1984

Agricultural policies

AGRICULTURAL STRUCTURAL ISSUES AND POLICY ALTERNATIVES FOR THE LATE 1980S

We are still more than six months from the convening of the 99th Congress and any serious consideration of new legislation to replace the expiring Agriculture and Food Act of 1981. But, we have already seen more interest and activity in that legislation than has attended any Farm Bill of recent memory. This widespread activity includes numerous conferences, special studies, and public engagement by foundations, think tanks, and academics, and intense preparation by the agricultural industry interest groups. It also extends to the Congress with Committee hearings and publications, and the Administration with listening sessions, special studies, and appointment of a Cabinet Council to develop proposals. These activities can be expected to increase and intensify in the months ahead.

This unusual interest so early largely derives from events and conditions that have combined to produce widespread dissatisfaction across the agricultural industry and beyond with the current farm and food policy. These conditions include:

- declining agricultural exports and worsening relations with our trading partners;
- declining commodity prices and farm incomes, and continued high real interest rates to which the capital intensive agricultural sector is highly sensitive;

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- o three years of declining farm asset values which, with reduced cash flow, have seriously eroded the financial position of many farm firms;
- o extraordinarily high farm program costs in a time of serious fiscal concern; and
- o administrative actions (e.g., the PIK program) that brought many new entrants whose interests were affected to the political process.

The predominant perception is that conditions remain poor, the programs are becoming more and more expensive, and yet policy is not leading to any longer term solutions.

There also is a relatively new element in this dissatisfaction--frustration arising from a growing awareness that forces outside of agriculture now are much more important to the agricultural economy than what can be determined by agricultural legislation. This is especially the case for macroeconomic policy, which is heavily influencing the value of the dollar and consequently influencing the competitiveness of our farm products in foreign markets, and interest rates which importantly affect farmers' production costs and cash flow requirements. Macroeconomic policy is beyond the scope of the Farm Bill, while at the same time the political establishment, both the Congress and the Administration, has shown little resolve for seriously addressing the issue.

The setting is further complicated by this being an election year, adding uncertainty as to the party occupying the White House in 1985 and the composition of the Congress, especially of the Committees most relevant to agriculture.

While 1985 may not be a watershed year or a critical crossroads for farm policy as we are wont to proclaim, it certainly is a time of unusual circumstances in which to be developing new legislation that will largely determine the policy direction through the remainder of the 1980s.

Other Complicating Factors and Issues

Even beyond these circumstances, there are other factors and issues complicating farm policy development at this particular point in time. These include:

- o an outmoded rationale for large-scale government intervention or public assistance--the absence of a more modern context in which to justify programs and provide policy direction;
- o seeming inability to come to grips with the instability issue;
- o increasing financial stress on some farms;
- o the reemergence of excess production capacity; and
- o a greatly changed farm structure that is a concern in itself, as well as how it affects program effectiveness and equity of benefit distribution.

The Outmoded Rationale

The historical rationale for large public sector involvement in agriculture is outmoded. It is no longer particularly strong or very convincing to the nonfarm public and an urban Congress.

The original rationale or justification for the farm programs begun in the 1930s was to improve the economic circumstance of the farm population. At that time, almost one-fourth of the population resided on the almost seven million farms. The farm sector was relatively homogeneous. There was little size difference among the vast majority of the farms. The incomes of farm people were scarcely 40 percent of incomes of the nonfarm population, and farmers were almost entirely dependent on farming for their livelihood. Rural areas did not enjoy access to the services and infrastructure available to the urban areas. Government programs thus were justified and received public support because such a large proportion of the nation's population needed public assistance.

The situation is far different today. Farm people comprise less than 2.5 percent of the population on 2.4 million farms. Their incomes in most years are closely commensurate with their nonfarm counterparts. Long run returns to farm businesses are not appreciably different from nonfarm investments. Substantial income is earned from nonfarm sources, greatly reducing the income disparity within the sector itself. And, rural areas have access to services comparable to metropolitan areas.

These changes over the past 50 years are bringing more critical scrutiny to the justification for large taxpayer transfers to the farm sector. Increasingly, nonfarm groups are pointing out that if farm incomes are no longer chronically low relative to the rest of society, why do we need to continue the large subsidies to the sector? Or, with all the emphasis on reducing federal spending and the budget deficit, how can we any longer justify the large Treasury outlays for farm programs? Farm interest groups have for so long cloaked themselves in the old time rhetoric of saving the family farm that they are unprepared to respond with a new broader-based rationale. The result is that the farm programs will be an inviting target in any broadly based effort at fiscal restraint in the next Congress.

Sector Instability

There is considerable evidence to suggest that as our dependence on foreign markets has grown from the early 1970s, the sector is subject to more instability which traces out to affect much of agribusiness and the food system. The sector is now vulnerable to abrupt market changes resulting from shifts in foreign supply and demand due to global weather, world economic conditions, and policy shifts by foreign governments, in addition to the inherent instability in domestic production and markets.

Ameliorating the impacts of this instability is frequently suggested as a strong rationale for government involvement in the sector. While this may be the case, it has yet to be fully and sufficiently developed. There still is no common agreement on what is meant by instability, let alone what the appropriate role of government in treating it might be, or who is intended to benefit from protection against instability from the external sources.

Farm Financial Stress

At the same time that the fundamental justification for continuation of the farm programs is being increasingly questioned, financial stress in the farm sector is emerging as a serious issue, being more widely discussed than at any time since the 1930s. Bankruptcy sales, forced liquidations, and the rising rate of farm business failures are receiving wide publicity and growing attention in the Congress.

Much of the current stress has its roots in the boom times of the 1970s and the conditions and expectations they created. Many farmers made investments whose success depended on continued high commodity prices, relatively rapid inflation, and low real interest rates.

But, those expectations were not realized. The global recession beginning in 1980 dampened demand and commodity prices, and farm income failed to advance. Land prices began falling, and quite sharply in some areas. These developments produced serious financial difficulties for a number of farmers, and heightened the concerns of lenders serving them.

The situation is indeed serious for some number of farmers. But, we still do not have fully complete information on the extent of the problem nor the consequences if left untreated. Some suggest that it is pervasive across the sector, constituting a "farm crisis"; others contend that the financial stress affects particular farmers, but is not a crisis engulfing the entire sector.

The nature of the problem does seem to make clear that commodity programs are not the remedy. Those farmers in the most serious difficulty would be little helped by even the most liberal commodity programs. Any such moves would only provide benefits to those not needing them, and bring all the other consequences that now are so familiar.

But, the danger is that without fully elaborating the problem and determining how extensive it is, the Congress could be stampeded into treating the problem in broad-brush fashion--such as higher price and income supports or broad-scale credit concessions--that would prove to be largely ineffective, very costly, and probably counterproductive in the long run.

Overcapacity

Another of the complicating factors is the reemergence of overcapacity in the sector, a familiar problem with which policy for the late 1980s will have to contend. The extent of this largely hinges on the strength of the export market and weather patterns. There appears to be a consensus that even as economic recovery spreads to the rest of the world, the rate of growth in world trade and specifically in U.S. exports in this decade will not return to the rate of the 1970s. The financial problems of much of the developing world (the growth markets) and the high value of the dollar are strong drags on growth. Most prognostications suggest U.S. agricultural export growth to average three to four percent annually, only about one-third the rate of the 1970s. But, even with the slower growth, the farm sector will become increasingly dependent on foreign sales since domestic consumption will grow only slowly.

The result is that with continued productivity gains we will have the ability to annually produce more than the combined domestic and export market demands.

The Current Structure

One of the major complicating factors that subsumes several issues--the outmoded rationale, program cost, equity of programs, efficiency, and others--is the current structure of the sector. It has evolved to the point essentially of having two distinct groups of farms--a relatively small number of commercial farms that produce the bulk of the nation's food and fiber and a relatively large number of farms accounting only for a small proportion of the aggregate farm output.

Consider the characteristics of one delineation of the two groups (1982 data), well known but worth repeating:

	Larger Farms (Over $40,000 Gross Sales)	Smaller Farms (Under $40,000 Gross Sales)
Number	700,000	1,700,000
Percent of All Farms	29	71
Percent of Total Output	88	12
Percent of Net Farm Income Earned	100	(Losses)
Average Assets Per Farm	$1,000,000	$190,000
Percent of All Farm Assets	69	31
Average Net Worth	$800,000	$170,000
Average 1982 Net Income	$45,000	$18,000
Percent of Total Off-Farm Income	20	80

But, even within the groups (however delineated) there is wide diversity. Many farms have no debt while others have debt-to-asset ratios exceeding 70 percent. It is difficult to make any generalizations about the groups, and especially about the farm sector as a whole.

It is increasingly clear that very small farmers do not need or use commodity programs. The larger farmers who are well off by almost any measure receive the majority of program benefits, both directly and indirectly. But, there remain some mid-size farms who would be unlikely to survive without the programs. This gives rise to the equity issue, likely to be a significant one especially concerning programs for larger farmers. In fact, there appears a growing sentiment to move away from the universal approach and toward more carefully focused programs with benefits for those adjudged to most need them.

Lessons From 50 Years

As we look to the 1985 Farm Bill, another complicating factor is how well the programs have worked over 50 years and what lessons we have learned.

When one compares the rhetoric and justification for the farm programs with the results, the record is bleak. If saving the family farm was the objective, then the results are pretty clear. If comparability of incomes was the objective, then the results are pretty clear there as well. Both the higher average incomes and reduced disparity among incomes of farm people are largely the result of expanded off-farm earning opportunities. D. Gale Johnson recently presented an assessment of the programs after 50 years citing seven specific lessons. He generally concludes:

> The strong implications of these lessons, both individually and collectively, is that price supports, deficiency payments, output quotas and supply management contribute little or nothing to the long run rate of return to farm resources.
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> And increasing the price of land through higher prices transfers wealth to those who own the land when the prices are increased. After a program of higher prices is in effect, the rate of return on assets is the same as before. The only difference is that more capital is required to have an economic sized unit. It has never been clear to me why there was any significant social gain created by increasing the price of land or why we wished to have policies that increased the amount of

capital required for a farm of sufficient size to provide farm people with the same real income as comparable nonfarm people.

There are valuable lessons from such assessments, and more appropriate than ever when we consider the current structure and heterogeneity of the sector today. They are especially relevant for consideration of methods to alleviate the farm financial stress problem and for modifying commodity programs in the 1985 bill.

The General Alternatives

Even though the debate on the 1985 Farm Bill is far ahead of the traditional schedule, there are few areas on which consensus is emerging. There have been calls for radical new approaches to replace the 50-year old programs, but none has emerged with any strong political support. Likewise, sufficient political support appears unlikely for more familiar extremes such as complete abolition of the programs (free market agriculture) or for mandatory production controls and high support prices.

With so many uncertainties, both political and economic, it is far too early to predict the most likely policy direction with any reliability. Farm policy has always tended to be evolutionary, more responsive to prevailing economic conditions than to partisan politics, and 1985 is unlikely to be exceptional. This allows one to conjecture a bit about the range of economic circumstances that could condition the 1985 debate.

Abel and Daft have recently sketched the extremes, suggesting that if by some magic we should enter 1985 with declining interest rates and a weakening dollar, rising farm exports, rising commodity prices and farm incomes, and prospects for declining farm programs costs, the pressure for radical changes in policy and the level of consternation would be greatly reduced. In that event, emphasis would likely center on modifying current instruments:

- o increasing the flexibility of loan rates for greater responsiveness to market conditions;
- o increasing the flexibility of target prices, and perhaps focusing the benefits on medium-size farms (however defined); and
- o finding ways to increase the effectiveness of land retirement programs, and perhaps implementing multi-year diversion with greater emphasis on soil conservation.

At the other extreme, and with a somewhat higher probability, we could go into 1985 with large crops and weak commodity prices, farm income stagnant and the financial stress growing, high interest rates and a continued strong dollar, and prospects for continued high program costs. This situation would produce a highly charged debate and an uncertain outcome. Relevant questions then would include:

- o how to provide income support yet hold down budget costs;
- o how to support prices but avoid reducing competitiveness in foreign markets;
- o how to allow asset values to seek equilibrium without major disruptions in the farm credit market; and
- o limiting program benefits but keeping voluntary production controls viable.

Regardless of farm economic conditions, there is a high likelihood of a "deficit reduction steamroller" appearing in the next Congress. Budget considerations could in effect determine the agricultural policy outcome. This could encompass a bill finally emerging from the Congress but vetoed for being too costly and then a one-year extension of current law or even reversion to basic legislation. Or, we could see a situation in which farm interests, faced with getting nothing at all, are forced to accept major reforms. Or, with such disarray, we could see some creative new approach emerge.

The first extreme--the favorable one--at this time seems unlikely while the other one is more plausible. The conditions coupled with strong emphasis on reducing the budget deficit would appear to bode for considerable disarray in the 1985 debate.

References

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