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EMERGING POLICY ISSUES

(By Dr. Don Paarlberg, Director of Agricultural Economics, USDA)

The newly elected Congress will soon be in town. One of their first tasks will be legislation for the major farm commodities.

Legislation is expiring for wheat, corn, cotton, rice, wool, and Public Law 480. Also expiring is legislation that permits base plans for Class I milk. There may be an effort to require the building of a food reserve. In addition, there may be efforts to legislate a sugar program. And there may be revived efforts to change the peanut program, although that is permanent legislation. There may also be an effort to change the tobacco program, which is permanent legislation.

Rather than plunge directly into a discussion of the issues before us, I shall first sketch out the present position and how we got there. We may learn something by going through this process.

We got into legislation for farm commodities more than 40 years ago, during the Great Depression. The diagnosis, correct at that time, was that American farmers could not make a profit at the then-prevailing world prices. Our costs were too high and prices were too low. The prescription was to raise the level of farm prices for the major crops. This objective was pursued by restricting production.

We thus deliberately boosted domestic price levels above prices prevailing in the world market. The results, pursued for 40 years, were these:

1. We priced ourselves out of world markets and denied ourselves the market growth that might have been ours.
2. Our artificially-boosted prices speeded up the advance of technology and increased yields, making necessary deep acreage cuts. In 1972 we held out of production 62 million acres; 18 percent of our cropland.
3. Acreage limitations were painful, and mandatory restrictions proved unacceptable for most crops. So we began paying farmers for nonproduction. In 1972 these payments totaled $3½ billion.
4. The disinclination to accept tight supply controls resulted in piling up large carryover stocks, which hung over the market. The result was a large measure of market stability, essentially at the support level. The price floor tended to become the ceiling.
5. Such farm benefits as the system generated tended to accrue to the producers on a per-bushel or a per-bale basis, thus conferring its greatest help to the large producers whose incomes were already above the average farm and nonfarm level.
6. The system did indeed hold farm prices above competitive levels.

Now I shall make a subtle but very important point. We economists read from Alfred Marshall (and most of us believe it) that in the long run the price of a commodity tends to equal its cost of production. As we were taught this principle, we came to think that causation lay with production cost, and price was the result. But the experience of 40 years teaches us that causation can flow in the opposite direction—that a price held substantially above competitive levels for a long period can bring about an increase in production costs. How does this happen? The use of resources at less than capacity is inefficient, and increases costs per unit. Artificially high commodity prices became capitalized into land values, a benefit to the generation on the land when the law was passed but a cost to those young people who wanted to start farming. Thus, after the elapse of some years, costs mounted up to meet the artificially high prices, negating much of the intended effect.

There came growing dissatisfaction with this system. But we had become very dependent on it. It was clear to most, if not to all, that abandonment of the program would result in excessive supplies, sharply-reduced prices, depressed farm incomes, and a severe drop in land values. We were afraid to dismount from the tiger. Regardless of whether or not it had originally been true, the diagnosis of 40 years ago—that American farmers could not compete in the export markets at world prices—had become self-fulfilling.

This was the situation when the Congress passed the Agricultural Act of 1973. The major commodities treated by that Act were wheat, feed grains, and cotton. The central features of the Act were these:

1. Target prices and a deficiency payments scheme were substituted for the earlier plan of supporting prices directly.
2. A large measure of discretion was provided to the Secretary of Agriculture with respect to production controls. There was provision, at the option of the Secretary of Agriculture, for setting aside considerable acreage from which no crop could be harvested, in the event that supplies became excessive. Also the legislation gave discretion in setting loan rates.

Thus the Act embodied what has come to be known as "market orientation." It was passed with support from both political parties and with concurrence on the part of both the Executive and the Legislative branches.

The President signed this Act into law. Scarcely was the ink dry before there occurred a series of phenomenal and unforeseen events. Poor crops in the world, plus a worldwide inflationary upsurge, carried farm prices far above the loan and target levels. The Secretary of Agriculture used the authority given him by the Congress to suspend acreage controls. Thus our agricultural policy became market-oriented. *Without intending to do so, and without major confrontation, and with relatively little pain, we were escalated out of a policy we had pursued for 40 years!*

I have spent many years contemplating how we might disengage from our restrictive agricultural policies. But I had never envisioned the scenario that actually occurred. We dismounted from the tiger with less of a jolt than most expected.

Consider for a moment how good the experience has been, associated with the removal of restrictions. (Note that I say "associated with" rather than "caused by." The distinction is relevant; there were multiple causes for the events of recent years.)

Farm incomes during the 4 years of "market orientation" averaged, in real terms, 4 percent above the level of the 4 years preceding.

Agricultural exports, during these 4 years averaged, in tonnage, 46 percent above the previous 4 years. These exports helped generate the foreign exchange with which to pay for our oil imports and helped keep the dollar strong.

Taxpayers have been relieved of the burden of paying for non-production.

Consumers welcome full production, which they rightly associate with an abundant supply of food.

Business firms welcome the larger volume associated with current policies.

Laboring people favor the additional jobs that come from full resource use.

Of course, the policy change did not occur for certain crops: peanuts, tobacco, or long-staple cotton. And it occurred only partially for rice. But it did occur for the major crops.

Most people are now convinced that we *can* compete in world markets with the major crops. Our endowment in soil, climate and topography is the world's best. Our farm people are unexcelled in the level of their technology and in their managerial skill. Our institutions—credit, education, research, transportation, and marketing—are the envy of virtually all our foreign visitors.

This new feeling, that we *can* compete, can also be self-fulfilling. It can lead to actions that bring about the assumed postulate. Such is the power of an idea!

This is the setting within which the Agricultural Act of 1977 comes up for consideration.

The critical question, as I see it, is whether we continue with a market-oriented policy or whether we revert to artificially-high prices, burdensome surpluses, and production controls. As you can judge from my comments, I think it is important that we continue the course upon which we have ventured.

I think it is unlikely that we would *deliberately* return to the policies from which we have now escaped. Consider the good experience we have had in agriculture under the new policy. Consider that we have just come through a Presidential campaign in which neither of the candidates advocated production controls. Consider that the remaining advocates of the old order have been reduced largely to the producers of tobacco, and a few other crops, plus some dedicated control advocates among the producers of wheat, corn, and cotton. Consider the growing power of the consumers, who are unlikely to support a return to limitations on output. Consider that concern about the adequacy of food supplies is still widely prevalent, and finds reduced production ideologically objectionable.

If we revert to the policies we have just escaped, it is likely that we do so *unintentionally*. We escaped from them unintentionally; we might again embrace them the same way!

This is how it might occur:

1. Out of a desire to help farmers, we might get the loan levels and the target prices too high.

2. We might thus price ourselves out of world markets and again pile up surpluses.

3. To minimize such a pileup and to avoid the costly payments associated with excessively high target prices, we might again feel impelled to restrict output.

We would then come full cycle and, without wishing to do so, return to the programs from which we have escaped.

How might such a development be averted?

On the one hand are those people who fear that any increase in loan levels, and in target prices could plunge us back into surplus stocks, acreage restrictions, and costly payments. On the other hand are those who think the targets and loans are far too low and should be sharply increased.

Fortunately there is room for compromise. The inflationary surge of the last 4 years has carried prices substantially and, I think, permanently, above the levels that prevailed before the economic storm struck. The trick will be to get the loans and the target prices up to levels high enough to provide assurance against temporary and unwarranted sharp price declines, and yet keep them low enough so that we don't back into the problems from which we have escaped.

And the finding of this optimum point should not be an issue with farmers on the one hand and non-farmers on the other. Farmers have an interest in discovering this optimum level. For that matter, non-farmers have a similar interest. Both city and farm people would lose from tight-fisted policies that deny safeguards to farm people on the one hand and open-handed policies that lead to a return to old programs on the other.

The Department of Agriculture will be working hard during coming months, trying to identify optimum levels for both loans and target prices. And we shall consider both the short-run and long-run aspects of the question.

What I am saying is that the politics of confrontation, which characterized farm policy debates for so many years should not be revived for the Agricultural Act of 1977. Farmers and non-farmers alike would only lose.

There is another—and related—issue to which I shall adress myself before concluding. That is the matter of grain reserves. My comment is that there is ample authority, already in the law, to serve the public interest so far as grain reserves are concerned.

Under present legislation and with the options available under the charter of the Commodity Credit Corporation, it is possible for the Secretary of Agriculture to:

—Provide incentives to farmers to carry stocks of grain under their own ownershp.
—Provide incentives to the commercial trade to carry grain, under commercial ownership.
—Purchase and hold grain for the account of the Government.
—Establish loan programs at such levels as to increase the likelihood of Government takeover.

Furthermore, there is authority for the U.S. Government to work out, with other countries, an international system of nationally held grain reserves. This has been attempted but has not been successful.

The Secretary of Agriculture also has authority to use a variety of programs to move grain into use overseas:

Market promotion.
Public Law 480.
CCC credit.

This is a formidable arsenal of tools.

My point is that a Secretary of Agriculture can use these tools, flexibly, in accordance with events as they develop. It is my belief that this can be done better, on a discretionary basis in line with economic events, than can be prescribed, beforehand, by the Congress, making decisions before the relevant evolving facts are known.

The Secretary of Agriculture will continue to be subject to pressures from all sides—from advocates of high prices and from advocates of low prices; from pro-storage people and from anti-storage people. It is my view that the rival views on these matters are now more nearly balanced than they have been hitherto, and that a Secretary of Agriculture is likely, in this circumstance, to come fairly close to representing the broad public interest.

As to whether the Congress can specify beforehand, just what our stock-management policies should be, I am inclined to be doubtful. My many years as a member of the Board of Directors of the Commodity Credit Corporation, trying to operate within the specifics of acquisition and release as enacted by the Congress, leaves me with some justified misgivings.

We hear much, these days, about the "Genesis Strategy" drawn from the experience of Joseph in Egypt, over 3,000 years ago, when he laid up supplies out of the seven years of abundance for use during the seven years of short crops that followed. This is a fine story, and it worked out well. It should point out, however, that Joseph had an advance, private long-range crop report from the highest possible authority, the Lord Himself. There is no evidence that the Members of the Congress are on similar terms with the Deity.

The summation of this statement is that we have been wise or fortunate, or both, in escaping from the programs of the past. If we will set aside confrontation politics, there is reason to believe we can hold these gains. If we treat the issue in low key fashion, almost everyone will gain. To draw up again the battlelines of the past can produce nothing but losers.