AGRICULTURE IN THE 1980'S: CURRENT AND EMERGING POLICY ISSUES

Kenneth R. Farrell

INTRODUCTION

Your program chairman asked that I direct my remarks to the subject of impacts of Reagan economics on agriculture. I do so with some trepidation since it is not clear which parts of current economic policies should be attributed to the Reagan administration, the Congress, the Federal Reserve Board, and preceding administrations. Further, I have some doubt as to what economic policy is, or is about to become, at any specific point in time. In reviewing current policies and programs, I also shall attempt to identify longer-run policy issues which might command our attention as agricultural economists.

CURRENT ECONOMIC AND POLICY SETTING

I need not dwell on the fact that agriculture is undergoing severe economic stress in 1982. The severity of the stress differs regionally, between crop and livestock producers, and among producers depending upon the financial structure of the farm firm and the extent to which their capital investments are leveraged. However, while the general financial position of producers has deteriorated and many, particularly cash grain producers, are experiencing severe cash flow problems there is little evidence to suggest that the financial foundations of the sector are in jeopardy as yet. Operators' real net farm income for 1982 will be very low despite recent strength in livestock markets and some improvement in crop prices. But that statistic does not take into account the sizeable nonfarm income earned by many operators. And, as Melichar has pointed out in a recent paper, the real wealth represented by farm assets remains high by historical standards (1981 = 4 x 1940) notwithstanding the current decline in land prices.

On balance, the prevailing view seems to be that agriculture can survive the economic distress of 1982 without widespread, irreparable harm. However, continued stress of the current magnitude in 1983 would induce a substantial "shakeout" in the industry. At this point, economists or other soothsayers have little which can be said with any significant degree of certainty concerning 1983. There are not only the usual vagaries of weather which will determine the size of crops worldwide but great uncertainty as to when economic recovery will occur and its robustness in the United States and abroad.

The Joint Economic Committee recently held hearings on economic conditions in agriculture. Four prominent agricultural economists were invited to offer their views and appropriate remedial public policy and program actions. The views and recommendations of those economists illustrate the complexity of current food and agricultural policy issues and a wide diversity as to appropriate remedial action.

One of the economists concluded that real prices and income in agriculture "...are low in large part because of the significant rise in the value of the U.S. dollar." He went on to say that while the large crop of last year and slack in the general economy were also important contributors to current problems that "...U.S. agriculture faces a significant (longer run) problem because I don't expect the value of the dollar to decline even if interest rates should decline." His policy prescriptions? Shift resources out of agriculture, consider development of an income insurance program to cope with the problems of market instability, and reform international institutions to secure greater stability in international monetary markets and more liberalized agricultural trade. As for conventional commodity programs, he dismisses them as "...not capable of dealing with the situation."

Another concludes "...current economic ills of the farming economy trace mainly to a burst of inflation in 1980 and a burst of good weather in 1981 - both of a transitory nature and quite unlike the chronic overcapacity which arose from excess resources that characterized farming in the 1950's and 1960's." He suggests that there is only a temporary overcapacity of about 4 percent, "...approximating the accumulated production caused by unusually favorable weather in the 1980's, the cost-price squeeze from inflation, and high dairy price supports dating prior to the 1980's." His policy recommendations consist of a series of immediate program adjustments to divert land from production, provide greater flow of concessional credit through FmHA, reinstitution of a conservation reserve patterned after that of the late 1950's, and a Presidential commission to develop recommendations on the dairy program. However, he cites as his most important recommendation the development of a credible program to balance the federal budget of fiscal year 1984 as a means of bringing down interest rates.

A third observer takes a decidedly pessimistic view of the state of the American economy ("We are back to 1931") and concludes that "unless and until demand strengthens, the agricultural sector can do little about its situation." He worries that in development of economic policies "We are reverting to the 1920's, reestablishing the philosophies and policies of Andrew Mellon," that "farm laws enacted since 1970 have been progressively weaker instruments for supply control," that tax laws and loopholes threaten the viability of agriculture. In a neatly turned phrase, he concludes that "...the 1981 farm law as currently being administered will run into very serious trouble unless the economy blooms and the Corn Belt doesn't." He offers no specific policy recommendations.

The fourth commentator attributes the current price and income problems to some combination of worldwide recession, strengthening of the U.S. dollar, high interest rates and high levels

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Kenneth R. Farrell is Director, Food and Agricultural Policy Program, Resources for the Future, Washington, DC.

of domestic inflation, good weather, high food prices coupled with declining real consumer income, and rising unemployment. Early 1982 is viewed as a "...cyclical downtrend which is being deepened by recession in many countries." He apparently subscribes to "prevailing conventional wisdom" which depicts rising but unstable prices for agricultural commodities throughout the 1980's. He outlines a range of possible U.S. policy actions including doing nothing, raising target prices and implementing supply management provisions of the 1981 Act, CCC acquisition of grain stocks and strong supply control measures, increased PL 480 sales, erection of stringent U.S. trade barriers to isolate the U.S. market, and various forms of cartels to manage selected international commodity markets. However, "In sum, it is not clear what actions should be taken."

One of the significant common threads in those statements is the limited extent to which the current economic malaise was controllable within the farm sector and can be corrected by conventional agricultural policies. The "burst of inflation" in 1980 which ratcheted upwards farm production costs stemmed from macroeconomic policies in the U.S. and abroad; so did the rise in unemployment and the softening of demand in 1981-82. The bounteous crops of 1981 and 1982 were largely acts of God. None of those results could have been controlled by agriculture nor dealt with in the confines of traditional agricultural policy. Given that it is now infeasible to initiate more stringent supply management provisions for the 1982 crop than the voluntary diversion already announced, the economic circumstances for agriculture in 1982 are now largely beyond the reach of commodity programs as currently authorized.

On one other point our commentators are in unanimous agreement - price and income instability is a chronic and deepening problem for which there are no singular, easy solutions in a globally, interdependent system of agricultural markets. We simply can't "have our cake and eat it too." So long as we have a major dependency upon export markets we must be expected to bear the costs as well as the benefits of an inherently unstable system of markets.

CURRENT POLICIES AND PROGRAMS

I turn now to a closer focus on the current administration's policies and programs and their impacts on agriculture. To be fair and reasonable about such judgments, and they are just that, several qualifiers are appropriate.

First, it is useful to remind ourselves of the distinction between policy goals and policy instruments or programs. The former set broad directions for legislative purposes and for program development and administration. These goals have been enunciated reasonably clearly by the current administration with respect to agriculture - lesser presence of government in the management of agriculture and agricultural markets, reduced budget exposure, and export expansion being the mainstays. Cumulatively these goals add to greater reliance upon market forces to allocate resources and bring about adjustments in agriculture. In the 18 months in power, the administration has been quite consistent in pursuit of those goals.

Policy instruments are the means to effectuate policy goals as authorized by the Congress, past and present, and subsequently articulated and codified in programmatic and administrative rules and regulations in the Executive branch. For agriculture this process has resulted in a myriad of rules and regulations, sometimes conflicting, and perhaps not fully comprehended by anyone. Cumulatively, they provide very wide discretion to the Secretary to effectuate policy. The Agriculture and Food Act of 1981, with some important exceptions, generally broadened the discretionary authorities of the Secretary but left intact the general array of policy instruments of the 1977 Act. So, while the players and the position of the fences have changed, it is basically the same game that has been played since 1977.

The administration has been selective and generally consistent in its use of policy instruments to conform to its policy goals. They have, for example, resisted a paid land diversion, and pressures to raise loan and target prices. But to some extent they have fallen victim to the current economic climate in agriculture. Although a mandatory, paid land diversion has been avoided, a voluntary diversion is in place; stocks are accumulating at a rapid rate in the reserve program; and net transfers to farmers are soaring beyond forecasts of a few months ago to a projected level of nearly $20 billion for fiscal year 1982. Net CCC outlays are projected at $10.4 billion for the year - over 3.0 times fiscal year 1981 outlays and more than three-fourths the administration's 1981 projected commodity-related outlays for the entire four year life of the new Act. Barring a major turnaround in commodity supply-demand prospects for 1982, there is certain to be intense pressure for larger diversion, including paid diversion, for 1983. One might properly reach the conclusion that what we have thus far under the Reagan administration are some slightly new twists to old farm programs but largely more of the same.

I now turn briefly to an overview of the principal components of the administration's economic policies bearing upon agriculture.

Perhaps the most appropriate conclusion to draw concerning current macroeconomic policy is that it is in a state of flux if not disarray. While inflation has been substantially reduced, the short run societal costs have been high in the form of unemployment, stagnation of economic growth, high unused plant capacity, an increasing number of bankruptcies, and uncertainty about the future. Historically high nominal and real interest rates have exacted a major toll in the costs of business throughout the economy resulting in deferment of capital spending plans, reductions in inventories, and a substantial slowing of activity in a broad range of commodity markets. In the farm sector, operators have sharply reduced purchases of capital equipment and moderately reduced purchases of other supplies with spillover effects into the input supply industries.

Despite intense pressure, the Federal Reserve Bank gives no evidence of significantly altering its tight money policy initiated in late 1980. Fiscal policy is enmeshed in political and philosophical differences within the Congress, within the administration, and between the two. The recent budget resolution for fiscal year 1983 promises a budget deficit of $104 billion with a high probability of it going higher than lower. CBO baseline projections made earlier this year on the assumption that taxing and spending policies then in effect continued into the future, range upward to nearly $200 billion by fiscal year 1985. Although those policies will not persist as is already evident in the struggle over the fiscal year 1983 budget, they are indicative of the magnitude of the budget problem.

The administration continues to adhere publicly to the "supply-side" argument that tax reductions as scheduled in the 1981 Tax Act and subsequent increases in saving and investment coupled with containment of federal spending and budget deficits will result in longer-term expansion of economic activity, increased employment, and inflation well below the rates of the late 1970's and early 1980's. But its resolve in that policy is weakening as evident in the tax revisions now under discussion. There is growing impatience and doubt in many sectors of the economy concerning the magnitude and distribution of the short-run costs of current policies relative to uncertain longer-run benefits.

There is general consensus that the key to near-term recovery turns importantly on reduction in real interest rates and that such reductions depend upon reduction in the federal budget deficit and modification of Federal Reserve Board policies. As yet, financial markets do not reflect confidence that outlying-year deficits will be reduced. Thus, pressure mounts on the Federal Reserve Board to take action to loosen the money supply even at the risk of increased inflation. My own "guesstimate" is that we will continue to experience high rates of real interest, although lower than at present, well into the latter months of this year or early months of 1983; that recovery will be weak with unemployment at relatively high levels and gradually increasing rates of inflation. For agriculture, such a scenario would mean continued pressures on costs of capital and soft domestic demand well into 1983. Of course, should the longer-run "supply-side" objectives be achieved, agriculture might gain substantially.

Agricultural Policies: As indicated previously, the agricultural policy instruments available to the administration are largely those of preceding years modified marginally by the 1981 Agriculture and Food Act. However, a number of issues, some immediate and some longer-run, should be noted.

1. Commodity Price Policies: The 1981 Act specifies minimum loan rates and target prices for wheat and feed grains through 1985. At the discretion of the Secretary, target prices may be increased based on changes in costs of production; loan rates also may be raised to maintain the competitive relationship of wheat to other grains. Depending upon economic conditions, we can expect legislative initiatives in the Congress to increase target prices and/or loan rates. The administration is likely to resist such ad hoc legislation in the interest of constraining budget exposure. And, based upon the rationale of the Congress in shelving last week the Farm Crisis Act, any major changes in these provisions of the 1981 Act seem unlikely in the near future.

But not so for the dairy provisions. The administration-backed bill now pending in Congress proposes sweeping authority for the Secretary to set the dairy price support, to create a dairy advisory board to the Secretary, and to allow the CCC to donate dairy products overseas and to needy households in the United States. The administration has indicated that if the bill is enacted, support rates would not be adjusted before January 1983 and not lowered beyond $12 per hundredweight. Although it is unlikely that such broad authority will be granted by the Congress, clearly some measures must be taken to bring the dairy program under control.

Other than dairy, the sugar program seems most clearly out of balance. Otherwise, the major program issues of the near term will be primarily those relating to supply management and operation of the reserve programs for wheat and feed grains.

Longer run, however, commodity price programs of the current vintage rest upon increasingly shaky political, economic and budgetary foundations. Gardner, in his recent book, The Governing of Agriculture, argues for phasing out commodity price programs, leaving farmers to insure against price risks by means of commodity futures and options markets. Government would operate a supply stabilization program clearly divorced from farm income stabilization purposes to mitigate food price instability. As he correctly observes, the tendency to mix supply stabilization with farm income support objectives in current commodity stabilization programs works very imperfectly and at high social costs. Schuh and others have suggested development of a farm income insurance program as an extension of current all-risk crop insurance programs. The 1981 Act calls for study of that option. Both approaches deserve the further attention of economists before expiration of the current Act in 1985.

In summary, there are few attributes of current commodity programs, except sugar, which can be uniquely identified with the Reagan administration. To the extent that options have been available, the administration has chosen to administer the programs consistent with its policy goals of minimizing budget costs and lesser government presence. However, the major tests of administration policies are yet to come.

2. Trade Policies: The administration has placed strong emphasis on maintenance or expansion of U.S. agricultural exports as an integral part of its agricultural policies. One of its first acts was to lift the embargo on exports to the U.S.S.R. More recently, the President articulated a three-part statement of policy on farm exports: (1) no restrictions will be imposed on

exports because of rising domestic prices, (2) exports will not be singled out as an instrument of foreign policy, (3) world markets must be freed of trade barriers and unfair trade practices. A new grains agreement with the USSR has been discussed but not executed. Other initiatives include mounting pressure upon the EC and Japan for reduction of trade barriers, pressure on the EC to eliminate export subsidies on wheat flour and cereals, "jawboning" of other major producing nations to share with the United States in resource adjustments to the current large wheat and coarse grain supplies.

At the same time, however, the administration seeks to have other industrial nations join the United States in economic leverage against the USSR - sanctions which surely would include agricultural trade and technology if they were to be effective. A recent announcement indicates that the National Security Council is studying such strategic economic issues, including U.S. grain export policy.

There are several aspects of an "all-out" export policy which merit consideration. There is, of course, doubt about whether the historically high levels of exports and the enlarged U.S. market shares of the late 1970's and early 1980's can be maintained in the face of prospective global economic and monetary conditions and competition from third country suppliers whatever the administration goals. And there must be some concern lest in striving to maintain those volumes and shares, we are driven to resorting to longer run counterproductive trade and subsidy "wars." But more fundamentally, there are the consequences of additional induced instability in an all-out export policy - instability not only in cash grain markets but in the livestock sector as well. Further, there is question of the longer-run "real" costs of export expansion at levels which induce additional marginal lands into production with consequent social costs in the form of soil erosion and environmental degradation.

Another policy issue that will continue to vie for attention is, as Schuh, McCalla and others have pointed out, the adequacy of international trading institutions. Should we continue with primary emphasis on multilateral trade institutions or should we pursue the development of families of bilateral agreements as suggested recently by Bosworth and Lawrence? Finally, there are the nagging, not easily resolved issues which we share with other developed countries concerning market access by the developing nations. All of these are trade-related policy issues likely to extend well beyond the time of the current administration.

3. Natural Resource and Environmental Policies: Natural resource and environmental policies related to agriculture span an exceedingly broad and diverse gamut of issues at the federal and state levels. At the federal level, the U.S. Departments of Agriculture, Interior, and Environmental Protection Agency share broad, sometimes overlapping and competing, responsibilities. And, of course, public policies concerning resources and the environment are shaped importantly by judicial decisions.

Although content of policies and programs concerning resources and the environment is in the early stages of evolution, policy goals as enunciated to date are consistent with overall economic and political philosophies of the administration - reduction, simplification, or elimination of federal regulations; containment or reduction of budget outlays; less federal presence with delegation of authorities and responsibilities back to the states.

Perhaps the most controversial of program actions to date have been those related to the scaling back of programs in EPA related to air and water pollution and monitoring of environmental quality and proposals of the Interior Department to speed development of publicly held natural resources through private sector involvement. Although some of the program decisions and several of the policy goals announced to date ultimately might have important direct and indirect impacts upon agriculture (e.g., registration of agricultural chemicals, opening of public lands to commercial use) it is simply too soon to draw definitive conclusions. Environmental groups may be expected to continue to challenge the administration on issues ranging from soil erosion to acid rain to wildlife extinction. It will be some time before the results of this classical political struggle reveal themselves in any major changes in public policy.

In the U.S.D.A., the Secretary has expressed strong support for programs to protect and conserve natural resources within the constraint of current levels of funding. The centerpiece program of the Department is the Soil and Water Resource Conservation Act through which programs are to be developed and coordinated. Immediate program emphasis is to be given to control of soil erosion and reduction of flood damage in small upstream waterways. Programs are to be targeted more precisely to problem areas through matching block grants to the states. Greater decision making authority is to be vested at the local level. On an experimental basis, conservation programs will be linked to FmHA loan activities through cross-compliance procedures - linkage far short of that desired by some.

The 1981 Farm Bill included the Farmland Protection Policy Act - legislation which requires the U.S.D.A. and other federal agencies to review and take appropriate measures to guard against activities of the federal government which may cause U.S. farmland to be irreversibly converted to non-agricultural uses. Despite the recommendations of the N.A.L.S. and the emergence of new interest groups related to land use, there is no eveidence that either the administration or the Congress is prepared to initiate new programs to regulate use of prime agricultural land.

On balance, the Reagan administration policies and programs for natural resources and the environment represent a rather unclear admixture at ths time. Although it is possible for interest groups to feel either threatened or encouraged depending upon their vested point of view, it will continue to be difficualt to draw any "overarching" conclusions until policies have been articulated in a more cogent manner than at present.

Longer-run linkages among agriculture, natural resources, and the environment pose basic public policy issues with which this and succeeding administrations must begin to grapple in a more comprehensive, holistic way. Among those issues are those pertaining to land use, erosion, development and allocation of increasingly scarce water resources and deterioration of water quality. Water institutions and policies which have provided historically privileged use of water in agriculture, will surely come under intense scrutiny as water demand expands differentially among sectors and regions in competition for limited supplies and virtual elimination of large scale, high capital-using public water development projects. There is little evidence to support the thesis that physical limitations to our natural resource base will become a serious constraint to agricultural production by the year 2000 when the issue is placed in an economic context. But there is cause to reexamine the performance of markets and the premises upon which the allocative functions of some current public policies and institutions are based.

4. Economic and Other Regulatory Policies: Regulatory policies and programs encompass a myriad of federal and state activities which constrain or condition the operation of agricultural markets. Regulatory reform was one of the much publicized "planks" upon which the current administration came to power. In these remarks, I will touch briefly on only two groups of regulatory programs having significance to agriculture as well as consumers - food safety and antitrust.

Food safety regulations are currently under review within the U.S.D.A. It is difficult to know just which of the many changes under discussion may be adopted finally. But based upon recommendations of an internal working group, the preferred direction of change can be seen. Those recommendations include: relaxation of zero tolerance standards on food ingredients which pose a danger to human health; modification of the Delaney clause with the effect of loosening the current stringent standards and tolerances concerning carcinogenic substances in food; support of voluntary sodium labelling; simplification of food labelling and quality control inspection procedures; modification of beef grading standards. Several of these proposals are being bitterly contested by consumer groups.

Last week the Justice Department issued new antitrust guidelines signaling a more permissive era for corporate mergers. The new guidelines no longer include a special set of rules for conglomerate mergers between companies in different business areas or for vertical mergers. Such mergers will be judged solely on how they affect the companies that will be in direct competition with the merged company. A new formula, the Herfindahl index, is established as a means of triggering Justice Department challenge of a merger. In almost all cases, it will take a larger merger to trigger such action now than under previous policy. F.T.C. merger guidelines, the first in its 65 year history, also have been issued with the same general effect as those of Justice, although with less rigid adherence to the Herphindahl index.

CONCLUSIONS AND IMPLICATIONS

From the foregoing review of the Reagan administration economic and agricultural policies, I draw the following conclusions, all admittedly highly judgmental, concerning their impacts on agriculture.

1) The impacts of macroeconomic policies have been substantial and negative in the short run. With no significant evidence of a near term change in monetary policy of the Federal Reserve Board, impending political compromises in fiscal policy and no convincing evidence that discipline will be worked to bring outlying-year federal budget deficits into closer balance, general economic recovery and reduction in interest rates, both essential to economic recovery in agriculture, are highly uncertain as to timing and magnitude.

2) Bounteous crops in 1981 and 1982, both beyond the control of agriculture and the Reagan administration, and a slowing in export demand stemming in part from domestic macroeconomic policy and international monetary policies have exacerbated short-run economic problems in agriculture to the extent that 1982 real farm income will be near the lowest since the end of the great depression. Those conditions are well beyond the reach of public policy in 1982 and very likely will pose fundamental, difficult choices for the administration concerning supply management and trade policies in 1983.

3) Agricultural policies as embodied in the 1981 Act and other major statutes are fundamentally unchanged from those of the past 5 years. The Reagan administration has utilized available policy instruments in a selective, fiscally conservative manner consistent with goals of reducing the presence of government in agricultural affairs. Yet it, too, has fallen victim of the times, with much larger transfer payments than previously projected and a land diversion program which even in its voluntary, unpaid form is anathema to the philosophical leanings of the administration. In brief, we have more of the same with a few new wrinkles, many of which have had only marginal effects to date. The full test of the administration's policy resolves is yet to come.

4) Lurking beneath the immediate policy issues is a large array of deep-seated, complex food, agricultural, resource and environmental policy issues with which this and succeeding administrations must begin to grapple - commodity price and stabilization programs; trade and the role of food in strategic planning and execution of foreign policy; the development of natural resource and environmental policies to facilitate goals of conservation yet rational economic use of resources in a longer-run context.

Whatever one's judgments concerning the impacts of Reagan economic policy on agriculture, there exists a very large policy-oriented research agenda to challenge agricultural economists for years to come.

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