1-26-1994

# Stewardship Payments: A Potential New Policy Direction for the 1995 Farm Bill; Cattle and Hog Outlook: 1994

Thomas L. Dobbs
*South Dakota State University*, thomas.dobbs@sdstate.edu

Gene E. Murra
*South Dakota State University*

ECONOMICS
COMMENTATOR

SOUTH DAKOTA STATE UNIVERSITY
No. 331 Jan. 26, 1994

## STEWARDSHIP PAYMENTS: A POTENTIAL NEW POLICY DIRECTION FOR THE 1995 FARM BILL

Thomas L. Dobbs
Economics Professor

A new Federal "Farm Bill" will be due in 1995 if legislation is rewritten according to the normal 5-year cycle. Dialogue has already begun on potential directions such legislation might take, and alternatives are likely to come into sharper focus in 1994 and to be intensely debated in 1995.

The history of most farm legislation since the 1930s has been one of "marginal" or incremental changes over time, with the overall structure remaining largely unchanged. This policy structure is one in which prices of major food grains, feed grains, and cotton are "supported" through a combination of loan and deficiency payments. In return, farmers normally must "set aside" (idle) some of their acreage, limit the acreage of program crops they plant, and--starting in recent years--begin to comply with certain resource conservation standards.

The attention to resource conservation, environmental quality, and long-term sustainability concerns increased substantially in the 1985 Farm Bill and was broadened and reinforced in the 1990 Bill. Every indication is that those concerns will continue to receive major attention in 1995 and beyond.

It is also possible that changes embodied in the 1995 Farm Bill may be somewhat "radical", not just "marginal". For example, some individuals are beginning to advocate a new policy direction in which a substantial portion of funds currently devoted to traditional commodity support payments would be shifted to "stewardship payments" (or "green payments") directly aimed at amelioration of environmental problems in agriculture. The nature and implications of such a new policy direction are briefly explored in this issue of the Commentator. (Continued on p.2)

## CATTLE AND HOG OUTLOOK - 1994

Gene E. Murra
Extension Livestock
Marketing Specialist

In many respects, the cattle and hog industries will be heading in opposite directions in 1994. For example, cattle prices, at least in the first half of 1994 should be lower than they were in 1993. For hogs, prices in 1994 likely will be higher than they were in 1993. The cattle industry likely will continue the slow expansion noted for the past two or three years. Hog numbers could be lower in 1994 than in 1993, a continuation of the small reduction noted in 1993 compared to 1992.

It is easy to see why some of the changes are expected in 1994. For cattle, cow-calf producers have had several profitable years. Profits, first noted again in 1986 after several bad years, encourage expansion. In addition, weather conditions helped produce very favorable pasture conditions and large supplies of roughage in the major cow-calf areas of the U.S. This helped to encourage an expansion in the total inventory of cattle.
(Continue on p.3)

*********************************************

## GRAIN PRICE POTENTIAL

Richard Shane
Extension Grain
Marketing Specialist

The January USDA Supply and Demand Report was bullish as the grain trade had expected. The numbers in the report indicated a further reduction in corn and soybean production compared to the December report and a further reduction in market year ending stocks for all three U.S. major grain commodities--corn, soybeans and wheat.
(Continued on page 3)

**Stewardship payments, a potential new direction**

A stewardship payments program would use payments to farmers as direct incentives to induce changes in farming practices and systems. Some Federal programs introduced on a modest scale in recent years that are of this nature include the Integrated Crop Management Program and the Water Quality Incentive Program. Stewardship program advocates feel that through this approach farmers would be provided incentives to respond to both: (a) market forces, regarding which crops to grow, and (b) society's growing demands for resource conservation and a reduction in agriculture's adverse environmental effects (such as ground water contamination).

The stewardship payments would be tied either (a) to farming practices intended to accomplish specific environmental results or (b) to actual environmental results. A stewardship program presumably would be quite broad, so that environmental objectives in agriculture could be pursued largely through this program, rather than through continued marginal changes in commodity-based income support programs.

Designing a cost-effective stewardship program would be a challenge. Part of the challenge would be to design it in such a way that it is tailored to the particular agro-climatic conditions and environmental problems of different regions but is not too complex to administer. Basing the stewardship payments on actual environmental results is the economic ideal, but that may not generally be administratively feasible. Basing payments on results, at this time, would require the kind of monitoring that likely would be prohibitively expensive or sometimes impossible. Instead, it probably would be necessary to base payments on compliance with sets of practices. Wherever possible, farmers would be permitted to choose among alternative practices that are judged adequate (on the basis of current scientific knowledge) to achieve the relevant environmental results. In this way, within certain constraints, farmers would be able to seek least-cost alternatives. However, the danger from the environmental point of view is that, over time, there would be tremendous political pressure to broaden the list of "qualifying practices" beyond those which could reasonably be warranted on technical grounds.

**Potential implications of a stewardship program**

A stewardship program could entail substantial administrative costs for the implementing agencies. However, those costs might be offset at least in part by reduced administrative costs for the conventional commodity programs if those programs were eliminated or reduced and simplified.

A key issue is whether or not a stewardship program is the most cost-effective way to achieve environmental objectives related to agriculture. To the extent that farmers reduce environmental externalities, their costs of production are likely to go up some. The intent of stewardship payments would be to induce farmers to make least-cost changes in farming practices and systems in order to reduce external costs to acceptable levels. Costs to the Federal budget and to consumers (in the form of higher food prices) associated with a stewardship program need to be compared with those associated with other means of pursuing the same environmental objectives. Of course, considerations of "fairness" also are part of the policy determination process.

Shifting a substantial portion of the Federal farm program budget from commodity programs to a stewardship program would constitute a major shift in policy. Unless political economy compromises are carefully crafted, this shift could result in major income gains to some regions and major losses to others. Some farming areas that currently are quite dependent on commodity program payments may not be eligible for very much income transfer in the form of stewardship payments, depending upon how environmental criteria are specified and weighted. Conversely, some areas which currently receive little in the form of commodity payments may have agriculturally related environmental problems which society considers to be quite severe, thus making farmers in those areas eligible for stewardship payments that could be substantial, in aggregate.

Politically acceptable compromises may need to take a broad view of agricultural sustainability issues, initially allocating about the same amount (or proportion) of dollars to stewardship programs in each region that are "taken out" of commodity programs in that region. Those dollars could then be focused on the most severe environmental problems associated with the agriculture of each respective region. Even if such political compromises are struck, there could be gainers and losers among farmers and among other economic entities within areas if Federal policy were to shift emphasis to stewardship payments. However, some agriculture groups eventually may endorse a stewardship program if they conclude that their economic losses would be even greater with continued erosion of public support for farm programs in their present form.

**For more information**, readers may request copies of Policy Studies Program Report No. 2, Enhancing Agricultural Sustainability Through Changes in Federal Commodity Policy: Marginal Versus Radical Change, by Thomas L. Dobbs, at a cost of $6.00 per copy from:

Henry A. Wallace Institute
for Alternative Agriculture
9200 Edmonston Road, Suite 117
Greenbelt, Maryland 20770
(301) 441-8777

*********************************************

**(Cattle & Hog Outlook ... Cont'd from p.1)**

For hogs, lower prices in much of 1993 along with higher corn prices helped put a lid on expansion. While it is not clear if all segments of the industry are cutting back, many are, especially those in the "small-size" producer category.

In general, both industries will continue "concentration" trends which started in the cattle industry in the 1970's but have been more noticeable in the hog industry in recent years. Fewer participants at all levels, from producer to processor to wholesaler, along with more vertical integration will push livestock more toward the situation noted in the poultry industry. While both have a long way to go to be like poultry, moves will be in that direction rather than away from it.

Demand increases in foreign markets noted in recent years in both industries should be maintainable. Some small increases could even be noted. In the domestic market, beef may have a more difficult time "holding its own" than will pork. Price could be a key factor here.

The price outlook for pork producers is somewhat optimistic. Granted, early 1994 has not been profitable and probably won't be. Slaughter hog prices in the low to mid-$40's could hang around for a month or so. The mid-$40's by Spring and the low $50's by Summer are expected. Some dropping off to the mid-to-high $40's for this Fall would be above levels seen in late 1993.

Fed cattle producers won't enjoy the above $80 levels seen early in 1993. Even the mid-$70's may be tough to reach. The most likely time for 1994's peak would be this Spring. Then, above $75 is possible but $80 seems out-of-reach.

Feeder cattle prices in 1994 probably will be $10 or more below 1993 levels. Lower fed cattle prices, higher grain prices (at least early in the year), and losses by feedlots should pressure prices. Even then, prices for Fall calves in the $90's could be possible.

In general, 1994 could be one of small profits for hog producers, medium losses to fed cattle producers (exceptions could be for those who have low cost, poor quality feed to use), and small profits for cow-calf operators. The situation is not expected to be as wild as some years in the past, either from a "good" or "bad" perspective.

*********************************************

**(Grain Price Potential-- Cont'd from p.1)**

Corn surplus is estimated by USDA to be at an 18 year low of around 800 million bushels. Surplus was near one billion bushels in 1983-84 and 1980-81. Each of these years was followed by a "normal" production year and corn prices trended down through harvest to around $2.00 per bushel. This is the most probable outcome for 1994 as well--down trend with normal crop. But, hold on to your hats, a small surplus coupled with flooding this spring or drought this summer could push corn prices to all time highs. The trade will be very sensitive to weather conditions and will over react to any "abnormalities" giving producers opportunities to forward price at the best prices since 1988. Be prepared because these psychological markets are characterized by quick spikes up and even faster falls. Now is the time to write down your price targets and price strategy to capture that price. You may even want to consider some of the current forward pricing opportunities as these

SOUTH DAKOTA STATE UNIVERSITY
Economics Department
Box 504A
Brookings, SD 57007

**Address Correction Requested**



prices do exceed the five year harvest time average.

**Soybean** surplus is also projected to be low at 150 million bushels. Soybean surpluses have been nearly this low five other times in the past twenty years. In each of these five years, farmers had the opportunity to sell beans at $7.00 per bushel or more. This year, however, record soybean production is expected in Brazil and Argentina and the market year price peak is past unless the weather turns bad at planting time in the U.S. Current prices should be considered in a step up forward pricing strategy for 1994 soybean production as the current price offerings are above the five year harvest time average. Holding 1993 crop beans means you are speculating on a weather rally in the spring or summer and are passing up the current five year highs for this time of year. Consider an out-of-the-money call option as an alternative to continued storage. The option gives you upside potential but no down side as the beans have already been sold. As with corn, be ready to price 1994 production on a weather market this spring or summer. Weather markets lead to marketing opportunities several months before harvest so forward pricing techniques must be used to capture the highs.

**Wheat** surplus in the U.S. has been low for the last two years and have been this low only one other year in the last twenty. So why haven't prices soared? World supplies have been plentiful and U.S. exports have been subsidized through the Export Enhancement Program. U.S. share of world trade has been falling. The uptrend in the wheat market is looking very toppy and most likely will trend down into harvest time if a normal seasonal pattern emerges with normal weather this spring. As with corn and soybeans, a weather market could develop. Be ready to price wheat on such developments.

Forward pricing techniques will most likely be required to take advantage of a spring market rally related to weather.

**Sunflower** prices are currently very high compared to historical levels. Old crop sun seed prices could go higher on a weather rally, but keep in mind the relatively high price now and the potential to price some of 1994 expected production at relatively good prices. Sunflower acreage is expected to increase sharply in 1994. The next report that will affect our pricing is the March USDA Prospective Plantings. Otherwise, weather is the only factor which will create large price moves to the upside in the next few months.

*****************************************

ECONOMICS
COMMENTATOR

EDITOR: Donald C. Taylor, Agricultural Economist

ECONOMICS DEPARTMENT
South Dakota State University
Box 504A
Brookings, SD 57007
Phone: (605) 688 - 4141

475 copies of this newsletter were produced at a cost of less than $100