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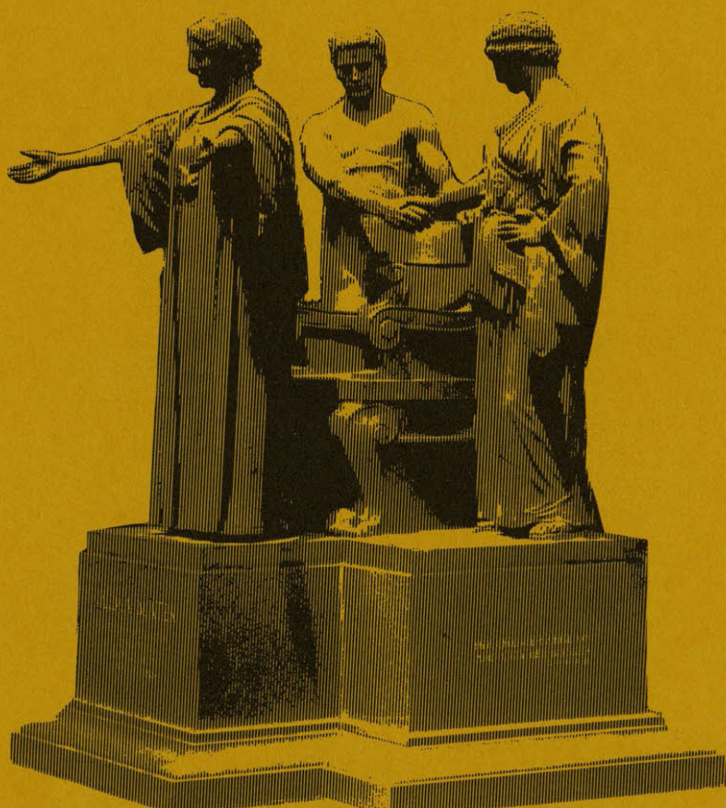

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AGRICULTURAL POLICY AND THE AGRICULTURAL OUTLOOK

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One agricultural reporter recently commented that the big uncertainties in agriculture were the two Ws--weather and Washington. In a year like 1986 when an estimated $25 billion of farm income will come directly from farm commodity programs, can there be any doubt that agricultural policy plays a key role in farm price and income prospects?

John Schnittker quite appropriately describes the current farm policy situation in his article in Choices:

"What appeared in 1984 to be strong political momentum for farm policy reform was largely aborted in 1985. The actual and prospective loss of many thousands of farmers over a five year period became a central political rallying point in opposition to any material reductions in federal subsidies to U. S. farmers, and later in support of higher subsidies. Congress again decided to spend more money than ever in the name of helping small and mid-sized farmers, without actually directing any substantial part of the money to long term measures to treat the causes of farm distress.

"Neither the five year 1985 farm bill nor the bill to restructure the Federal Farm Credit System provides any real hope of survival of the most financially insecure farmers. There is no sign of renewed 1970s style prosperity, to return declining farm balance sheets back to their peak of around 1980. That era is gone."

In our discussion today, we will look mostly at the commodity programs and also at other policies affecting agriculture in the next few years. We will not make any detailed assessment of whether these policies are good or bad, right or wrong. Such assessments involve value judgement--a subject for another discussion.

Our objective will be to examine the policy decisions and how they affect the agricultural outlook. The major point is that for every policy decision, there is a consequence. And today, few if any agricultural commodities can escape the consequences of some policy decision.

Policies Affecting the Agricultural Outlook

At least six types of policies affect the agricultural outlook:

1. Commodity programs.

2. International trade.

3. Conservation and environmental.

4. Credit.

5. Taxes and Tax Reform.

6. Monetary and Fiscal.

Commodity Programs

The Food Security Act of 1985 sets the course of commodity programs through 1990. For the North Central States, wheat, feed grains and soybeans are the major commodity programs of interest. The key policy instruments to watch are target prices, loan rates, and acreage reduction. Here are the basics as established by law.

Table 1. Minimum Wheat and Corn Target Prices and Loan Rates, Crop Years 1986-90.

Item	1986	1987	1988	1989	1990
Wheat					
Target price	$ 4.38	$ 4.38	$ 4.29	$4.16	$4.00
Basic loan rate	3.00	2.85*	2.71*	2.57*	2.44*
Actual loan rate	2.40**	2.28**			
Corn					
Target price	3.03	3.03	2.97	2.88	2.75
Basic loan rate	2.40	2.28*	2.17*	2.06*	1.96*
Actual loan rate	1.92**				
Soybeans					
Loan rate	5.02	5.02	***	***	***
Minimum discretionary	4.77	4.77	4.50	4.50	4.50

* Projected minimum basic loan rate. The rate established by law is to be 75-85 percent of the five year average market price dropping the high and low years but not less than 5 percent below the previous year.

**The actual loan rate announced by the Secretary using discretionary authority.

***75 percent of the simple five year average market price excluding high and low years.

Source: Economic Research Service, Agr. Information Bulletin 498

Loan Rates and Target Prices

The 1985 Act established the basic loan rates for wheat, corn and soybeans but gave the Secretary discretionary authority to reduce the loan rate further if supply conditions warranted. The goal was to re-establish the United States to a competitive position in the world market. But the drop in the basic loan rate was limited to 5 percent per year.

The target prices for wheat and feed grains were frozen for 1986 and 1987 at 1985 levels. Beginning in 1988 a gradual reduction begins as shown in Table 1. Setting the level of target prices was the most difficult issue to settle in writing the whole 1985 Food Security Act. The actions in the House and insistence of certain Senators on a 4 year freeze finally resulted in the 2 year freeze compromise. Consequently, we see substantial deficiency payments, larger than ever before because of the decision to reduce loan rates the full limit allowed by law in an effort to recover our declining share of the export market.

The Act also requires that the preliminary announcement of the loan rate for soybeans must be made after August 1 while the final rate must be announced no later than October 1 and may not be less than the preliminary level. As of Friday, August 8 no announcement had been made but it was expected sometime during the week of August 11.

Acreage Reduction

As in previous legislation, the 1985 Act continues the authority to require acreage reductions to qualify for price support benefits. These may be in the form of acreage limitation (commonly called an acreage reduction program or ARP), set aside, or paid land diversion.

Table 2. Wheat Acreage Reduction Program

Crop Year	Allowable Reduction: With Carryover Stock of 1 Billion Bushels or Less	Allowable Reduction: With Carryover Stocks Greater Than 1 Billion Bushels
	percent	percent
1986	0-15	15-22 1/2[1]
1987	0-20	20-27 1/2
1988-90	0-20	20-30

[1]A 2 1/2-percent paid land diversion is also required with in-kind payments, if carryover stocks exceed 1 billion bushels. Producers who planted their wheat before the announcement of the 1986 program are eligible for land diversion payments ($2 per bushel) on an additional 10 percent of their crop base.

Table 3. Feed Grain Acreage Reduction Program

Crop Year	Allowable Reduction: With Carryover Stock of 2 Billion Bushels or Less	Allowable Reduction: With Carryover Stocks Greater Than 2 Billion Bushels
	percent	
1986	0-12 1/2	12 1/2-17[1]
1987-90	0-12 1/2	12 1/2-20

[1]A 2 1/2-percent paid land diversion is also required with in-kind payments, if carryover stocks exceed 2 billion bushels.

Acreage reduction or set aside programs must be announced by June 1 for wheat or September 30 for feed grains, prior to the year in which the crop is harvested. Adjustments may be made up to July 31 for wheat and November 15 for feed grains.

The 1985 Act also set limits on the amount of acreage reduction permitted depending upon the amount of carryover stocks. These are shown in Tables 2 and 3.

In view of current stocks and prospective stocks, the maximum allowable acreage reductions can be expected in 1987.

Dairy

The dairy title in the 1985 Act was a compromise between the Senate that wanted to simply reduce support prices and the House that passed a voluntary paid diversion program with producer assessments to finance part of it. Although the whole herd buyout program is expected to reduce government purchases in 1986 and reduce milk production in 1987, the problem of dairy surpluses may still be unsolved. At present there are no controls over producers who want to boost output or new producers who want to enter dairying.

Discretionary Program Options

The 1985 Act has a great many discretionary features that provide the Secretary with many choices and lead to confusion and uncertainty among farmers who participate in these programs. For extension educators, it requires constant vigilance to keep abreast with these changes.

For example, in announcing the 1987 wheat program, the Secretary said that if the farmer owned reserve quantities exceed 17 percent of the estimated domestic and export use for the 1987-88 market year, no entry into the reserve will be allowed.

Offsetting compliance requirements will not apply to the 1987 wheat program and actual crop yields for 1987 and subsequent years will not be used to establish farm program payment yields in 1988 and the future.

Lyng also said he would the reserve the right to implement program options to reduce costs, as outlined in the 1985 Act, which may include reopening and changing contracts if producers voluntarily agree to the change.

The Secretary also did not announce one option that had been under discussion, a program under which producers could offer through a bidding system to take another 10 percent or more of their wheat base out of production on top of the earlier announced unpaid acreage reduction requirement of 27.5 percent.

Under the 1985 Act, some other discretionary options include:

Marketing loan. Under this program, farmers sell their commodities on the market and pay off their government loans at the world market price or 70 percent of the basic loan rate, whichever is higher. Although there is some political pressure to use the marketing loan, the Secretary of Agriculture has resisted efforts to expand this program to wheat or feed grains. Soybeans are also covered under the marketing loan.

Loan Deficiency Payments. The Secretary may offer loan deficiency payments to producers who, although eligible to obtain loans, agree not to. The payment rate per bushel would be the announced loan level minus the repayment level used in the marketing loan. The amount of commodity eligible for this payment would be determined by multiplying the individual farm program acreage for the crop by the farm program payment yield. Some discussion of offering this payment on 1986 crops without the marketing loan came up in early July. No announcements have been made. Called POP (Producer Option Payment), one could interpret this approach as a bribe to keep a farmer from taking out a loan and then delivering his crop to the CCC when the market price failed to reach the loan level.

Inventory Reduction Payments. These payments may be made to producers who agree to forgo obtaining loans and receiving deficiency payments and who limit the amount of wheat and feed grains planted for harvest to the crop acreage base less half of any acreage to be diverted by an ARP and PLD. Payments would be made in-kind.

Disaster payments. Although the 1985 Act does not automatically entitle producers to disaster payments if they can obtain crop insurance, the Secretary may make disaster payments to producers when certain emergency conditions have been met.

Cross Compliance. The Secretary may require that when an acreage reduction program is in effect that the acreage planted for any other program crop may not exceed the acreage base for that crop.

Wheat marketing quotas. The Secretary may set national marketing quotas for the 1987-90 crop of wheat. If announced, a referendum must be held by August 1, 1986. Since that date is passed, this provision is already not applicable.

Price support for corn silage. For 1986-90, the Secretary may make loans and purchases available to producers who cut, purchase or exchange corn for silage and agree to participate in an acreage reduction or set aside program.

Acreage Bases and Yields. In an effort to provide equity and fairness in setting bases and yields, considerable confusion and uncertainty were created. Although certain rules are established, the Secretary also has some discretion in setting bases and yields.

Advance payments. Advance deficiency payments were required in 1986 and are at the discretion of the Secretary for 1987-90 crops. Advance recourse commodity loans may also be made to producers for commodities with nonrecourse loan programs.

Interest payment certificates. The Secretary may issue commodity certificates to producers who repay their loans with interest. The value of the certificates would be equal to the interest paid.

Payments in Kind (PIK). PIK payments are authorized under the wheat, feed grains, cotton, rice and peanut titles of the Act.

Paid Land Diversion (PLD). The Secretary has the discretion to offer a paid land diversion program if such payments will assist in obtaining the necessary adjustments in total acreage. It can be offered whether or not an acreage reduction or set aside program is in effect.

International Trade

The trade title of the 1985 Act changes or expands several food aid and export promotion activities. Targeted assistance and intermediate credit guarantee programs supplement export promotion programs. Specific commercial program shipments are exempt from cargo preference requirements. However, Public Law 480 shipments are subject to an increasing proportion to go in American ships.

The tone of the entire trade title is to make U.S. agricultural commodities more competitive and use whatever means possible to recover lost export markets.

The most significant (and controversial as time has shown) is the Market Development and Expansion section that originally authorized $2 billion, and was later reduced to at least $1 billion but not more than $1.5 billion. Using CCC-owned commodities, the program is to provide U.S. exporters, users, processors, or foreign purchasers the CCC commodities at no cost to encourage the development, maintenance and expansion of U.S. agricultural export markets.

The goal is to make commodities more competitive by offsetting subsidies or other unfair trade practices, the adverse effects of price support levels above competitor's export prices or fluctuations in exchange rates. Among foreign purchasers, priority shall be given to those who are traditional purchasers of U.S. agricultural commodities and products and who continue to purchase a greater amount of them than in a previous period. Reasonable precautions are to be taken to prevent resale and avoid displacement of usual U.S. marketings.

Since another section of this program is devoted to foreign trade, the main point to emphasize here is that the trend in agricultural exports could have an important bearing on what changes may be attempted or made in the 1985 Food Security Act including the commodity programs.

If exports decline further or remain stable, expect to see pressure to move to mandatory production controls and raise domestic prices through higher loan rates, reducing deficiency payments and export subsidy costs. Recent Administration actions such as the veto on the textiles bill suggests an unwillingness to give up on trying to revive agricultural exports at this time.

Conservation

The 1985 Act made major changes in the Conservation title. The three major features affecting farming operations and management decisions are:

1. highly erodible land conservation, commonly referred to as "sodbuster" provisions, along with conservation cross compliance.

2. wetlands conservation, referred to as "swampbuster" provisions.

3. Conservation Reserve, which called for establishing a conservation reserve of 40 to 45 million acres by 1990.

The conservation cross compliance provisions require approved conservation plans on highly erodible land by 1990 and full compliance by 1995 on highly erodible land growing crops from 1981-85 to be eligible for farm program benefits. On all other highly erodible land, the provision became effective December 23, 1985 and requires approved conservation plans on erodible cropland to be eligible for farm program benefits. Highly erodible land plowed between December 23, 1985 and June 27, 1986 is exempt from penalties for one year.

Under the wetlands conservation provision, program benefits are denied to producers who convert wetlands to cropland after December 23, 1985.

The Conservation Reserve was established with a schedule of minimum and maximum acreages over crop years 1986-1990. They are shown in Table 4 below.

Table 4. Conservation Reserve Acreage, Crop Years 1986-90

Range	1986	1987	1988	1989	1990
Minimum[1]	5	15	25	35	40
Maximum	45	45	45	45	45

[1]The Secretary may reduce the number of acres placed in the reserve by up to 25 percent if rental payments will probably be significantly lower in the following year.

Source: ERS Agr. Information Bulletin 498.

Using a bid system for 10 year contracts, the USDA did not get the desired number of acres in the reserve in 1986. The first bid period in March resulted in only 838,356 acres on 10,307 farms being accepted. The average rental payment was $41.82 an acre.

During the second sign up period the program added 3,000,681 acres on 22,863 farms at an average rental cost of $44.23 per acre. So the 1986 contracts totalled about 3.8 million acres.

A third bid period ends August 15 seeking contracts for 1987. Later bid periods are expected in November and in the spring of 1987. If acreage contracted falls below the established targets, some changes in length of contracts, specifications for highly erodible land, or payments may be made. It should be watched carefully since the extent of success in retiring cropland could have some effect on crop acreage and oversupply of wheat and feed grains.

Credit

The Credit title in the 1985 Act deals primarily with credit from the Farmers home Administration (FmHA). The Act adds joint farming operations to the eligibility list for FmHA farm ownership, soil and water conservation, recreation and farm operating loans.

Owners of larger than family-sized farms are also eligible for loan provided they are related and each holds an interest that when taken separately is no larger than a family sized farm.

The Secretary may not restrict loan eligibility only to farmers who had FmHA loans outstanding when the Act was signed. Some changes are also made in eligibility requirements for emergency loans.

One section of this title sets up guidelines for disposition and leasing of farmland acquired by the FmHA with preferences for family sized farms and operators.

A provision also provides for interest rate reduction on FmHA guaranteed loans.

The major farm credit legislation The Farm Credit Amendments Act of 1985 was a separate bill designed to protect the Farm Credit System from bankruptcy. This bill signed at the same time as the Food Security Act calls for closer regulation of the farm credit banks by the Farm Credit Administration, flexibility in channeling funds within the Farm Credit System, and if necessary, capital infusion of up to $5 billion from the Federal Treasury if needed after all other steps have been taken.

The recent report that the Farm Credit system deficit in the second quarter was $762 million would suggest future needs for assistance under this Act. (Wall Street Journal, August 7, 1986) The Farmers Home Administration had delinquent farm debt of $5.8 billion on September 30, 1985. Demands for loans and credit guarantees from FmHA are expected to continue. FmHA policy will be to increase the proportion of its guaranteed loans.

Taxes and Tax Reform

The major policy decisions in 1986 that could affect the agricultural outlook relate to tax reform and how it will affect the farm business. Many would not associate tax policy with farm policy but most of you can appreciate how tax regulations affect after tax income. At this stage in the tax reform deliberations, we can only be aware that if a final bill is passed, there will be implications for farm financial and farm management decisions.

Some of these are: loss deductions for nonfarmers who invest in livestock or farming activities; the qualifications for material participation in farming activities; income averaging and possible special rules for some farmers; depreciation and possible changes from previous tax laws; investment tax credit, capital gains and losses, soil and water conservation expenditures, land clearing expenditures, and limits on prepaid farm expenses.

Much criticism has been directed toward our tax policies and its stimulation of over-investment in agriculture. For the long run, tax reform could benefit agriculture but in the short run it could reduce some of the current beneficial deductions for operating farmers.

Monetary and Fiscal Policy

A discussion of agricultural policy and agricultural outlook would not be complete without recognizing that some public policy decisions outside of traditional commodity policy may have the most effect on the economic welfare of many farmers.

Much attention has been given to the effects of macroeconomic policies upon agriculture. Their effects on interest rates, the value of the dollar, demand for agricultural exports, costs of imports, inflation or deflation, suggest many ways that monetary and fiscal policies affect agriculture.

One of the less publicized farmer demonstrations in Washington during 1985 was a "balanced budget brigade" that made the rounds with Congressional and Executive Department officials urging fiscal restraint and a move toward balancing the budget. Perhaps some one was listening since the Gramm Rudman Hollings Act was the significant outcome of a realization that budget deficits of $200 billion could some day lead to some serious consequences.

A full discussion of the effects of monetary and fiscal policy changes would require most of the rest of the day. But in a discussion of policies affecting agriculture we must recognize that it may be as significant as any farm commodity for farm financial programs administered by the U.S. Department of Agriculture.

Policy and Politics

In an election year like 1986, policies are hard to separate from politics. The announcement to subsidize wheat sales to the Soviet Union may not be just co-incidental with major (and possibly close) Senate races in North and South Dakota, Kansas, Oklahoma, Colorado, and Idaho. Or the efforts to hasten drought relief to the Southeast with rather generous arrangements in providing CCC owned commodities to eligible farmers could also be influenced by Senate races in North Carolina, Georgia, Florida, and Alabama. The control of the U. S. Senate in the next Congress will be an important influence on future direction in agricultural policy.

The outcome of the wheat poll is not expected to have any effect on USDA decisions but it will be watched closely by members of Congress. A strong farmer preference for mandatory controls could lead to Congressional efforts to push legislation in this direction. A rejection by farmers would dampen agitation for such controls.

Since the 1985 Act runs through the 1990 crop year, a new Act will have to be written in an election year. The rationale for the change was to avoid writing a bill in the first year of a new Administration and a new

Secretary of Agriculture. But the consequence is writing a bill in a year of Congressional elections.

What the effect on new policies will be is hard to estimate.

High program costs--estimated at $25 billion or more--during the current fiscal year, along with individual reports of extremely high payments to individuals, are likely to bring about efforts to limit payments in some way. Commodity groups traditionally have not favored such limitations and their growing influence in Congress suggests that any efforts toward targeting will be difficult to achieve.

Conclusions

1. The 1985 Act and its implementation in 1986 with the lowering of loan rates and maintenance of target prices has made participation in commodity programs about the only rational decision that most farmers could make. The same situation is also likely to apply during 1987 and probably 1988-90.

2. The increased share of net farm income coming from direct payments at a time when the federal government is trying to reduce expenditures and move toward a balanced budget suggests a day of reckoning when high program costs will collide with budget balancing efforts.

3. The 1985 Act lays out a five year plan for target prices, loan rates tied to market prices, acreage reductions tied to carryover stocks, and other market situations. Loan rates may be low enough to let price be determined by domestic and international demand free of government influence.

4. Much of the quest for market orientation is built upon an assumption that lower market prices will rebuild the U. S. competitive position in the export market for the major commodities. Some recovery seems possible but it may come too slowly and with insufficient volume to satisfy the political forces that would revise the 1985 Act, rather than give it several years to see what happens.

5. The Conservation Reserve participation has been disappointing, probably because the policy makers did not anticipate the reluctance of farmers to commit land for 10 years at a fixed return, especially at a time when deficiency payments offer such high returns to keep cropland under the annual programs. Some adjustments will be needed, and seem likely, to get higher participation.

6. Farmers have been frustrated by the delays in program announcements, changes in announced programs, and continued uncertainty about how the rules will apply to them. With the complexities of these programs, and wide range of discretionary provisions, the situation is not likely to improve during the remaining life of the Food Security Act of 1985.

7. Members of Congress have sincere intentions and dedicated loyalty to their constituents and supporters, but limited understanding of the economic consequences and complexities of their legislation that must be implemented in the specialized and widely dispersed U. S. agricultural sector.

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