AGRICULTURAL POLICY AT A DECISION POINT

Ronald D. Knutson
Texas A&M University

From an economic, social, and political perspective we are at a crucial decision point in our policy with respect to agriculture. Our current set of farm policies and programs is based on the premise that in the 1970s the agricultural economy emerged from the chronic surpluses of the 1950s and 1960s into a new economic era of tighter supplies. In response to the changed economic conditions, policies were redirected from the price and income support-production control policies of the 1950s and 1960s to the export-oriented price and income stabilization policies of the 1970s. Export markets grew rapidly under favorable demand expansion conditions.

Farmers responded to the resulting favorable income conditions, albeit more unstable prices, by increasing production. The quantity of resources committed to production, including land, increased. Exports expanded to the point where production from two out of every five cropland acres was sold abroad. The world market became the prime determinant of the U.S. farm prices — both in level and variability.

In the 1970s a new set of farm programs added to the programs that had been adopted over the previous two decades. This new farm policy combination appeared to work reasonably well. One of the most critical new policy tools, the farmer-owned grain reserve, accumulated grain at harvest. Within the next nine months, the price generally rose sufficiently that the grains in it could be marketed profitably later that year. In fact, the reserve was so dependable in hitting the release trigger that farmers began to look at it as a one year commodity loan — much like the regular CCC price support loan.

It was suggested that the reserve entry price would become the price floor and the maximum deficiency payment would be the difference between the target price and the reserve entry price. Commodity market analysts, consultants, and speculators began to plan strategy by it. Some economists may have even based their outlook on the anticipated price impact of the reserve. There was nothing wrong with that as long as the reserve continued to work as intended.

In the 1980s, the roof fell in on most farmers, on economists who speculated surpluses were at an end, and on policymakers. Two years of favorable production combined with lagging exports filled the farmer-owned grain reserve to capacity. In aggregate terms, nominal net farm income fell to about where it was during the 1960s. As soon as it became evident that this build-up of stocks was not just a temporary aberration, political pressure began to build for help from Washington.

The help desired from some producer-oriented interest groups appears to be largely a return to the policies of the 1950s and 1960s. The administration has been basically unsympathetic to this approach. It has been constrained on ideological and political grounds. That is, the Reagan administration abhors production controls — other than ineffective acreage controls — more than it dislikes increases in government spending for high deficiency payments and expenditures on the farmer owned grain reserve. The administration may believe that only ineffective production controls are politically acceptable.

The Supply-Demand Balance Issue

The policy direction chosen at this time should be heavily influenced by the resolution of the current supply-demand balance issue. That is, did we indeed in the late 1960s and early 1970s make the transition from a situation of chronic surpluses to a tighter overall supply-demand balance or were the 1970s just an aberration?

If the 1970s were just an aberration, then we are once again faced with the same set of policy issues that we faced two decades ago. If not, then we can continue to hone and fine tune our current set of policies and programs to make them more able to deal with year-to-year shifts in the supply-demand balance.

Policy analysts must first recognize that the supply-demand balance issue is not a domestic issue. It is, instead a question of whether the productive capacity of the world's farmers is sufficient to consistently outrun effective demand over a long enough time period that farm prices and incomes are chronically at unacceptably low levels.

This is a question which cannot be analyzed by looking strictly at domestic stocks and observing that the carryover of U.S. grain has doubled in the past two years (Table 1). Not only is the time period too short to draw a reliable conclusion, but it is world stocks — not U.S. stocks — that are the relevant base for measurement and comparison. The decline and subsequent increase in world carryover as a percent of utilization in Table 1 is interesting, but inconclusive in terms of resolving the supply-demand balance issue that gives rise to the policy debate currently facing policy analysts.

The data suggest that world carryover stocks have increased substantially from the low levels of the mid-1970s but have not yet reached the high levels that existed in the early 1960s. World stocks are, nevertheless high and could reach record levels with another year or two of good crops and stagnant world economic conditions. It is, however, also

Table 1 — Total grain utilization and carryover, U.S. and world selected years.

Year	Carryover		Utilization		Carryover as percent of utilization		U.S. Carryover as percent of world
	U.S.	World	U.S.	World	U.S.	World	
	-------mmt-------				------percent------		
1960-61		197		832		24	
1961-62	102	170	140	853	72	20	60
1965-66	59	143	150	957	39	15	41
1970-71	55	165	164	1,144	34	15	33
1975-76	37	138	155	1,232	24	11	27
1980-81	60	171	172	1,452	35	12	35
1982-83	123	238	186	1,479	66	16	52

Source: Foreign Agricultural Circular, and World Supply and Demand Estimates, USDA, Washington, D.C.

important to note the sensitivity of the stock level as a percent of utilization as shown in Table 1. In 1960 to 1961 world carryover as a percent of utilization fell by four percentage points. Such abrupt changes have to be a major concern to U.S. policymakers who are continuously under the watchful eye of those directly involved with issues of hunger and malnutrition.

The data in Table 1 make another important point. The United States is quite clearly once again holding a disproportionate share of the world grain stocks. This large share of world stocks suggests a return to, or continuation of, the residual supplier status. This situation can be attributed directly to government policies including the establishment of the farmer-owned grain reserve, embargoes and related activities. These policies support the U.S. price while sending a message to foreign buyers that the United States is not a dependable supplier.

The supply-demand balance issue is a complex question and fundamental to the resolution of the current policy debate. I believe there was a shift toward a tighter supply-demand balance in the 1970s. The current surplus conditions can be explained by a convergence of generally favorable production conditions, a depressed world economy, high interest rates, and an increase in the value of the dollar. Government policy must bear its share of the blame for creating these conditions. Remember that the favorable income conditions of the 1970s were, to an important extent, the result of a rapidly expanding export demand. When the rate of growth of export demand began to lag while production continued to expand, stocks began to accumulate.

Those who were expecting utopian prices and incomes throughout the 1980s and beyond were obviously mistaken. Periods of surplus production extending over three to five years are not only possible but are more likely than comparable length periods of deficit production. Such a conclusion places inordinate demands on both the policies and the policymakers. Policy must, under these conditions, be sufficiently flexible to deal with both the surplus and the deficit conditions.

The Policy Alternatives and Their Consequences

While several farm policy alternatives could be discussed only three will be treated here:

- A reversion to the policies of the 1960s.
- A continuation of current policies.
- Pursuit of a pure export expansion policy.

Each will be discussed assuming I have correctly assessed the supply-demand balance issue. However, even if there has been a reversion to the chronic surpluses of the 1960s, this discussion is not without meaning. That is, it provides insight into the magnitude of the adjustment required to revert back to the policies of that era.

A Reversion to the 1960s

The policies of the 1960s can probably best be characterized as a mixture of high price supports, production controls, and export subsidies. Price supports were high in the context of the world price, not necessarily producer returns. That is, exports required subsidies but supports were not high enough to generate a farm income that was anywhere near comparable to nonfarm income. Production controls were a combination of allotment and longer-term land retirement programs held over from the 1950s and modified to meet political and economic conditions in the 1960s.

It is important to realize that a reversion to the policies of the 1960s today has consequences that extend beyond the impacts generally associated with these policies in the 1960s. The world along with U.S. agriculture has changed tremendously since these policies were established and subsequently abolished.

The consequences in terms of stabilization, capitalization of program benefits and efficiency still apply. A new consequence lies in the magnitude of adjustment that would be required. In the 1960s there was no commercial export market of significance to worry about. Today the production from two out of every five acres is exported. It is economic folly to think that it would be possible to cut back on production without seriously jeopardizing our position in the export market. This is the case for more than one reason.

- When the U.S. is controlling production, our prices would be expected to be less competitive in the world market. The U.S. would in essence be supporting the price for the world.

• The U.S. would have to cut back on production enough to either support the world price or isolate itself from the world market through a system of import quotas and export subsidies.

• Other countries would respond to the U.S. production control initiative by increasing their own production. This economically rational reaction was experienced this past year when Canada overtly encouraged its farmers to expand output. A comparable reaction likely occurred throughout the world whether by government encouragement or by economic incentives.

• The U.S. economy is much more dependent on agricultural exports today. Politically it could not afford to subsidize them while economically it could not afford to give them up because of their balance of trade implications.

• As a leader of the free world, serious political consequences could result from a U.S. public policy error that resulted in a shortfall in the world food supply. A policy misjudgment would not be as easily explained or forgiven in the 1980s as it was in 1972.

It can be seen from even this cursory review that major adjustments would be required in the farm economy as well as the political economy if a production control policy were to be vigorously pursued. However, the precise magnitude of these adjustments is difficult to predict and could undoubtedly be the subject of considerable debate.

I doubt whether the USDA has either the fortitude or the ability to implement an effective production control program. Don Paarlberg in his two agricultural policy books spends considerable time documenting the ineffectiveness of production control policies on the major commodities. He attributes this ineffectiveness largely to a lack of will. Today, questions may also arise as to capability. These questions have become particularly evident in the management of the acreage reduction program. The magnitude of slippage in the program raises serious questions regarding USDA's desire and ability to effectively implement a production control program.

If forced to make a choice between allotments with quotas and longer-term land retirement as a means of implementing this alternative, I would opt for land retirement. Even though the program costs would be higher, the voluntary nature of the program, its flexibility, and its less obvious capitalization effects make land retirement programs advantageous. In addition and perhaps most important, history has taught us that allotment programs are extremely difficult to abandon once installed as a policy instrument.

Continuation of Current Policies

The biggest problem with continuing the current policies is one of explaining what our current policy is. At a recent Agricultural Policy Advisory Committee meeting in Washington, D.C., the discussion centered on the need for the Reagan administration to establish a trade policy. While export expansion has been a major agricultural, economic, and foreign policy goal of four presidents, it has been subservient to other foreign policy goals on several occasions.

Likewise, our domestic farm policy has over time increasingly run the risk of pricing U.S. farm products out of the world market. Specific policies with this inclination include the maintenance of a high reserve entry and release price as well as the propensity of the Congress to continuously increase loan rates in the face of low world prices.

Contributing to the problem of defining our policy is the adoption of a highly ineffective set-aside or acreage reduction program. While program participation has been lower than justified by the benefits for several crops, the rules by which the program operates foster an unusually high level of slippage. The fault appears to lie in the rules although it may also lie in the enforcement of the rules. The basic problem is a lack of a clear productivity requirement on the land that is set aside. As a result of only a previous cropping requirement, largely unproductive land has been withdrawn from production. While this policy has taken some land out of farming that should never have been farmed, it has not reduced production. An additional example that facilitates high slippage is allowing the skiprow in cotton to qualify as set-aside acres. Under the current acreage reduction rules and enforcement policies, one should not anticipate a substantial decline in production.

Is there any reason to predict 1983's paid diversion will lead to different results? No, not as long as the rules of the game are the same. An effective paid diversion would require that the land diverted either be of average productivity or that the payment be based on the productivity of the land. Neither of these requirements is apparently anticipated.

This raises the interesting question of how the Congressional Budget Office could have concluded that a paid diversion would reduce government outlays on agriculture in 1983. The diversion will not pay for itself unless the rules of the game are changed.

A continuation of current policies could, over time just as surely strangle our export market potential as the imposition of production controls — but without any producer benefits. In reaction to lagging exports and European Community export subsidies, there is considerable discussion of the use of export subsidies by the United States. Even the Farm Bureau has endorsed an export subsidy policy. Most of the talk has been about selective subsidies in those markets where the United States has lost a substantial market share to the European Community. However, serious question exists as to whether a selective subsidy policy can be pursued without degenerating into a major trade war. Real dangers exist for farmers in the current policy direction —

largely because there is no clearcut policy. The worst possible policy is no policy or a policy created by default.

Export Expansion Policy

An export expansion farm policy would have as its sole objective increasing the sales of farm products abroad. There would be no assistance to farmers except as it relates to foreign market development. This is the type of policy that many expected for agriculture when President Reagan took office. It was the policy espoused by Secretary Earl Butz. Pursuit of a policy that was truly designed to expand exports would require several basic changes from the current U.S. policy. These changes include:

- A denial of the use of food as a tool of foreign policy except in the event of a declared war.

- Setting the price support level below the world market price. This policy was declared in the 1977 farm bill. The bill, in fact, provided that if the world market price came within 5 percent of the loan rate, the loan rate would automatically be lowered. This was truly an export oriented concept; however, the Congress has had such a propensity to raise the loan rate that this policy has since been abandoned. U.S. loan rates are now desperately close to once again pricing the U.S. farmer out of the world market.

- The denial of the use of production controls and the recognition that these policy tools are inconsistent with an export oriented farm policy.

- The establishment and funding of an export credit policy that allows the United States to consistently compete on credit terms in the world market. An export revolving fund may be a key to a consistent export policy.

Are such policy initiatives politically durable? They may not be. It may well be that the world food supply-demand balance has not yet tightened sufficiently to allow an export oriented farm policy. That may be the lesson of the past decade.

Closing Observations

The key to developing a consistent farm policy lies in a determination of where we are in the supply-demand balance. If as some suggest we are still in a situation of chronic surpluses, then efforts to control production are once again in order. At the other end of the policy spectrum is the implementation of a pure export expansion policy. In between lies a myriad of policy options all of which run the risk of jeopardizing our competitive position in the export market and thus drive policy choices back toward the production control alternative. Those forces are clearly evident currently.

The impacts of production control and price support policies on exports are not apparent to many who would prefer to revert to the policies of the 1950s and 1960s. The issues involved are broader than agriculture because of the importance of farm exports to the overall economy. The burden falls on us, as policy educators, to make all interest groups aware of the nature of the issues, the alternatives, and their consequences.