Number 1470

THE AGRICULTURAL POLICY ARENA has been active in recent weeks, imparting considerable strength to grain and soybean prices. In February the Administration boosted storage payments on grain placed in the long-term reserve program. In March the Senate debated three major bills which would markedly change 1978 farm programs if enacted. All three were eventually tacked on as amendments to a minor House bill passed by the Senate just prior to the Easter recess. During the Easter recess the Administration, making use of the flexibilities of last year's legislation, announced several modifications in existing program regulations. This week, a conference committee adopted the flexible-parity concept included in the previous assortment of proposals from the Senate. All of these developments have contributed to confusion among farmers over what to expect of 1978 farm programs. Unfortunately, the confusion comes when planting is already well under way in the South, and it may be too late for farmers in the Midwest to digest the implications of the latest developments and alter their plans significantly before planting.

The only certain changes in 1978 commodity programs so far are those recently announced by the Administation. These changes, among other things, enhance the attractiveness of the grain reserve program, implement a paid land diversion option for the feed grain and cotton programs, and boost the soybean loan rate from \$3.50 per bushel to \$4.50 per bushel. Enactment of the conference committee bill requires the approval of both houses of Congress and the signature of President Carter. The Administration has promised a veto if the bill clears Congress. In essence, the bill would raise loan rates and provide scaled-up target prices based on the level of set-aside. If enacted, for example, the corn loan rate would rise to \$2.25 per bushel, and the target price could go as high as \$3.45 for farmers who set aside an acreage equivalent to 50 percent of 1978 corn plantings.

Changes in the grain reserve program announced by the Administration were designed to increase participation by farmers and strengthen the role of the program in supporting higher grain prices. The ceiling on the amount of grain that could be placed in the reserve program was lifted to an unspecified level. Operating ceilings previously included 9 million metric tons for wheat (330 million bushels) and 17 million metric tons for feed grains (equivalent to 670 million bushels of corn). Interest charges were waived on Commodity Credit Corporation (CCC) loans covering grain in the reserve for the second and third year of the three-year program. In addition, direct entry for 1977 crops of corn and sorghum can begin May 1. Direct entry allows grain to move straight into the reserve program without first being placed under the initial nine-month CCC loan.

There was considerable evidence that farmers were leaning towards participation in the reserve program even prior to these latest changes. Large amounts of wheat entered the reserve program in March, reflecting a February boost that pushed the annual storage payment to 25 cents a bushel and the expiring CCC loans on 1976 crop wheat. Unofficial USDA estimates indicate that 287 million bushels of wheat had entered the reserve as of April 5. The waiving of interest charges after the first year will further stimulate participation. Moreover, uncapping the ceiling on the amount that can be placed in reserve suggests that substantial quantities of grain can be shielded from free market supplies at prices below the trigger levels for releasing stocks from the reserve. Previous operating ceilings were designed to hold about 40 to 45 percent of the ending wheat and feed grain stocks in the reserve program.

The land diversion feature incorporated in the recent changes pertains to the feed grain and cotton programs. Farmers that participate in the 1978 feed grain program by meeting the required 10 percent set-aside and limit 1978 plantings of corn and other feed grains to no more than in 1977 will have the option of setting aside additional acreage equivalent to 10 percent of actual 1978 plantings. On the additional acreage set aside, the farmer will receive a payment equivalent to 20 cents a bushel times the farm's normal yield times the acreage *actually planted*. For a farmer with a normal corn yield of 100 bushels an acre, the effective payment would be \$100 for each acre set aside, or \$200 for each *additional* acre set aside.

Current farm program provisions

	Wheat	Corn	Sorghum	Barley	Oats	Soybeans
1978 price supports[1] *(per bu.)*						
Loan rate	$2.25	$2.00	$1.90	$1.63	$1.03	$4.50
Target price	$3.05[2]	$2.10	$2.28p	$2.25p	n.a.	n.a.
1978 set-aside provisions *(percent)*						
Voluntary acreage reduction[3]	20	5	5	20	n.a.	n.a.
Required set-aside[4]	20	10	10	10	n.a.	n.a.
Optional paid set-aside[4]	5	10	10	10	n.a.	n.a.
Grain reserve provisions *(per bu.)*						
Annual storage payment	$ .25	$ .25	$ .25	$ .25	$ .19	n.a.
Release price[6]	$3.15	$2.50	$2.38	$2.04	$1.29	n.a.
Call price[7]	$3.94	$2.80	$2.66	$2.28	$1.44	n.a.

p Preliminary.

n.a. Not applicable.

[1]Loan rates can be adjusted by Secretary of Agriculture.

[2]If 1978 wheat production exceeds 1.8 million bushels, the wheat target price will be lowered to $3 per bushel.

[3]Figures indicate the percent reduction from *1977* plantings required to assure 100 percent target price (deficiency payment) protection. If plantings exceed the level indicated by the voluntary acreage reduction, target price protection could drop to as low as 80 percent.

[4]The percent figures apply to actual *1978* plantings. Participants must abide by the required set-aside on all set-aside crops planted in order to be eligible for program benefits.

[5]A complimentary feature in the wheat program permits farmers to graze or hay up to 40 percent of actual planted wheat acreage in 1978.

[6]The release price represents the price at which storage payments are terminated and farmers can remove the grain from the reserve with no penalty.

[7]The call price reflects the price at which farmers must repay their CCC loans on grain in the reserve.

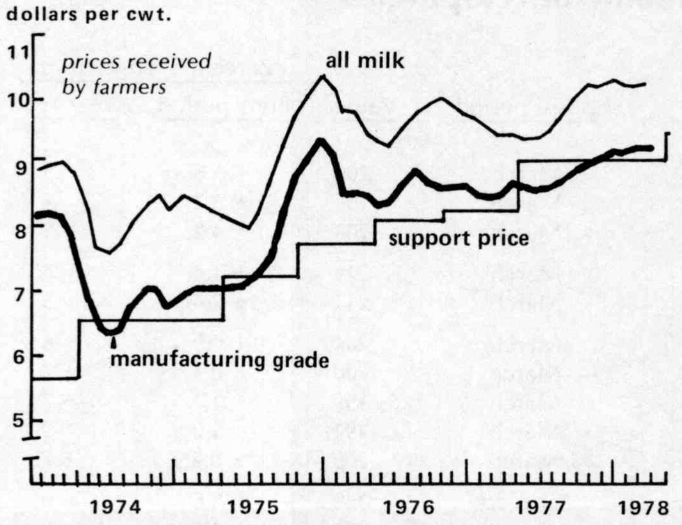
For farmers that still have the flexibility to change their planting intentions and have enough lower quality land in their normal crop acreage base, these payment rates appear sufficient to attract a larger cutback in feed grain plantings than previously expected. USDA analysts estimate that inclusion of the paid land diversion feature in the feed grain program will idle about 10 million acres: 6 million in initial set-aside and 4 million in paid diversion. A companion feature in the cotton program is expected to idle 1 million acres.

Gary L. Benjamin
Agricultural Economist

HIGHER DAIRY SUPPORT PRICES went into effect April 1 raising the price for manufacturing milk 4.8 percent to $9.43 per hundredweight. The increase stems from provisions of the Food and Agriculture Act of 1977 requiring semiannual adjustments in the milk support price to reflect changing production costs. Lack of growth in commercial demand last year coupled with increased production culminated in sharply expanded government purchases in an effort to hold manufacturing milk prices to the support level—a synopsis that may also apply for much of 1978.

Milk prices received by farmers during the first three months of 1978 averaged 6 to 8 percent above a year earlier. While the April 1 increase in milk support prices will boost prices received by dairy farmers still further, an added benefit will be manufacturing milk prices averaging near the support price. Throughout most of 1977 manufacturing milk prices failed to reach the support price, apparently because of problems in clearing barrel cheese to the Commodity Credit Corporation. The cheese industry is reportedly now better able to cope with USDA purchasing procedures and specifications. More efficient clearing of cheese could alleviate much of the cause of last year's price disparity, preventing a recurrence of the difficulties in reaching the support level.

Higher support prices will raise milk prices



Efforts by the government to bolster prices received by dairy farmers have been reflected at the retail level in the prices paid by consumers for milk and dairy products. The February retail dairy price index was roughly 4 percent higher than a year earlier. Most of the increase was due to a rise in retail prices of manufactured dairy products.

Milk production in the United States totaled 123 billion pounds in 1977—2 percent more than in 1976 and the highest level since 1965. The increase was due to higher milk output per cow—up nearly 3 percent last year to 11,194 pounds—since the U.S. milking herd was reduced by slightly less than 1 percent. In turn, the higher milk output per cow reflected increased use of concentrates in feed rations. The enhanced milk-feed price ratio, which encouraged the expanded concentrate feeding, benefited from the combination of higher support prices and lower grain prices. During the first two months of 1978, total U.S. milk production has averaged roughly half of 1 percent above the year-ago level.

Seventh District states increased milk production by 1.2 billion pounds during 1977—a 3.6 percent rise that was more than twice the 1.7 percent increase for the rest of the United States. District states accounted for 28 percent of the nation's production. Wisconsin widened its lead as the largest producer state, representing 17 percent of the total U.S. milk production.

Commercial disappearance of milk last year was slightly in excess of 116 billion pounds milk equivalent—essentially unchanged from the 1976 level. Cheese sales provided most of the strength in commercial disappearance, while sales of butter, nonfat dry milk, and canned milk trailed their 1976 levels. Although increases in fluid milk prices last year were small compared with the increases in prices of other nonalcoholic beverages, whole milk usage was less than in 1976. Increases in sales of lowfat and skim items held total fluid milk sales marginally above the year-earlier level.

Purchases of dairy products under the USDA's price support program jumped to 6.1 billion pounds milk equivalent—more than the total of the preceding three years and the largest annual level of government purchases since 1971. Because of the large government purchases of dairy products, the USDA increased its donations to school feeding programs substantially from the low levels of 1976. Total USDA donations were large enough to offset the marginal decline in commercial use and raise per capita civilian consumption slightly.

The outlook for dairy farmers over the next several months appears favorable. The likelihood of farm milk prices failing to achieve support levels is substantially less than a year ago now that processors are more familiar with USDA purchase requirements. Higher support prices should significantly enhance dairy receipts throughout 1978. In combination with the still favorable milk-feed price relationships, prospects for a further improvement this year in farmers' earnings appear very good.

Government purchases under the price support program will no doubt continue large during 1978 and could approach the levels of last year. Rising consumer income and expected rises in retail meat prices suggest commercial use of cheese may climb further this year. Commercial stocks of dairy products were slightly smaller at the beginning of this year relative to a year earlier, suggesting the industry would be better able to handle a heavy spring surplus than a year ago. Although a year-to-year expansion in commercial disappearance is likely, the magnitude of the rise is not expected to be enough to boost farm milk prices significantly above the support level.

Most observers expect increased feeding of grain and other concentrates in response to the year-to-year improvement in milk-feed price relationships. However, early indications suggest that heavy grain feeding has not materialized to the degree previously expected. With cattle prices throughout 1978 likely to be sharply above year-ago levels, there are added incentives for culling the dairy herd. Although a large supply of replacement heifers exists, a further contraction in the U.S. dairy herd is generally conceded. Nevertheless, it is not clear to what extent increased milk output per cow may offset the effect of a shrinking dairy herd, and therefore milk production in 1978 is likely to average near the high level of last year.

Don A. Langford
Agricultural Economist

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Index of prices received by farmers	1967=100	March	200	+ 3.6	+ 5
Crops	1967=100	March	196	+ 3.2	− 7
Livestock	1967=100	March	204	+ 4.1	+19
Index of prices paid by farmers	1967=100	March	214	+ 1.4	+ 6
Production items	1967=100	March	211	+ 2.4	+ 5
Producer price index* *(finished goods)*	1967=100	March	204	+ 0.9	+ 6
Foods	1967=100	March	200	+ 0.4	+ 7
Processed foods and feeds	1967=100	March	197	+ 1.1	+ 7
Agricultural chemicals	1967=100	March	191	+ 1.0	+ 2
Agricultural machinery and equipment	1967=100	March	208	+ 0.2	+ 7
Consumer price index** *(all items)*	1967=100	February	188	+ 0.6	+ 6
Food at home	1967=100	February	200	+ 1.6	+ 8
Cash prices received by farmers					
Corn	dol. per bu.	March	2.11	+ 3.9	−10
Soybeans	dol. per bu.	March	6.28	+13.6	−20
Wheat	dol. per bu.	March	2.65	+ 2.3	+ 9
Sorghum	dol. per cwt.	March	3.26	+ 1.9	− 8
Oats	dol. per bu.	March	1.15	− 5.7	−30
Steers and heifers	dol. per cwt.	March	46.70	+ 9.4	+30
Hogs	dol. per cwt.	March	46.80	− 2.3	+26
Milk, all sold to plants	dol. per cwt.	March	10.20	0	+ 8
Broilers	cents per lb.	March	24.8	+ 2.1	+ 2
Eggs	cents per doz.	March	55.4	+ 0.5	− 6
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	4th Quarter	96	+ 6.1	+ 4
Net realized farm income	bil. dol.	4th Quarter	22	+22.9	+ 4
Nonagricultural personal income	bil. dol.	February	1,599	+ 0.7	+11

*Formerly called wholesale price index.

**For all urban consumers.

FEDERAL RESERVE BANK OF CHICAGO
Public Information Center
P. O. Box 834
Chicago, Illinois 60690
(312) 322-5112

FEDERAL RESERVE BANK OF CHICAGO
AGRICULTURAL LETTER

MR.O.B.JESNESS AGL-IL
INSTITUTE OF AGRICULTURE,
UNIVERSITY OF MINN.
ST.PAUL,MN 55108