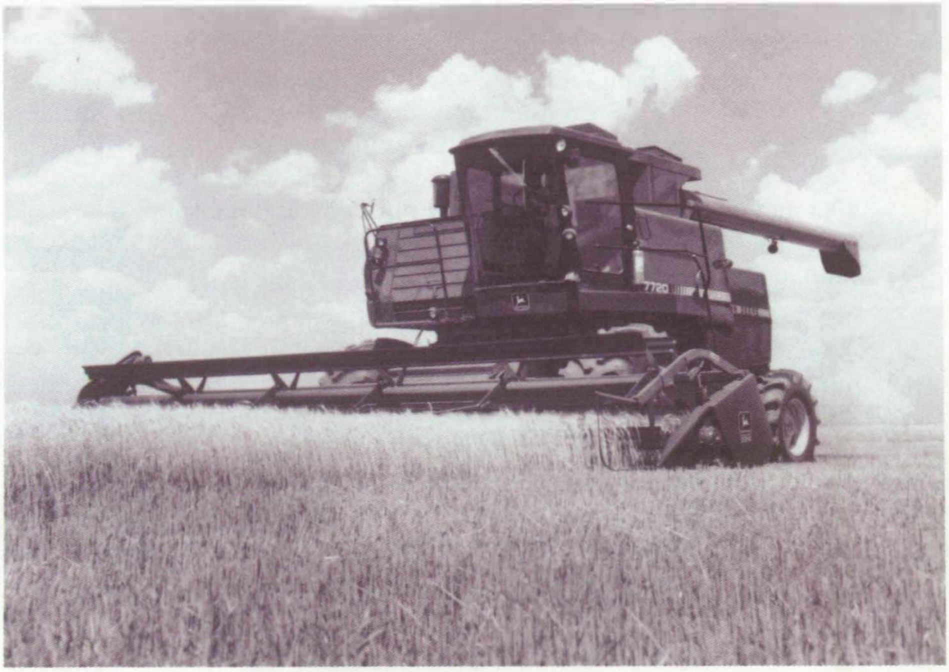
Government Wheat Programs

Kenneth W. Bailey and Joy L. Harwood
(202) 786-1840

Wheat is used in bakery products, noodles, pasta, and feed for livestock. Even though this "staff of life" is a basic food commodity, few consumers understand the intricacies behind its production and marketing. The Federal Government's wheat program plays a big role in determining how much wheat farmers grow and the income they receive. The current program has its roots in the Agricultural Adjustment Act of 1938, which was the first comprehensive price support legislation with nonrecourse loans. The Food Security Act of 1985 is the most recent piece of major farm legislation. An update is expected in 1990.

Two major objectives of the 1985 Act were to make the United States more competitive in world agricultural markets and to continue supporting farm income. Two facets of the Act, lower loan rates and export promotion programs, have increased U.S. competitiveness in the international wheat market. Target prices and deficiency payments, which cushion the impact of falling wheat prices during the transition to a more competitive environment, have helped support wheat producers' incomes.

The 1985 Act continues Federal provisions for nonrecourse loans, target price protection, and acreage reduction. The law came at a time of falling wheat exports, large stock buildups, and declining farm incomes. Provisions designed to make U.S. prices more responsive to world market conditions include: a more market-responsive loan rate, generic certificates, and various export promotion programs. The law gives the Secretary of Agriculture greater flexibility in setting loan rates to meet foreign competition.



National Association of Wheat Growers

Producer loans continue as a part of the wheat program. These loans are nonrecourse since a farmer may pay off the loan with interest or forfeit the grain to the Commodity Credit Corporation (CCC). The "basic" loan rate for crop years 1987 through 1990—running from June 1 to May 31—is set between 75 and 85 percent of a 5-year moving average farm price, dropping the high and low values. However, this rate cannot be reduced by more than 5 percent from the previous year. The Secretary has authority to reduce the basic loan rate an additional 20 percent to encourage exports and prevent stock buildups. The announced loan rate declined from $3.30 per bushel for the 1985 crop to $2.06 for the 1989 crop.

The 1985 Act also continues target prices. For wheat, they were frozen at $4.38 per bushel for crop years 1986 and 1987 and then declined slightly to $4.23 in 1988 and $4.10 this year.

Participating producers are eligible to receive deficiency payments at a rate equal to the difference between the target price and the higher of the loan rate or the national average farm price during the first 5 months of the marketing year (June through October). A producer's deficiency payment is determined by multiplying the payment rate—target price minus loan rate or market price—times the eligible quantity. The amount of wheat eligible for deficiency payments is calculated by multiplying the program yield and the permitted acreage. *(Program terms are defined in the Glossary.)* Payments can be made in cash or generic certificates *(see box).*

The 1985 Act changed the way program yields are determined. In the past, farmers were able to use an average of actual yields to determine their program yields. Under the 1985 Act, however, program yields are calculated as the average program yield on the farm during crop years 1981-85, excluding the years with the highest and lowest yields. As a result, program yields have been effectively frozen.

Bailey, on leave from ERS, is working at the Food and Agricultural Policy Research Institute, University of Missouri at Columbia. Harwood is an agricultural economist with the Crops Branch, Commodity Economics Division.

In order to receive deficiency payments, producers must cut back on the acreage they plant if supplies are expected to be excessive. Under the 1985 Act, USDA has announced an acreage reduction program (ARP) for wheat each year. For crop years 1987-90, if projected stocks of wheat for the beginning of a crop year are 1 billion bushels or less, the ARP cannot exceed 20 percent of the crop acreage base. If beginning stocks are projected to exceed 1 billion bushels, the ARP must be at least 20 percent. The ARP for wheat was 22.5 percent in crop year 1986 and 27.5 in 1987 and 1988. The Secretary lowered the ARP to 10 percent for the 1989 crop because beginning stocks were expected to be below 1 billion bushels.

If supplies are projected to be excessive even with an ARP in effect, the Secretary can also offer producers a paid land diversion. Farmers can voluntarily take more land out of production—10 percent of their crop acreage base, for example—and receive a payment in return. Winter wheat farmers were offered $2 per bushel in 1986 to reduce their acreage an additional 5 or 10 percent. Another program that takes land out of production is the Conservation Reserve. New with the 1985 Act, the program is designed to help farmers save their highly erodible cropland. *(See Federal Corn and Sorghum Programs for a full description of the Reserve.)*

Generic Certificates

Generic certificates are a new feature of the 1985 Food Security Act. They are used in lieu of cash to pay farmers for participating in numerous Government programs including acreage reduction, paid land diversion, the Conservation Reserve, disaster, and emergency feed programs. Generic certificates have a fixed dollar face value and an 8-month life, beginning at the end of the month they were issued. They are called generic because they can be exchanged for a variety of commodities from the Commodity Credit Corporation.

The 1985 Act allows producers to sell or transfer certificates to others. Producers benefited when certificates sold for more than their face value. That was the case between the spring of 1986, when certificates were first issued, and the spring of 1988. Certificates then sold at a discount or near par until July 1989. Between July and September 1989, they again sold for more than face value.

Programs Affecting Wheat Exports

A number of export programs were implemented or continued under the Food Security Act. Among them, the Export Enhancement Program, CCC credit guarantees, and food aid programs have substantially contributed to U.S. wheat export volume. These export programs have been important because the U.S. dollar has not depreciated significantly in some important overseas markets and because some countries continue their export subsidies while other importing nations erect trade barriers. These export programs have helped U.S. wheat exporters compete.

The Export Enhancement Program (EEP), announced in May 1985, helps U.S. exporters compete in specific markets with other countries' subsidized exports, particularly those from the European Community *(see box)*. Through July 14, 1989, about 61 million metric tons of wheat were sold under this program. That represents approximately 50 percent of U.S. wheat exports in fiscal 1986 and over 60 percent in 1987, much of which was financed by CCC credit guarantees.

The CCC also operates two export credit guarantee programs, GSM-102 and GSM-103. Under the Short-Term Export Credit Program (GSM-102), the CCC guarantees repayment of the private credit extended to importers in specified countries for the purchase of designated U.S. agricultural commodities. GSM-102 covers credit extended for up to 3 years. The Intermediate Export Credit Guarantee Program, or GSM-103, is similar except it covers private credit extended for 3 to 10 years. These programs work in conjunction with EEP and allow importers in some countries to receive help in purchasing commodities through commercial channels.

Since passage of the 1985 Act, U.S. wheat exports expanded from 915 million bushels in the 1985/86 marketing year to a high of 1.6 billion in 1987/88 *(table 1)*. (Like the crop year for wheat, the marketing year runs from June 1 to May 31.) The U.S. share of the world wheat market likewise grew from 27 percent in 1985/86 to 42 percent in 1988/89. Before crop year 1986, U.S. export prices were propped up by the loan rate regardless of world market conditions. The lower loan rate and EEP allow U.S. exporters to be competitive.

The use of generic certificates and wheat auctions also significantly contributed to the export expansion. Prior to passage of the 1985 Act, the CCC could not sell stocks in domestic commercial markets unless farm prices reached a specified CCC release price. During 1986-88, however, generic certificates and wheat auctions were used to release CCC stocks onto the market to meet strong export demand, despite farm prices well below the CCC release price. Beginning November 6, 1987, certificate holders could exchange their certificates at an accepted bid price for CCC-owned

The Export Enhancement Program

Under the Export Enhancement Program (EEP), the Commodity Credit Corporation (CCC) provides bonuses to U.S. exporters to enable them to meet prevailing world prices for commodities to destinations targeted by the CCC.

EEP employs a two-step, competitive bid process that helps American exporters compete, while minimizing bonuses awarded from CCC stocks. Initially, the CCC targets a country for a specific quantity of a commodity. U.S. exporters then compete for the sale, knowing they might have the opportunity to obtain a CCC bonus. The exporters make a sale contingent on receiving a CCC bonus and then bid against each other for the bonus. The CCC evaluates sale prices and bids to see if they fall within an acceptable range, and then awards the bonuses. Exporters who receive a bonus in the form of a generic certificate may then sell the certificate or exchange it for CCC stocks.

In the program's first year, North African and Middle Eastern countries were the primary wheat purchasers. Those regions now account for one-third of all EEP wheat sales. After the first year, the program expanded to other countries, such as the Soviet Union and China.

Almost half of all EEP wheat sales have been directed to the USSR and China. In 1987/88, the United States sold 8.8 million tons to the Soviet Union and 4.9 million tons to China. EEP sales to China increased in 1988/89, but relatively lower feed grain prices encouraged Soviet importers to purchase more corn and sorghum—without EEP bonuses—than wheat under EEP.

Table 1. Wheat Exports Rose to 1.6 Billion Bushels in 1987/88

Item	Marketing year[1]				
	1984/85	1985/86	1986/87	1987/88	1988/89[2]
	Million bushels				
Supply	4,003	3,866	4,018	3,945	3,095
Beginning stocks	1,399	1,425	1,905	1,821	1,261
Production	2,595	2,425	2,092	2,107	1,811
Imports	9	16	21	16	23
Utilization	2,578	1,961	2,197	2,684	2,397
Domestic	1,154	1,046	1,193	1,092	973
Food	651	674	698	726	727
Seed and industrial	98	93	84	85	103
Feed and residual	405	279	411	281	143
Exports	1,424	915	1,004	1,592	1,424
Ending stocks	1,425	1,905	1,821	1,261	698
Commercial	390	707	359	511	221
Farmer-owned reserve[3]	657	596	632	467	287
CCC inventory	378	602	830	283	190

[1]The crop and marketing year for wheat runs from June 1 to May 31. [2]Estimated. [3]Includes quantities in the special producer storage loan program.

wheat. Exchanges were heaviest during the initial months of the auctions, but dropped sharply after April 1988 because that year's drought greatly reduced stocks. A monthly average of 64 million bushels was sold between November 1987 and March 1988. Between April 1988 and February 15, 1989, monthly sales averaged 0.5 million bushels.

Program Impacts on Wheat Producers

The Food Security Act of 1985 provides income protection to participating wheat producers through deficiency payments. Participation in the program grew from 60 percent of the national wheat acreage base in crop year 1984 to a high of 87.5 percent in 1987. Several factors prompted this rise. For one, those who participated earned more than those who did not. Large surplus stocks and a drop in the loan rate caused nonparticipant returns to fall dramatically. Returns to farmers participating in the program were cushioned by rising deficiency payments, despite stringent acreage reduction requirements, since target prices were frozen at 1985 levels in 1986 and 1987.

Generic commodity certificates also contributed to greater participation. Normally, when prices are below the loan rate, farmers put their grain under loan for 9 months and pay storage costs. With certificates, however, they can put grain under loan, redeem those loans immediately with commodity certificates, and market the grain, thus avoiding storage costs. Generic certificates provide a mechanism for moving wheat stocks into commercial channels. This increased the price risk to nonparticipants, since the loan rate no longer set an effective price floor in the domestic market. Certificates increased loan placements and effectively prevented producers from forfeiting wheat to the CCC, thereby reducing CCC stock buildups.

Also influencing participation is the way the 1985 Act changed the definition of a farm's crop acreage base. Under the Agriculture and Food Act of 1981, a farm's wheat base equaled the number of acres planted and "considered" planted (idled under Government programs) during the previous year. A farm's wheat acreage base is now calculated as a 5-year moving average of planted and "considered" planted acres. In other words, under the 1985 Act, producers who do not participate for a year can only increase their crop acreage base by 20 percent of the additional acres they planted that year.

Government payments rose dramatically under the 1985 Act, but have declined in recent years as U.S. agriculture moved toward greater competition and less burdensome stocks. The market value of production fell 32 percent between marketing years 1985/86 and 1986/87 due to the drastic reduction in loan rates that allowed market prices to fall to $2.42 per bushel from $3.08 in 1985/86. Deficiency payments, however, increased from $1.5 billion in 1985/86 to $3.5 billion in 1986/87 because of lower farm prices, a frozen target price, and higher participation in the wheat program *(table 2)*. The income support provided by deficiency payments and other program benefits prevented a substantial decline in wheat producers' net farm income in 1986/87 and again in 1987/88.

Government payments as a percentage of gross farm income increased from 24 percent in 1985/86 to 43 percent in 1986/87, declining slightly to 40 percent in 1987/88. However, the percentage is expected to drop to near 20 percent in 1988/89. This is due to lower deficiency payments, which are projected to fall over 60 percent between 1987/88 and 1988/89 because of smaller world stocks, stronger world demand, and the 1988 drought, all of which pushed world wheat prices up.

Table 2. Wheat Program Participation Increased in 1987/88

Item	1984/85	1985/86	1986/87	1987/88	1988/89[2]
	Marketing year[1]				
	Million acres				
Acreage					
National base	94.0	94.0	92.2	91.8	91.7
Acreage reduction	9.1	11.9	15.8	20.2	19.2
Paid land diversion	5.6	6.9	3.9	—	—
Conservation reserve	—	—	0.6	4.2	6.9
Total planted	79.2	75.6	72.1	65.8	65.5
Harvested	66.9	64.7	60.7	56.0	53.2
	Bushels per acre				
Yield	38.8	37.5	34.4	37.7	34.1
	Dollars per bushel				
Prices					
Target price	4.38	4.38	4.38	4.38	4.23
Loan rate	3.30	3.30	2.40	2.28	2.21
Average farm price	3.39	3.08	2.42	2.57	3.72
Deficiency payment rate	1.00	1.08	1.98	1.81	0.69
	Million dollars				
Income	10,860	9,720	8,900	9,029	8,768
Market value of production	9,129	7,374	5,044	5,415	6,739
Government payments	1,731	2,346	3,856	3,614	2,029
Deficiency	1,050	1,540	3,457	3,292	1,305
Diversion	507	648	227	—	—
Conservation reserve	—	—	0	210	391
Other[3]	174	158	172	112	333

— = not applicable. [1]The crop and marketing year for wheat runs from June 1 to May 31. [2] Estimated. [3]Includes Farmer-owned reserve storage payments and disaster payments.

Program Impacts on Flour Millers

By lowering average farm prices in 1986 and 1987, the Food Security Act reduced the price millers pay for wheat. Over the short run, lower prices likely enhanced the profitability of milling operations. However, because flour milling is an extremely competitive business, profits were probably short lived. Bakers often change their flour suppliers from year to year. Often the lowest-price, highest-volume operation gets the business.

The 1985 Act's expansion of flour exports also affected millers, even though such shipments typically account for less than 10 percent of the total U.S. flour supply. Flour exports help millers maintain a level of profitability that would otherwise be difficult.

While millers have benefited from the Act, the greatest asset to these processors in the 1980's has been the growing consumer demand for flour-based products. Per capita consumption of flour in the United States was 128 pounds in 1988, the highest mark since the early 1950's and 11 pounds over the 1980 level. The growing health-consciousness of consumers, an increase in consumption of flour-based frozen meals like lasagna, the jump in sales from in-store bakeries and restaurants, and the greater variety of flour-based products all helped raise consumer demand.

Effects on Consumers

The lower wheat prices enjoyed by millers in 1986 and 1987 had little effect on retail prices for wheat-based foods. The amount of wheat needed to produce a loaf of bread usually costs less than 10 percent of the retail price. Processing, packaging, and distributing account for most of the cost of cereal and bakery products.

Increases in retail prices for wheat-based foods since passage of the 1985 Act appear to be demand driven. Overall, retail prices of baked goods have been relatively stable, even though the prices of popular items have risen substantially. For instance, the retail price of white bread rose 18 percent between 1980 and 1988, although it fell between 1986 and 1987. The prices of two other popular items—french and whole wheat bread—increased substantially between 1980 and 1988, 40 and 29 percent, respectively. ■

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