AGRICULTURAL POLICY PROSPECTS UNDER A REPUBLICAN ADMINISTRATION, 1989-93*

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If a Republican administration is elected for 1989-93, I expect it to advocate continuation of the trends established in the 1985 Farm Bill. The main innovations in policy would come in the context of a GATT agreement in which we were able to negotiate a phased reduction in the level of agricultural subsidies to all commodities in all countries simultaneously. Only in that situation would I expect any radical changes in U.S. farm policy -- under either a Democratic or a Republican administration.

In addition to the trade negotiations in Geneva, the other important influence on the next Farm Bill will be the pressure for deficit reduction, which will be hanging over the next administration, again regardless of who is sitting in the White House. The next Farm Bill is not likely to be written in 1990 when the Food Security Act of 1985 expires. In 1989 when Congress addresses the Federal budget deficit, agricultural programs are likely to suffer some cuts. Nobody in Congress wants to write a farm bill in an election year, so I would expect an extension of current law next year with modest modifications in levels of several policy instruments to meet the budget target. The first time Congress will consider writing an omnibus farm bill is likely to be in 1991.

FARM POLICY PROVISIONS

Now let me turn to some specific provisions in farm policy.

Loan rates

The 1985 Farm Bill set loan rates on a downward trajectory towards a 75% of moving average market price formula with a limit to how fast we could get to that formula. I anticipate that a Bush administration would advocate staying the course, continuing to reduce loan rates until we get to that formula determination of loan rates. In a normal year, the loan rates would serve as a safety net, but in most years, they would be below market clearing prices and would not get in the way of our export competitiveness. The

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not get in the way of our export competitiveness. The single most important objective in writing the 1985 Act was to restore international competitiveness by undoing the problem created by the 1981 Act in which we artificially supported not only our own prices, but the whole world market price structure and thereby priced themselves out of the international market. Preserving the international competitiveness of American agriculture by keeping loan rates moving towards the formula would likely be an important Bush priority.

Export policies, including export subsidies

The export enhancement program for wheat, marketing loans for cotton and rice, and "PIK and roll" for corn, were all measures taken to ensure international competitiveness. Because there was a limit to how fast loan rates could be dropped towards the moving average formula, we had to ensure that our commodities were internationally competitive, and this got us back into the business of explicit export subsidies to make sure that our prices were down to international levels. Unfortunately, in administering the export subsidies, I feel USDA more than compensated for the lack of competitiveness. In the GATT Round, we're likely to see the export subsidies negotiated away. Export subsidies may or may not become inactive in the meantime with the higher prices in the international market, but I would not expect the next administration to give up the authority to subsidize exports until we get something in exchange for abandoning the subsidies in the GATT Round of trade negotiations.

Target prices and deficiency payments

In the 1985 Farm Bill, target prices were frozen for one or two years depending on the commodity, and then reduced by 10% in nominal terms over the remaining years of the Farm Bill. With the necessary reduction in loan rates to re-establish international competitiveness, this widening gap between target prices and loan rates caused a substantial increase in the budget cost, especially in the first couple of years of the 1985 Farm Bill. The freeze in target prices was advocated to protect farm income and to respond to the farm financial stress that many farmers experienced in the early 1980's. Unfortunately, this was a very blunt instrument for addressing the farm financial stress, but presumably, it did prevent as many farmers from failing financially as might have occurred in the absence of those large income transfers. In any case, in 1987, the frozen target prices caused record high net farm income (by any measure) by a substantial margin and probably created unjustified expectations of what the market could be expected to return in the future. A future Republican administration is likely to approach deficit reduction by advocating faster reductions in target prices.

A second aspect of deficiency payments in future policy debates will concern decoupling payments to farmers from current or future production. The essential objective is that the target price not be the supply inducing price in agriculture. Decoupling was begun in the 1985 Farm Bill by reducing farmers' program payment yields by up to 10% from their 1985 level. This means that the target price is no longer the price received by farmers at the margin. Rather the expected world price or loan rate, whichever is higher, is the relevant price at the margin. The 1985 Farm Bill also established the 50-92 provision which was later extended to 0-92 in December, 1987. These two measures began the process of decoupling payments, at least at the margin, from the current volume of production. They ought to reduce the incentive to overproduction in inefficient and high cost producing areas. Some degree of further decoupling is likely to be advocated by a Republican administration to ensure that we not revert to the situation in which the target price once again becomes the supply inducing price and stimulates overproduction in high cost areas. Decoupling is also being discussed in the GATT negotiations in Geneva, not just by the United States, but by other countries as well.

One aspect of deficiency payments that concerns many farmers is the rigidity of the 1985 Farm Bill that severely limits farmers' acreage allocation decisions. There is sufficient dissatisfaction among farmers and the trade that this is likely to be relaxed in the next Farm Bill. In 1988, for example, the market signals were saying we needed to plant more soybeans and oats, but no farmer could afford not to plant his or her corn base in order to protect that base. A Bush administration would likely advocate a reduction in the rigidities associated with the present acreage reduction programs that prevent farmers from responding to market signals.

Acreage reduction

The 1985 Farm Bill provided a major commitment to acreage reduction, via the annual acreage reduction programs (ARPs), the authority to have paid diversion and the 45 million acre conservation reserve. In writing the 1985 Act, Congress responded to the environmental concerns about soil conservation and the commodity groups' desire for more supply control. The measures also addressed the very real problem of reducing the burdensome stocks accumulated under the ill-conceived loan rate provisions of the 1981 Act that priced the United States out of the export market. But the implementation of the 1985 Act and the drought of 1988 have worked stocks down to the point that by 1989, we should see a significant reduction in the budget cost of carrying these stocks. This is likely to permit significantly smaller annual acreage reduction requirements and no need for paid diversion. Certainly by the time the full 45 million acre conservation reserve is phased in, there should be little need for annual acreage reduction. One of the important issues in the debate over the next Farm Bill will be whether that conservation reserve ought to be expanded from 45 to say 65 million acres. The key issue is going to be whether or not this would unduly tighten the commodity markets, and my conclusion is that it would.

Payments-in-kind

As stocks are reduced, payments-in-kind should become a moot point. The payment-in-kind authorizations were put in place in the 1985 Act to circumvent the budget constraint in order to transfer more resources to farmers than the cash budget constraint would prevent. (When the U.S. Government gives away assets, this does not get recorded as a current budget outlay.) Generic certificates were used to implement these payments-in-kind because Congress refused to lower the release price on CCC and farmer owned reserve grain and cotton in the 1985 Act. The release price for Farmer Owned Reserve grain is 140% of the loan rate at which that grain entered the Reserve, and the release price on CCC owned grain is 115% of that release price. Given the much higher loan rates of the early 1980's, this means that CCC and FOR stocks would have been effectively insulated from the market in the absense of payments-in-kind via certs.

USDA's payment-in-kind authorities and the use of certs to implement them means that the administrators of ASCS, under the guidance of the Secretary of Agriculture, have been the principal determinants of short run commodity market liquidity and therefore, of short run market price movements -- until the drought took over this summer. I anticipate that a Republican administration would advocate removing the generic payment-in-kind certificate authority in the next Farm Bill because of philosophical opposition to bureaucrats having that much control over short run commodity market liquidity and therefore market price movements. Furthermore, other agencies within the Executive Branch have a great deal of concern about USDA's gaining the right to print money in the 1985 Farm Bill. (Generic certificates are dollar-denominated certificates, payable to bearer, fully negotiable, and, better than cash, they are backed by real goods.) Once we have moved through all the Farmer Owned Reserve and CCC inventories that had been accumulated under the 1981 Act, the issue of release price should also become less of a concern because 140% of the new loan rates will be much closer to expected market prices.

Crop and income insurance

An issue that the drought of 1988 will raise in future farm policy debate is crop and income insurance. While it is too early to tell what the final impact of this drought will be, I expect it to substantially increase the interest in crop insurance and why crop insurance doesn't work. Many will ask why we don't build a premium for crop insurance into the normal cost of production in such a risky business. We are also likely to see some reconsideration of the analyses done in the early 1980's concerning income insurance alternatives, such as the Canadian Western Grains Stabilization Schemes as a possible approach to future farm policy. A Republican administration would prefer to let the market work and insure against disasters like the 1988 drought through insurance market mechanisms. Nevertheless, no radical changes in farm policy instruments are likely in the short term.

OTHER COMMODITIES

Several other commodity programs merit comment.

Dairy and Sugar

A Republican administration is likely to press for continued reduction in the support price for milk as long as Commodity Credit Corporation net removals exceed 5 billion pounds of milk equivalent per year. That is, we would continue on the same trend as established in the 1985 Farm Bill with a 50 cent per cwt reduction in the support price each January 1st until excess supply falls below 5 billion lbs. This reduction will be delayed because of the drought, but a Republican administration is likely to press to get back on that formula starting in 1990.

The 1985 Farm Bill froze sugar support prices and mandated that sugar import quotas be reduced as much as necessary to ensure that U.S. market prices stay high enough to ensure no forfeitures of sugar under loan. A Republican administration would probably continue to advocate deregulation of the sugar market by letting the loan rate fall to somewhere below expected market clearing prices. But, unless the GATT Round results in a generalized liberalization of world agricultural trade, the precedents are poor for much reduction in sugar loan rates.

Other commodities

There are a number of other less costly commodities within the overall farm policy structure, such as peanuts, wool, mohair, honey and tobacco. The rhetoric will support greater deregulation, but the administration is likely to be more flexible in these commodities, particularly since they are less costly on budget. Being flexible on these commodities often helps administrations achieve higher objectives such as budgets, taxes, defense, or foreign policy issues. These commodity programs are always good stock in trade for acquiring votes in support of higher order objectives, so I would not expect high priority to be put on achieving deregulation in these commodities once concessions have been extracted in exchange for flexibility on them.

The one situation in which significant deregulation in these commodities would occur is in the context of an international trade agreement in which all countries agreed to cut the level of subsidies and the amount of intervention in agriculture trade in all commodities simultaneously. Otherwise I would not expect any great reduction in the level of assistance to these commodities.

OTHER ISSUES

Trade policy

A Bush administration could be expected to put high priority on progress in the multilateral trade negotiations to reduce production-distorting and trade-distorting agricultural subsidies around the world and to reduce agricultural trade barriers to the greatest extent possible. George Bush has already called for an international economic summit focusing on agriculture where he would press for a simultaneous, multilateral reduction in subsidies and trade barriers to agricultural products. Bush has made it clear that he would not advocate unilateral disarmament by the United States in agricultural policy, but he would be fully willing to negotiate a generalized reduction in agricultural subsidies and trade barriers to level the playing field around the world. He would fully expect the United States to participate by reducing its own subsidies and trade barriers in concert with other countries' reducing theirs at the same time.

Rural development

A Republican administration would view rural development as an important component of the long run solution to low rural incomes. It would see deficiency payments as only a short run band-aid to raise low rural incomes, not a permanent solution to problems of low income in rural America. Part of the savings from reduced commodity program payments might be channeled towards rural economic development. Rural economic development is needed to diversify the rural economic base to generate larger tax revenues and to create more off-farm employment opportunities in rural America. A Bush administration would likely advocate a joint local, state, and federal effort emphasizing education, including worker re-training, and investments in rural infrastructure in order to ensure that the necessary conditions are in place for rural economic development.

Research

A Bush administration would likely also press for some increase in research expenditures, particularly on new uses for crops and on alternative agriculture. Research would be viewed by a Bush administration as an important element in market development and in ensuring the long term international competitiveness of American agriculture.

Deficit reduction

Whoever is sitting in the White House in the next administration is going to have to address very seriously the question of deficit reduction. Farm program payments, which have been the fastest growing item in percentage terms in the federal budget in the first seven years of the 1980's will have to contribute to deficit reduction. There are too many other priorities of much greater concern to non-rural Congressmen that have been deferred in the 1990's while resources have been applied to farm income maintenance, export subsidies, financial stress, the drought, and bailing out the Farm Credit System. The need for deficit reduction will effectively prevent any increase in farm program costs in the early 1990's and will keep the pressure on to reduce the cost of deficiency payments, the largest component of farm program costs. So, in conclusion, the two forces which will have the greatest impact on the next Farm Bill will be the progress that has been made in Geneva in the trade negotiations and the pressure for U.S. Federal budget deficit reduction.

SUMMARY

In summary, I see no radical changes in farm policy instruments in the next Farm Bill regardless of who is elected President, but I would expect a Bush administration to advocate greater flexibility for farmers to respond to market signals by allocating their resources on the basis of expected returns. I would expect him to advocate removing artificial incentives to overproduction in inefficient or high cost producing areas here and abroad by aggressively seeking to reduce agricultural subsidies and trade barriers around the world. I would expect him to put considerable emphasis on rural economic development as an important means of addressing the problems of low income in rural America. And, if successful at negotiating lower subsidies and trade barriers simultaneously in all commodities around the world, then there would be a possibility of a faster phase down in the levels of some of these policy instruments or possibly of some restructuring of the policy instruments we use in order to decouple payments from production.

Two final points need to be made. One of these is that while the next administration will propose a new farm bill, the Congress will dispose. There is tremendous inertia in present farm policy, and there is great inertia in the membership of Congress, particularly in the House of Representatives. Members of Congress have a feel for how the present policy instruments work in practice, even if they do not like them. Congressmen tend to be very cautious about adopting new instruments which have never been tested in practice. Furthermore, the commodity organizations are generally content with the present policy instruments. Taken together, these forces provide inertia to continue the present measures, albeit at different levels. No matter who is President, the Congress ultimately decides on what policy instruments are authorized, and more of the same is the most likely outcome, with the levels of the instruments being the main items of debate.

Finally, the choice of Secretary of Agriculture will be an extremely important factor in future farm policy. While writing the 1985 Farm Bill, when the Congressional Agriculture committees could not reach consensus on a certain issue or on the level to set a policy instrument, they often provided discretion to the Secretary of Agriculture to use the instrument within broad parameters. Rather than take the political heat themselves for mandating the use of or for setting the level of those instruments, the Congress transferred the heat to the Secretary of Agriculture. I would expect the same thing to happen in the next Farm Bill when there will be a lot of issues that are just too politically sensitive for the Congressional committees to decide. So the next administration is likely to make its greatest imprint on policy in 1989-93 through its implementation decisions, not through radical changes in the policies themselves -- unless a major breakthrough occurs in the international trade negotiations.