COMMODITY PROGRAMS AND RURAL REVITALIZATION

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During the 1980s, economic disruptions in several key industries have increased financial stress in many parts of rural America. Difficulties in mining and energy extraction, import-competing manufacturing and agriculture have combined to raise the rural unemployment rate above the metro rate, a reversal of what happened during much of the 1970s. Job creation in rural areas has been much slower than in metro areas, contributing to a net out-migration of 632,000 people in 1985–86 after an annual average net in-migration during the 1970s.

Agriculture's problems have played a part—small nationally, but large in some regions—in the rural stresses of the 1980s. Farm commodity programs have been at the hub of the debate over the cause of agriculture's slowdown and in the proposed remedies for future farm and rural growth. The $26 billion in federal spending on farm programs in FY 1986 has been viewed as rural economic assistance, not enough by some, yet too much by others. Still others argue that the level of spending is not the issue. They believe the instruments and provisions of today's farm programs are inappropriate.

Origin of Today's Commodity Programs

The term "farm programs" is wide ranging, including everything from production adjustment and price support to import quotas, credit, crop insurance and export subsidy programs. The focus here is on "commodity programs," a more narrow term usually meaning price and income support and production adjustment programs for major program commodities. The major program crops are wheat, rice, feed grains (corn, sorghum, barley, oats), upland cotton and soybeans. The dairy program is the major commodity program for livestock.

These major commodity programs accounted for $22.7 billion (or 88 percent) of Commodity Credit Corporation (CCC) spending on farm programs in FY 1986. The remaining commodity programs for wool,

mohair, peanuts, tobacco, sugar and honey accounted for well below $1 billion in expenditures.

Today's commodity programs are generally traced to the Agricultural Adjustment Act (AAA) of 1933, which had as its goal the attainment of "parity"—the 1909–1914 level of purchasing power—for farm commodities. The AAA of 1933, along with the AAA of 1938, introduced most of the primary instruments of commodity programs used since then. The changing conditions in commodity markets over the past fifty years brought refinements in the policy tools and their levels. Table 1 traces the evolution of commodity program instruments in relation to market conditions.

Table 1. Evolution of Major Commodity Program Instruments

Period	Commodity Supply Situation	Major Program Instrument Changes
1930s	Early '30s: Excess capacity	Voluntary paid diversion Direct parity payments (Food stamps/school lunch program
	Late '30s: Excess capacity	Nonrecourse loans (price supports) Payments to conserve land Mandatory marketing quotas
1940s	War shortages	Fixed price supports raised Direct payments eliminated Production controls suspended
1950s	Excess capacity	Price supports made flexible and reduced Soil Bank Mandatory marketing quotas resumed (P.L. 480/export subsidies)
1960s	Excess capacity	Price supports reduced Direct price support payments Mandatory marketing quotas eliminated Voluntary paid diversion
1970s	Shortages	Price supports raised Direct deficiency payments (target price introduced, tied to production cost) Voluntary "unpaid" diversion (set-aside) Market orientation
1980s	Excess capacity	Price supports raised then lowered and made market-based Target prices raised then reduced Voluntary "unpaid" diversion (ARPs) Paid diversion Conservation reserve Commodity certificates Marketing loans

Very early in our nation's history, when 80 to 90 percent of the population was farmers, most national economic programs were farm programs and the correlation between farm programs and rural economic programs was near perfect. Even during the depression of the 1930s, the then-new commodity programs could still be viewed as wide-ranging rural assistance programs because one-quarter of the population was farmers. The massive drop in commodity prices during the depression resulted in lower incomes for much of rural America and formed the basis for income parity as a farm policy objective. The 1933 act sought to raise prices by paying farmers to voluntarily idle cropland. Direct payments, called parity payments, were made to support incomes. Later, the 1938 act mandated nonrecourse loans and introduced mandatory production controls in the form of marketing quotas.

Strong demand and declining stocks during and immediately after World War II provided the opportunity to relax production controls and raise price support levels to a rigid 90 percent of parity. In the late 1940s, weaker prices and surpluses began to emerge. The Agricultural Act of 1949 introduced flexible price-support levels between 75 and 90 percent of parity, depending on supply. However, flexible supports did not go into effect until after the Korean War. The 1950s and 1960s saw heavy supply control through the Soil Bank and a resumption of mandatory production controls as well as a focus on demand expansion through lower support prices and export assistance programs. This was a period of relative price stability—heavy production control, increasingly competitive pricing and large stocks. Some think the 1950s and 1960s were a harbinger of the late 1980s and early 1990s.

In the 1970s, voluntary "unpaid" land diversions, known as set-asides, became the key supply control tool. Eligibility for price and income support, instead of requiring only idling of land, could require diversion. The earlier fixed price-support payments were replaced by deficiency payments, based on the difference between established target prices and market prices. The shortages and high market prices in the 1970s resulted in a market-oriented agriculture with limited supply controls and small government payments. The environment provided the opportunity, as did World War II, to raise farm price supports and increase the rigidity of program instruments, as evidenced in the 1981 farm bill.

In the early 1980s, export markets eroded, surpluses and farm bankruptcies increased and program spending skyrocketed. The 1985 farm bill moved to restore global price competitiveness with lower, market-oriented loan rates, marketing loans and export subsidies and to reduce production with acreage reduction programs (ARPs), paid acreage diversion and retirement of erodible land. Target prices were reduced slightly to limit overproduction incentives and reduce program costs. Policy changes of the 1980s are very remi-

niscent of those of the 1960s: greater government control on the supply side, and market-price orientation and export assistance on the demand side.

Farm Program Effects and Limitations

Volumes have been written about the economic effects of fifty years of farm programs. This section surveys farm sector effects of farm programs, including some of their limitations, and observations about farm policy and the underlying trends realized irrespective of farm policy.

1. Farm prices greater than market prices (such as today's target prices or 1950s loan rates) lead to production in excess of demand at the price support level. Consequently, total and government-owned stocks build, program costs rise and acreage reduction programs are needed to limit federal outlays. Clear evidence is offered by the experiences of the 1950s, 1960s, late 1970s and early 1980s.

2. Farm programs and production costs are interrelated. Acreage reduction programs (ARP's, set-asides, quotas, etc.) tend to be cost-increasing because, with the farm production plant operating at less than full capacity, fixed costs are spread over fewer acres. Moreover, there is always pressure to increase price and income support levels in response to changes in production costs. Government-guaranteed returns above market levels lead to higher land prices and production costs and, in turn, to greater pressure to adjust support levels in a never-ending cycle.

3. The effect of high target prices on production capacity may be obscured in the short run because target prices are, in part, compensation for idling acreage. However, as long as the criteria for receiving payments per unit of output is *in any way* dependent on the quantity produced, long-run production capacity will be higher because the payment incentive will elicit a response. Because the problem-causing policy instruments are revised only after a lag, new offsetting instruments are often implemented. ARPs are an example: they are favored because they recapture for taxpayers part of the problem-causing subsidy. Unfortunately, policy instruments often "buy out" rather than recapture the subsidy, thereby compounding the program cost. The dairy termination and the recent corn bonus conservation reserve programs are examples. In effect, the government bids against itself.

4. Price supports above market-clearing prices reduce demand and raise surpluses. High prices created by isolating government stocks cause effects especially on the export side that are easy to underestimate. Foreign production is encouraged by the U.S. price/risk umbrella and the increases may only emerge after a period of increased investment in foreign agriculture. Tobacco and sugar-product im-

ports are historical examples and the current soybean market may offer a future example.

Our mature domestic market and secular yield increases for program crops dictate export dependency if the U.S. land base is to be fully utilized. But, the elasticity of export demand greatly exceeds that of domestic demand, so high price supports cause a faster and larger loss in export markets. The symptom is often misdiagnosed as a problem and export subsidies are prescribed.

Our inability to fully measure the effects of policy distortions stems from underestimating the full range of adjustments the distortions cause: foreign supply response for the crop, substitute product production response, demand response for the crop and demand response to substitute crops and processed products.

European Community (EC) consumption of nongrain feeds in response to high feed grain prices is an example. As the deviation between actual prices and market clearing prices increases, the historical data and institutional structure underlying past experience breaks down. Under these conditions, historical relationships are inadequate for forecasting future events. Historical analysis could not have accurately predicted EC sugar-containing product imports or cassava or citrus pellet imports. Economists often underestimate the effect of policy distortions because, by relying on past data to forecast future events, the ability of markets to adapt and change is overlooked.

5. Commodity programs do not change the long-run rate of return to labor, capital and land (Johnson). Programs that raise farm prices above market price levels attract mobile resources into agriculture, but because there are no barriers to entry and resource supplies are elastic, returns per unit of resource change little. Land, fixed in supply, has its price bid up to reflect the increase in future income to land generated by the commodity programs. Land prices rise to the point at which the income rate of return to land is comparable to nonfarm investments of similar risk. Thus, programs tend to create wealth for current landowners. Pressure to maintain wealth is a key reason it is so difficult to reduce target prices and loan rates when market prices fall below them, and why offsetting compensatory instruments are used (See point 3).

6. Farm programs are a series of short-run policies in pursuit of changing markets established to cushion the structural adjustments in agriculture. Farm programs cannot alter long-run market fundamentals. For example, the inflexible policy tools of the 1940s, 1950s, late 1970s and early 1980s prevented adjustment to a declining market. As the secular and program-induced trend toward lower real prices continued, government intervention and program costs became ever-increasing. Programs then catch the market only under drought or unexpected export demand surges. These bliss points have

proven short-lived (1980, 1983) and as prices decline and program costs recover and mount, program instruments are revised to chase the market. Valiant attempts are also made to disguise the program costs by shifting them to other sectors of the economy.

7. The distribution of commodity program benefits is highly skewed—most benefits go to a relatively small number of larger-than-average farms. History, inertia, precedent and politics—not economics—explain why some commodities are regulated and some are not.

Looking at program crop producers, Table 2 shows the pattern of 1985 crop deficiency and diversion payments by base acreage. Farms with 300 base acres or less accounted for 86 percent of farms receiving payments and received 51 percent of the payments. The 2 percent of farms with more than 1,000 base acres received 14 percent of payments.

Table 2. Distribution of Direct Commodity Payments, 1985 Crops[1]

Total crop base acres of farms	Share of payments	Share of farms	Payment per farm
	—percent—		dollars
.1 to 40	3.0	20.9	975
40.1 to 300	47.7	65.4	4,975
300.1 to 700	27.0	10.3	17,885
700.1 to 1,000	8.4	1.7	32,655
1,000 to 2,000	9.8	1.4	49,365
2,000.1+	4.1	.3	93,045
	100.0	100.0	

[1]ASCS data for farms receiving payments; include deficiency and diversion; farms are ASCS farms; farm numbers and payments made to farms with unknown base acreages are excluded.

Table 3 provides more detail for the 1985 calendar year from the USDA's Farm Costs and Returns Survey (FCRS), including farm program payments by sales rather than base acres (Harrington; Lee). The skewness is much more pronounced when nonrecipients of payments are considered—with only 34 percent of U.S. farms receiving payments, a mere 13 percent of *all* U.S. farms received 74 percent of total payments. Although payments per farm rise as farm size increases, payments to moderate-sized farms accounted for a larger share of gross income than for large or small-sized farms. Payments were concentrated among grain farms and 58 percent of payments went to the Lake States, Corn Belt and Northern Plains. Because of high payment rates under the cotton and rice programs, payments per farm were highest in the Delta.

Table 3. Distribution of Government Payments to Farm Operators, 1985[1]

Farm type, sales class, & region	% of U.S. total payments	% of farms receiving payments	% of class gross farm income	Avg. payment (dollars) per recipient
Farm Type				
Cash grain	62	68	9	13,000
Tobacco & cotton	10	25	9	24,000
Veg., fruit, or nut	2	9	1	15,000
Other crops	2	25	3	7,000
Beef, hog, or sheep	14	22	2	6,000
Dairy	9	37	2	8,000
Poultry	[a]	9	[a]	3,000
Other livestock	1	8	1	6,000
Sales Class				
$500,000 or over	15	54	2	49,000
$250,000 to $499,999	22	61	5	25,000
$100,000 to $249,000	37	64	6	14,000
$ 40,000 to $ 99,999	19	55	6	7,000
$ 20,000 to $ 39,999	5	38	5	4,000
$ 10,000 to $ 19,999	1	26	3	2,000
Less than $ 10,000	1	8	2	1,000
Region				
Northeast	1	17	1	4,000
Lake States	12	42	5	8,000
Corn Belt	23	50	5	8,000
Northern Plains	23	67	8	13,000
Appalachian	2	15	2	4,000
Southeast	2	15	2	8,000
Delta	7	22	8	27,000
Southern Plains	14	26	6	16,000
Mountain	9	34	5	15,000
Pacific	7	17	3	19,000
All Farms	100	34	4	11,000

[1]Payments include deficiency, storage, conservation, dairy diversion, indemnity, and incentive.

[a] less than .5 percent.

8. Most program payments are not made to financially-stressed farmers. The 1985 FCRS data indicate only 16 percent of payments went to seriously financially stressed farms—those with negative cash flow (after deducting an allowance for living expenses and adding nonfarm income) and debt/asset ratios above .4 (Harrington). More than 40 percent of payments went to farms with positive cash flows and debts below 40 percent of assets, farms that hardly can be considered financially stressed.

9. Public perceptions run behind the structural changes that occur in agriculture irrespective of commodity programs. This leads to myths that become the foundations for policy "solutions."

Part of the problem is that the income, wealth and structural characteristics of agriculture are diverse within the sector. Policy makers tend to make programs on the basis of a small group of most financially distressed farmers rather than looking at the income and wealth position of the overall sector.

On the one hand, the inelasticity of food demand, production technology, economies of size and consolidation of farms in search of income parity have reduced farm numbers and increased average farm sizes and the trend will increase in the future. On the other hand, current commodity programs seemingly aim to stem the outmigration and preserve structure.

This summer, congressional policy debates over how to cut agricultural spending by $1.2 billion in FY 1988 have usually been accompanied by the statement, "We'll consider it as long as it doesn't reduce farm income." Policy makers tend to ignore the wealth and farm income position of all farmers, the rapid growth in their off-farm earnings and average incomes and wealth relative to nonfarm families.

10. Farm sector problems that motivate farm program changes are compounded by macroeconomic events. This further limits the ability of farm program changes to "solve" farm sector problems. For example, at least one analyst presents a convincing case that virtually the entire asset value loss in agriculture since 1981 has been due to changing real interest rates (Prentice). Changing exchange rates hastened the inappropriateness of fixed loan rates in the early 1980s. Another example is found in the structural adjustment in the nonfarm sector. In the 1950s, real net cash farm income was stable, yet farm numbers fell by 1.5 million as the nonfarm sector offered economic opportunity. The rural farm problem of the 1980s has been compounded by the tremendous job losses of the energy industry and import-competing manufacturing (Table 4). Off-farm employment opportunities have been limited in many areas increasing the adjustment costs for dislocated farmers.

Table 4. Farm and Nonfarm Employment Changes

Period	Change in farm numbers	Change in employment				
		Agriculture	Mining (inc. oil extraction)	Textiles	Primary, fabricated metal and machines (excl. electrical)	Transportation
1971–80	–469,000	– 30,000	+418,000	–186,000	+783,000	+139,000
1981–86	–220,000	–205,000	–347,000	–243,000	–922,000	+ 87,000

Commodity Programs and Rural Economy Linkages

Farm-Nonfarm Economic Bonds

How commodity programs affect rural economies depends on the size and geographical distribution of the farm sector and its links to the nonfarm sector. Farm production is but one part of the total food and fiber sector that also includes upstream industries that supply inputs to farming and downstream manufacturing and distribution industries. The food and fiber sector accounts for 18 percent of U.S. gross national product (GNP) and 19 percent of total employment (Lee, et al.). The farm production sector, however, makes up only about 2 percent of GNP and employment, about the same as the input industries. The downstream sector is the largest source of economic activity and employment, accounting for about 14 percent.

Reflecting the industrialization of the United States, the food and fiber sector has declined in relative importance over time. In 1930, farm production accounted for about 8 percent of GNP and 25 percent of the labor force, about five times greater than now. In 1947, total food and fiber sector employment was 41 percent of the U.S. labor force, more than twice the current share. And the food and fiber system's share of GNP has dropped about 15 percent over the past decade.

The farm sector, although small compared to U.S. GNP and employment, is linked closely to the rest of the economy and changes in farm output can affect the national economy. In the simplest terms, an increase in demand for farm products raises farm prices and incomes which, in turn, leads to increased spending by farmers for consumer and capital goods. This increased spending is multiplied throughout the economy to bring higher overall levels of production, income and employment.

For example, aggregate demand multipliers derived from input-output analysis are about 2 to 1 for most goods and services produced in the economy, including agricultural commodities. This means that each $1 billion of additional demand for raw farm commodities such as wheat or feed grains brings about $2 billion in additional GNP. At 1982 levels this would be likely to generate 30,000 to 35,000 jobs annually.

Increased aggregate demand can lead to increases in overall output, income and employment. However, increases in farm income caused by cutbacks in the sector's output can reduce overall economic output and employment. Acreage reduction programs, for example, reduce the demand for production inputs and may reduce the volume of production flowing through manufacturing and distribution industries. A small acreage reduction program would have little effect on overall GNP and employment, with most of the losses in the farm sector and input industries. USDA's analysis of the 1986 ARPs indicated that each 10 million acres of land idled—with little effect on prices due to current surpluses—caused a drop in sales of seed, chemicals and energy inputs of $1 billion (USDA 1986b). In contrast, another study has shown that a much larger acreage reduction program, restricting commodity sales to the point at which commodity prices could be raised to 80 percent of parity, would idle roughly 50 percent of the program acreage base (Harrington, et al.). The combination of sharply reduced input purchases and lower domestic and export demand would reduce GNP by $64 billion–$12 billion in upstream industries, $18 billion in the farm sector and $35 billion in manufacturing and distribution. Employment losses of 2.1 million jobs would be about 10 percent of the food and fiber sector's employment.

Farm-Rural Economy Bonds

Despite its national importance, the food and fiber sector provides only about 31 percent of the jobs in all nonmetro areas, ranging from 37 percent in the Northern Plains to 24 percent in the Northeast. Moreover, only about one third of total food and fiber sector jobs were in nonmetro areas in 1982 (Petrulis, et al.).

By industry, about 65 percent of farm employment was in nonmetro areas, 48 percent of input industry jobs, 34 percent of processing (higher for textiles and lower for food processing) and marketing employment, and only 18 percent of wholesaling and retailing jobs. A preliminary analysis of 1984 data under a slightly different industrial aggregation shows the nonmetro share of total food and fiber employment at 27 percent (Table 5).

By region, the Delta States and the Northern Plains accounted for the highest nonmetro concentrations of total food and fiber sector employment in 1982 at 60 and 71 percent, compared to a low of about 12 percent in the Northeast and Pacific nonmetro regions. Within each industry category, nonmetro shares of food and fiber sector employment ranged widely: farm sector, 91 percent in the Northern Plains to 29 percent in the Pacific; inputs, 75 percent in the Northern Plains to 22 percent in the Pacific; processing and marketing, 71 percent in the Delta to 7 percent in the Pacific; and wholesaling and retailing, 50 percent in the Northern Plains to 8 percent in the Pacific.

Table 5. Metro-Nonmetro Share of Employment: Selected Industries in the U.S. Food and Fiber System, 1984[1]

Sector	Metro	Nonmetro
	—percent—	
Farm	31	69
Food Processing	71	29
Textile Manufacturing	60	40
Other Manufacturing	79	21
Other Sectors	82	18
Trade	83	17
Transportation	85	15
Eating and Drinking	83	17
Total Food & Fiber	73	27

[1]Preliminary estimates provided by Gerald Schluter, ERS, USDA.

Among rural communities, it is clear that the economic importance of the farm sector and its linked upstream and downstream industries varies widely. However, commodity policies have the greatest economic impacts in those rural areas in which farming is the major source of economic activity. Of 2,443 nonmetro U.S. counties, there are 702 farm-dependent counties in which farm-related earnings were at least 20 percent of all county earnings during 1975–79. In 1950, there were more than 2,000 farm-dependent counties.

Obviously, with farming remaining a dominant source of economic activity in fewer than one-third of all rural counties, an industrial transformation has taken place in rural America. These farm-dependent counties are much more dependent on commodity support programs than other rural counties. In farm- dependent counties, upstream and downstream sectors are very dependent upon the economic health and the level of output of the farm sector. Among these farm-dependent counties, there are 173 export-dependent counties—those that have 50 percent or more of their farm sales from the export-oriented crops of corn, soybeans, wheat, cotton and rice. This is approximately 5 percent of all U.S. counties that are both farm- and export-dependent. They are most susceptible to changes in commodity policy.

Future Policy Directions

Current Program Strategy

The 1985 farm bill negotiations confronted four major problems: rising program costs, farm financial stress, loss of export markets and growing surpluses. Although macroeconomic and other factors

contributed, legislators recognized that these four problems could only be compounded by commodity program instruments that further drive supply and demand for market reality. As a result, the 1985 act provides a set of consistent tools to achieve a long-run adjustment to market forces. The primary objectives are to: (1) promote market price competitiveness and thereby restore demand; (2) phase down income supports to reduce program outlays and limit overproduction incentives; (3) protect farm income during the adjustment; and (4) utilize supply control to reduce excess supplies and retire erodible land.

It is important to understand two critical aspects of the 1985 farm bill: (1) The authorized program instruments start agriculture down a road that ultimately ends with demand, production and farm income being determined in a deregulated marketplace. (2) The effectiveness of the program instruments should be judged in combination, not separately, because their functions are complementary. This second point deserves elaboration because singling out program instruments and their effects can offer ambiguous evidence of both program success and failure.

One analyst, recently summarizing 1986's large program outlays and idled acreages, said, "Agriculture is the area in which federal policy has deteriorated most drastically since the Reagan-Bush administration took office" (Bovard, p. 16). Costs have been large and one could reasonably argue for a more rapid adjustment. Nevertheless, Bovard's view fails to recognize any strategy in the 1985 act. A summary of key program provisions and their outcomes identifies that strategy.

- Price supports have been tied to market prices and lowered drastically through so-called Findley cuts or virtually eliminated (cotton and rice) by marketing loans that allow repayment at market prices when prices are below loan rates. Total agricultural exports are responding to improved price competitiveness. Volume is expected to rise to 129 million tons in fiscal 1987, up 18 percent for the first rise in seven years. Domestic use is equally impressive. Compared with 1985–86, corn use in 1987–88 is expected to be up 12 percent; cotton up 14 percent; rice up 22 percent and soybean crush up 14 percent. Only wheat is expected to decline because of lower feed use. The strategy is to stop supporting global prices and foreign producers, let prices reflect supply/demand balance, recognize export dependency and compete for export share.

- Target prices are reduced over the life of the bill. However, the reductions have been more than offset by unanticipated production cost declines. The target price reductions are the first since target prices were introduced in the 1973 act. Nevertheless, target prices remain well above full economic costs of producing major crops (Table 6).

Table 6. Production Costs and Alternative Farm Prices for Major Crops, 1987 Crop Year

Item	Wheat	Rice	Corn	Upland Cotton
	$/bu.	$/cwt.	$/bu.	$/lb.
Full economic cost of production	3.50	7.40	2.05	.63
Target price	4.38	11.66	3.03	.794
80% of parity price[1]	5.45	15.36	3.95	1.02
Effective target price[2]	3.42	9.13	2.61	.68

Deficiency payments have been separated from actual yields and the permitted growth in payment bases has been slowed. These are steps in the direction of separating the production incentive from the federal payment. Program cost is a direct result of fixed target prices and lower loan rates. Increased cost exposure was a strategy of the 1985 act—both designed and anticipated. It is the adjustment cost associated with instant price competitiveness.

• Supply control continues to be forced by too-high target prices and the government guarantees to be a home for surpluses. The strategy for eventual elimination of annual programs is through a combination of expanded demand under competitive market prices, reduction of excess capacity as the conservation reserve expands, higher prices as supply/demand balance improves and target prices reflecting market prices. The latter is unlikely to occur without subsequent legislation, suggesting that ARPs will be around for a long time.

• Commodity certificate payments and in-kind export subsidies are key parts of the price-competitiveness strategy. Probably costing 5 to 10 percent of their face value, certificates augment free supplies and permit sales at prices below rigid minimum loan rates for grain (Collins et al.). Certificates will be critical to accessing current huge farmer-owned reserve and CCC-owned stocks at competitive prices as overall surpluses fall. Without certificates, a market shock such as that in 1983 could be recreated—artificially high market prices induced by large acreage reduction programs and no market liquidity.

Mandatory Production Controls

The consequences of rejecting the current policy road and shifting to mandatory production controls have been thoroughly documented in history and in recent analysis. An early USDA study of one such

[1]Eighty percent of August 1987 parity prices.

[2]Market price needed on production from full base acreage to equal net return from receiving target price on acreage reduced by acreage reduction requirement. Not comparable to full economic cost of production because fixed costs are raised to reflect 1987 acreage reduction programs.

bill demonstrated the following effects: arbitrary political pricing based on parity prices, which are irrelevant to income parity; loss of exports or excessive export subsidies; loss of domestic demand due to substitutes and processed imports; decimation of the livestock and poultry sectors; loss of input industry sales; increased inefficiency in production; large increases in consumer costs; inability to control surpluses because of demand losses and limits on acreage idled; and no reduction in government costs because of export subsidies and loan outlays on surpluses. Attempts to shift budget costs of taxpayers to consumers fail. Program history has taught that such rigid deviations from the market ultimately will fail.

Three of the effects of mandatory controls are especially interesting because they are disbelieved or not understood. First, mandatory controls and parity prices represent a government-sponsored monopoly with monopoly profits being distributed among farmers. Table 6 clearly demonstrates the extent of the monopoly profits (as well as the rents the average producer is earning under current programs). The high parity-based prices are justified by being those that would restore cash flow to the group of most severely financially stressed farmers, irrespective of what other excess profits are transferred to other farmers. Second, the program replaces the progressive income tax financing of farm programs with regressive food taxes—yet, the program finds supporters in leaders of low-income groups that would be hardest hit. Third, the potential for displacing off-farm food and fiber sector workers is greater for this program than probably any other. Even so, the program is strongly supported by a major manufacturing industry labor union.

Greater Market Orientation

Another set of options would reduce government support and make farmers more dependent on market forces. Domestic policy reform is an objective of many nations that incur large farm support costs and are harmed in international markets by domestic agricultural policies. In Geneva on July 6, the United States proposed to the General Agreement on Tariffs and Trade (GATT) that by the year 2000 nations eliminate all subsidies that distort trade. The U.S. proposal would permit income transfers that are not trade distorting.

Current commodity policy, as discussed, gradually moves toward a greater market orientation through 1990. While the federal government is heavily involved in agriculture, the continuation of current policy beyond 1990 would lead to less government intervention and smaller taxpayer costs. The policy changes set in place by the 1985 farm bill could be accelerated. In practical terms, this would mean: (1) a faster rate of reduction in target prices, which would lower the level of income support; (2) authority for the Secretary of Agriculture

to reduce support prices by more than is now allowed; (3) smaller acreage reduction requirements; and (4) no requirement to plant program crops in order to receive payments.

An alternative to the current policy path is a move to a more market-oriented agriculture. One approach is the "decoupling" of income support from production. The concept is that income transfers to farmers should be production neutral; that is, transfers should not be tied to current production or affect production. One could conceive of income transfers having wide-ranging production effects. Freezing program payment yields, as done in the 1985 farm bill, reduces the incentive to increase yields for program payments. This marginal dilution of the production-payment link may be at one end of the spectrum. At the other end, fixed payments could be made to farmers irrespective of what they produce or whether they even remain in farming. Beyond this conceptual range, however, there are differing views as to what decoupling might mean in terms of commodity policy.

A widely-held view of decoupling is reflected in Senator Boschwitz's 1987 draft legislation covering 1990–1995 crops. Existing holders of commodity base acreages would receive declining annual payments computed on their 1989 base acreages regardless of whether they grew any program crops. Payments would be made through 1995, but at a lower level than in 1990. Support prices would continue to be set in relation to market prices as under current policy, but would likely be lower. Acreage reduction programs would be eliminated and authority to plant nonprogram crops on base acres would be phased in. Under this approach, decoupling is a transition policy to allow farmers to adjust to incomes determined by market conditions.

Decoupled income support, however, could be a permanent policy to provide income transfers to farmers. On the one hand, payments could be made to existing base holders. On the other, income support could be targeted to farmers based on need as determined by a means test. Certainly, a means-tested income maintenance program for U.S. farmers would be a fundamental policy change. Decoupling income support would probably intensify the debate as to why farmers should receive income transfers. A means-tested income support exclusively for farmers would be even more contentious for farmers as well as for other groups.

The consequences of more market-oriented commodity policies would be determined by the specific types of policies and a host of other factors. For example, an acceleration of changes in the current policy path would reduce income transfers to crop producers and increase the production of program crops. Most likely, crop producers would be worse off, at least in the intermediate term, because of lower (effective) farm prices. To the extent that farm asset values reflect the expectation of income streams based on current policy, a

reduction in expected income streams would reduce asset values. Consumers would not be affected much and taxpayers would benefit.

These consequences reflect the general direction of impacts; however, two important factors would affect the results of more market-oriented policies. The first is market price changes. *A priori*, incomes would fall if smaller income transfers were not offset by higher prices and/or increased production. Price changes for grains, oilseeds and cotton would be strongly influenced by exportable supplies and demand in international markets. There is a general expectation that a coordinated, multilateral reduction in domestic support levels would lead to higher world market prices for most commodities. Thus, U.S. crop producers would eventually receive higher market prices if domestic policies were reformed. Nevertheless, U.S. producers now receive effective prices that are well above current market prices. For example, participating wheat producers receive an effective price, adjusted for supply control programs, of about $3.42 per bushel on their total base acreages, compared to a market price of $2.50 per bushel (Table 6).

A second consideration is the extent to which other forms of income support would be substituted for current payments. Realistically, it is unlikely that payments can be substantially reduced, let alone eliminated, unless the income losses to producers are partially offset by higher market prices and/or other income transfers such as decoupled income support. If so, then alternative income support is an important issue.

Decoupled income support as proposed by Senator Boschwitz would make payments to farmers who now have base acreages. Depending on payment rates, the level of income transfers could decline as compared to current policy. Even so, the distribution would remain about the same. In contrast, a means-tested income support program could change both the level and distribution of income transfers. For example, income support might be given only to financially vulnerable farms (negative cash flows and high debt-to-asset ratios). Based on 1986 data, about 200,000 farms would be eligible; about 60 percent have annual sales less than $40,000 and 20 percent have sales of $40,000 to $99,999. Thus, the distribution of income support would change, mostly to farms with less than $100,000 in sales. Now about a third of government payments are made to such farms.

Implications for Rural Revitalization

How alternative commodity policies might affect rural communities is complex. Farming has strong linkages to sectors that supply its inputs and handle its products. As a result, local, regional and the national economies can be affected in the short run by changes in commodity programs. However, the farm-rural-general economic

linkages have weakened over time as farming has declined and nonfarming industries have grown. In general, the Delta, the Northern and Southern Plains and the Corn Belt are most sensitive to farm policy changes. The farm sector would be most affected in the farm-dependent areas. Specifically, those 173 rural counties that are both farm-dependent and export-crop dependent would probably be affected most by policy-induced changes in farm prices, incomes and production. In these regions, cash grain and cotton farms are dominant.

To help examine the effects of alternative policies, Table 7 presents the results of an econometric analysis of decoupling wheat payments, mandatory controls for wheat as proposed by Harkin-Gephardt and continuation of the 1985 act with declining target prices through 1995. As compared to current policy, both options raise net returns above cash expenses with the largest income gain to wheat producers from mandatory controls.

Table 7. Wheat: Mandatory Production Controls and Decoupling Compared with Continuation of Current Law, 1990–95 Crop Year Totals[1]

Item	Mandatory Controls	Decoupling
	—Difference from current law—	
Acreage planted (mil. ac.)	-62.0	+52.0
Exports (bil. bu.)	- 1.3	+ .9
Consumer expenditures (bil. dol.) (farm level)	+15.2	- 1.5
Net cash returns (bil. dol.)[2]	+28.7	+ 6.9
Program cost (bil. dol.)	+13.5	+ 8.7

Under mandatory controls, wheat-planted acreage during the 1990–95 period would total more than 60 million acres less compared to current policy. In contrast, decoupling would result in a substantial increase in both planted acreage and input use as idled land is returned to production. Under mandatory controls, upstream industries would be harmed by a $3 billion loss in sales to wheat producers for the 1990–95 period which would impair rural communities, especially communities like those in the Northern Plains where a large share of input industry jobs are in nonmetro areas.

In terms of downstream economic activity, lower prices as a result of decoupling lead to a larger volume of wheat exports and domestic

[1]Econometric simulation with all programs starting in 1990 crop year. Current programs assume an annual reduction in target price of 3.85 percent through 1995, minimum permitted or formula loan rates, and a 27.5 ARP in each year. Mandatory controls is the Harkin-Gephardt bill as submitted in the 100th Congress. ARPs are held at maximum permitted level with in-kind subsidies used to the maximum extent possible to maintain exports. Loan rates start at 70 percent of parity in 1990 and rise 1 point each year thereafter to 80 percent. Decoupling eliminates target prices and sets the loan rate at $1.60 per bushel. The transition payment is $1.35 bushel in 1990 and drops about 10 percent a year thereafter. The payment is made regardless of market price.
[2]Returns above variable cash production expenses.

use while much higher prices under mandatory controls cause use to fall. Under mandatory controls exports could have been kept equal to current programs by using smaller ARPs; however, program costs would have been greater. The gains or losses in downstream employment and output would have the most effect on rural communities such as those in the Delta and Northern Plains regions where a high proportion of downstream jobs are in nonmetro areas.

Under decoupling, with its lower prices, consumers fare better as compared to current policy while they would spend about $15 billion more at the farm level during 1990–95 because of mandatory controls. Taxpayers pay more under both options. Decoupling outlays rise because transition payments are made regardless of rising market prices that reduce payments under current policy. Under mandatory controls, in-kind export subsidies paid from stocks displace production and cause large loan outlays. The sum of the program cost increases and consumer cost changes about equal the farm income change under both options.

These examples for wheat suggest a mixed bag of results for rural communities. Wheat producers would have more income to spend, but in the case of mandatory controls, the contraction in wheat production would harm other businesses in rural communities. Further, as consumers and taxpayers, rural citizens would spend more of their incomes to support wheat producers under mandatory controls.

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