

AN OVERVIEW OF AGRICULTURAL POLICY ... PAST, PRESENT, AND FUTURE

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... the majority of Americans have come to be completely divorced from the land and, as a result, the general public understanding of agriculture and its problems has declined. Even American farmers themselves, driven by the daily necessities of making both ends meet and bewildered by the growing complexity of their individual lives, have found it increasingly difficult to comprehend and deal with the collective problems of American agriculture. . . . Strangely, however, no adequate attempt seems to have been made to give the general public an impartial, over-all picture of the vast governmental operations in the field of agriculture and of their cause and effects.

Evans Clark
Farm Policies of the United States, 1790-1950

These words, written in 1953, are as applicable today as they were 34 years ago. As then, the problems facing agriculture today are complex and daunting. Government spending on agricultural programs has increased dramatically since 1985; yet many farmers remain in financial difficulty. Also it still remains difficult for the average American to understand present policy and its relationship to contemporary farm problems. As an aid to understanding, this article sketches the historical development of United States agricultural policy. Special emphasis is placed on policy developments since 1930 as these developments make up the foundation of the present agricultural policy. As a preliminary, however, the first few paragraphs below highlight the chief policy issues of the period 1800 to 1930.

HISTORY OF AGRICULTURAL POLICY

In the broadest sense, agricultural policy is any government policy that affects the decisions of the agricultural industry regarding investment, production, pricing, or distribution. Since the original economy of the United States was almost exclusively agrarian, much of the early economic and trade policy was effectively agricultural policy. Thus, in the early federal period, whenever the federal government responded to the problems and needs of the economy, it was creating agricultural policy.

Pre-Civil War

In the early 1800s economic policy and hence, agricultural policy, stressed expansion and development. The United States possessed large amounts of undeveloped land that people were eager to settle and farm. Early federal legislation was directed toward accommodating those wishing to farm the lands. With the rise of nonfarm economic interests in the early to mid-1800s, however, national economic policy became less accommodative to agricultural interests. Congress erected tariffs on imported finished goods to protect the emerging domestic manufacturing industry. These tariffs, however, hurt farmers, who sold on the open market and wished to buy finished goods as cheaply as possible.

Congress also attempted to develop a stable currency and payments mechanism in the United States in the early to mid-1800s. A dependable payments system was held to be a prerequisite for the development of commerce within the United States and with foreign nations, particularly those of Europe. The most notable of the attempts to improve the payments mechanism were Congressional efforts to establish a lasting central bank. Farmers who were normally indebted opposed such institutions because they perceived that they would pursue "hard money" policies.

Although agricultural interests were, to some extent, overshadowed by those of other economic sectors by the mid-1800s, interest in agricultural

policy always revived when agriculture experienced economic downturns. Those downturns usually followed periods of high prices for farm commodities. When prices fell at the end of the booms, farm incomes dropped and farmers usually sought help from the Congress. Such an episode in the late 1850s led to the establishment of the United States Department of Agriculture (USDA), which was charged with assisting farmers to produce more efficiently.

Post-Civil War

The Civil War arguably exerted a larger influence on agriculture than any other event in the nineteenth century. High prices and scarce manpower during the war years induced the development and adoption of technology that substantially boosted farm productivity. Further, westward expansion in the postwar period brought substantial increases in the amount of land being settled and farmed. Not surprisingly, agricultural production outpaced demand and prices dropped.

Farmers pressed for legislation that would, in their view, increase the prices they received. Control of warehouse and shipping rates and cooperative marketing arrangements were areas where legislation was sought. Farmers thought they would receive higher net prices if they could eliminate the middleman, but their efforts to gain control over marketing proved unsuccessful and prices showed little change. Farmers also sought legislation promoting inflation in order to lessen their debt burden. These efforts were also fruitless.

With the beginning of the twentieth century, farm incomes improved dramatically. The end of western settlement caused slower growth in farm output while the United States population and the demand for food continued to grow. Farmland prices rose with the improved farm income prospects, which led to a greater demand for credit to purchase farms. Congress responded with the establishment of the farm land bank system. The Federal Land Bank System, established in 1916, was a cooperative system of twelve regional banks whose purpose was to raise private capital to provide credit to agriculture.

World War I generated a strong demand for food. Seeking to secure adequate supplies of food for our European allies, the federal government intervened in agricultural markets by entering into marketing agreements with domestic agricultural producers and setting guaranteed prices for hogs and wheat. Farmers responded with increased production. This intervention—the first of many—proved in retrospect to be quite important. It was the first time the federal

government entered the domestic agricultural market as a consumer on a large scale.

Post-World War I

War demand created relatively high agricultural prices that encouraged expansion of agricultural production in both the United States and Europe. As foreign production increased, however, demand for American products in Europe decreased, and world prices dropped sharply after peaking in early 1920. Although prices rose somewhat throughout the remainder of the decade, American farmers did not regain their wartime prosperity.

The end of the 1920s saw a sharp economic downturn. The stock market crash of 1929, tight money, and sharply lower farm prices adversely affected the agricultural sector. The stock market crash ended the urban prosperity of the 1920s and weakened domestic demand for agricultural products. Tight money caused many banks and insurance companies to seek new sources of liquidity. One way for them to increase their liquidity was to stop rolling over or refinancing farm mortgages. In the late 1920s and early 1930s many farm mortgages of the period were of a very short term, often three years or less, and were regularly rolled over at expiration. Due to low farm prices and a bleak outlook for the sector, many agricultural loans were not rolled over in the early 1930s.

The 1930s

As the 1930s began, farmers sought federal legislation to maintain the “fair” price levels of the 1920s and to provide adequate credit. Congress responded by considering a number of policies designed to support farm income. Congressional consideration concluded in the passage of the Agricultural Adjustment Act of 1933 (AAA) on May 12, 1933.

The AAA recognized that low agricultural prices were the result of domestic oversupply. Given this, higher farm prices could be achieved via three routes. First, production could be limited (see Box 1); second, consumption could be increased by subsidizing food for lower income groups; and third, consumption could be raised by raising aggregate incomes. AAA followed the first and third paths.

To limit production, AAA allowed the federal government to enter into voluntary agreements with farmers who would reduce their planted acreage of crops that were in surplus. Farmers who met acreage reduction requirements were offered benefit payments or supplementary income. Payments were in the form of rent on the acreage left out of produc-

tion. To pay for the output reduction programs, a processing tax was levied on the appropriate commodities.

To increase consumption, the government sought to raise employment levels and per capita incomes. Several programs were enacted to put people to work, often on government-sponsored projects. Although national income rose, it is not clear that this increase perceptibly boosted demand for agricultural products.

Congress also sought to make "adequate" credit available to the farm sector. Since Colonial days credit availability had been a concern of the farm sector. In the 1930s, farmers felt that long-term credit, which they used to purchase and improve farmland, was difficult to obtain. Further, farmers needed more flexibility in repayment terms because drought years hampered their ability to service debt.

On March 27, 1933, in response to these concerns, President Roosevelt, acting on authority granted by Congress, issued an order to reorganize the various farm credit agencies then in existence into one unified body called the Farm Credit Administration (FCA). This organization provided emergency refinancing of long-term farm debt. Later Congress passed the Emergency Farm Mortgage Act and the Farm Credit Act.

The Emergency Farm Mortgage Act provided authorization to raise \$2 billion (backed by bonds that were to be guaranteed by the federal government) to refinance non-land bank loans. The act further specified that existing and new land bank loan rates be reduced to 4.5 percent from the prevailing rate of 5.4 percent and that repayment schedules be "stretched out" when the weak financial condition of farmers dictated this to be necessary. The Act, as its name implies, was intended to be temporary assistance to farmers in adjusting to the depressed economic conditions of the period.

A second piece of legislation, the Farm Credit Act of 1933, was passed on June 16, 1933. The act was intended to provide a long-term solution to problems associated with farm debt. Specifically, it combined existing credit agencies with new ones to form the Farm Credit Administration. The system consisted of four segments that were equipped to provide long-term, intermediate-term, and short-term credit to farmers. The system still operates today.

The AAA of 1933 was amended in 1938 to establish loans to farmers at harvest using their crops as collateral, acreage allotments, market quotas for some commodities, and maintenance of prices in some prescribed ratio to those existing in the pre-World War I period.

Between 1940 and 1945, World War II strengthened prices for agricultural products. As with previous war-related booms, however, the postwar years saw surpluses and a downturn in the farm sector.

Post-World War II

The postwar era was characterized by farm commodity surplus. High prices and access to production technology rapidly expanded farm output in the late 1940s. The surge in output exceeded growth in demand, pushing prices down. Many farmers went out of business.

In this period, agricultural policy was based on the same framework as in 1933. Modifications of the 1933 farm bill were passed in the late 1940s, 1950s, and early 1960s. Most relied on land retirement plans in attempts to reduce the surpluses. Rising foreign sales finally reduced the surpluses in the early 1960s, but the strong sales were short-lived and commodity stocks began to pile up again late in the decade.

RECENT AGRICULTURAL EXPERIENCE

The most recent agricultural "boom and bust" cycle began in the early 1970s. The boom was caused by the combination of small world stocks of grains, strong economic growth, and relatively abundant credit worldwide. The price of grain was bid up globally as nations sought to improve their dietary standards. The United States, which held a large portion of world grain stocks, liquidated those stocks on the world market. The strong demand and decreasing stock levels raised prices and caused agricultural producers, especially in the United States, to invest in more efficient production techniques. Increased capital investment in farming was often funded by long-term debt.

As agricultural prices moved up, federal support prices followed. A price support is a guaranteed minimum or floor price: at that price the federal government will buy whatever the market will not absorb. Because prices could fall only as far as the support price, farmers were willing to take on long-term debt to finance land and equipment that expanded production.

The expansion of demand enjoyed by farmers during the 1970s vanished by the early 1980s. The boom ended in a manner similar to that following World War I. With world prices high in the 1970s, many nations began producing more of their own food and feed. Adding to their decision to do so in the early 1980s were their lower income prospects

Box 1
DOMESTIC AGRICULTURAL POLICY

Agricultural policy has historically sought to increase farm income by increasing gross farm receipts. Gross farm receipts are determined by the quantity of farm products sold multiplied by their market prices. Agricultural policies attempt to boost receipts by limiting output or by guaranteeing farmers a higher price. What follows explains the policies in terms of supply and demand for a representative agricultural commodity.

Output Constraints

The purpose of acreage reduction programs and other output limitations is to reduce supplies and boost prices. Acres taken out of production are often idled, leaving them unavailable for the production of other crops. As shown in Figure 1a, a decline in output rotates the commodity supply curve to the left. A perfect output control mechanism would make the curve vertical at the desired output. This raises the equilibrium market price of the commodity from P_1 to P_2 . Less effective output control mechanisms, however, will shift the supply curve to a position between S_1 and S_2 because attempts to limit output are in part thwarted by farmers using their remaining land more intensively.

Because the quantity of farm commodities demanded is relatively insensitive (inelastic) to changes in price, gross farm receipts (price times quantity) will be higher with the restrictions. In terms of Figure 1a,

rectangle a is greater than $c + d$, so farmers have a net gain. But the farmers' gain is at the expense of consumers who now pay more for less, so a represents a redistribution of income from consumers to farmers. That leaves two losses. First, triangle b represents the deadweight loss, that is, potential gains to consumers from transactions that do not take place due to the constraints. Second, triangle c represents the lost benefits to farmers from selling more at a lower price.

Guaranteed Price

The nonrecourse loan program acts as a "floor" to the market price. The government lends to the farmer an amount equal to the value of his crop at the guaranteed loan price. In return, the farmer puts up the crop as collateral. If the market price rises above the loan price, the farmer pays back the loan and keeps the rest. If market price is below the loan price, the farmer forfeits the crop and keeps the loan amount. In effect, then, under such a program part of the crop is "sold" to the government.

In Figure 1b, the government sets a guaranteed loan price at P_2 . At that price, farmers produce OQ_3 units of which OQ_2 are sold on the market, leaving an excess quantity supplied of Q_2Q_3 to be absorbed by the government. The dotted area represents a transfer from consumers to farmers due to higher prices. The shaded area represents government expenditures on the program, which are in part offset by the value of the stocks they have accumulated. The government is now faced with the problem of eliminating the excess.

Figure 1a

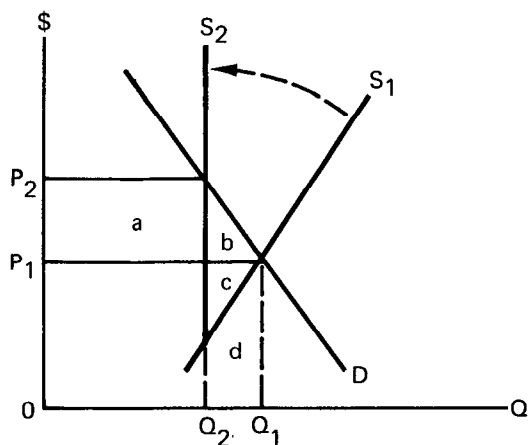
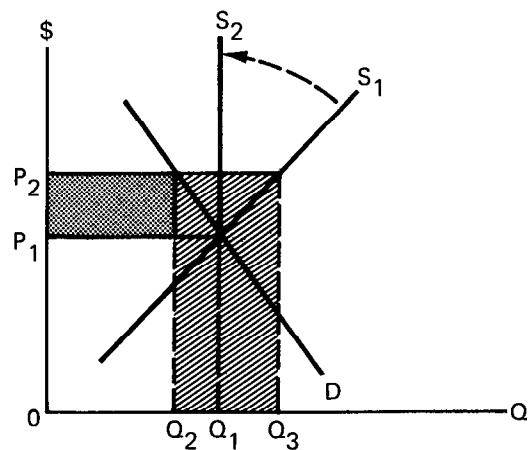


Figure 1b

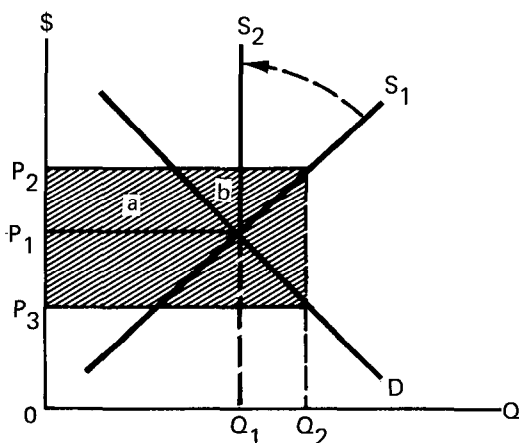


In practice, guaranteed prices are coupled with output reduction programs. If they are effective, they limit the subsidy amount and excess quantity supplied. To the extent that farmers work their remaining land more intensively, though, some subsidy and surplus production will remain.

Target Prices

Target prices increase farm receipts more directly. In Figure 1c, the government allows the market to clear but pays the farmer directly, by check, a premium equal to the difference between revenues at the target price (P_2) and revenues at the market price (which is expected to be P_1). From the farmers' point of view, this effectively shifts the demand curve up from D to the horizontal line at P_2 since the target price is known at the beginning of the season when crops are planted. From consumers' point of view, however, the market demand curve is still D . If no attempt is made to limit output, quantity supplied will increase to Q_2 but market price will fall to P_3 . Since the target price is still P_2 , the cost of the program to taxpayers is equal to the increase in gross farm receipts due to the target price, represented graphically by the shaded area. Output reduction programs could attempt to rotate the supply curve to S_2 and limit the subsidy to area $a+b$. Since output reductions are not likely to be completely effective, the amount transferred from taxpayers to farmers is likely to fall somewhere between the two areas.

Figure 1c



and their lessened access to credit. With lower export earnings and the need to service debt, many countries found themselves with less foreign exchange to purchase agricultural goods abroad. As a result, world demand for agricultural exports declined. The United States, which had benefited in the 1970s when world trade expanded, shouldered a large part of the decrease when world trade declined.

The poor prospect for agricultural prices in the 1980s was not recognized by those who formulated farm policy in 1981. The 1981 Farm Bill, structured in a manner similar to all agricultural legislation since the AAA of 1933, increased price supports for a variety of crops from 1981 to 1985. As a result, the gap between domestic price supports and world prices widened, providing additional incentives for American farmers to produce surpluses, and domestic stocks of grain to accumulate rapidly.

At the same time, a number of producers who had taken on long-term debt in the 1970s found that the price levels of the early 1980s provided them with insufficient income to service their debt. Such farmers, especially those who encountered drought or unforeseen problems, experienced financial stress and in some cases left agriculture through bankruptcy, foreclosure, or other means.

Striking parallels exist between the situation facing American agriculture in the 1930s and the 1980s. Today, as then, the farm sector is experiencing a period of depressed farm prices resulting from stock buildups. In both instances these stock buildups occurred after a slump in foreign demand. And finally, in both cases, the basic farm policy approach is similar. In fact, many farm analysts believe that current farm policy may have hampered adjustment by the agricultural sector to the latest episode of weak demand, and thus, may have contributed to the current problems facing agriculture.

THE 1985 FARM BILL

The architects of farm legislation in 1985 faced large and increasing government holdings of commodity stocks, widespread financial stress among farmers, and the overfarming of land and the resulting depletion of land resources. Of course, there were other influences. Tighter money and higher interest rates often made the rollover or expansion of loans more difficult. Also exports were affected adversely by the increased foreign exchange value of the dollar and trade barriers and restrictions imposed on United States agricultural products by foreign countries.

The drafters of the 1985 Farm Bill had two primary goals: the support of farm income and the reduction of domestic government-held grain stocks. Their secondary goal was to modify farm credit mechanisms which were facing financial problems. Initially these goals were to be met through programs that placed greater reliance on market signals to make agricultural policies effective for the long term.

The policy tools chosen by Congress, however, turned out to be little different from those employed almost continuously over the past fifty years. The Food Security Act of 1985 was hardly a revolutionary departure from previous farm policy, although it was billed as such during its formulation. Although the Bill eliminated the yearly increases in support prices in effect since 1977, it retained the traditional two-tiered price support system and otherwise merely extended production limits, trade incentives, and farm credit programs.

Commodity Programs

The commodity programs that are the backbone of the 1985 Farm Bill, attempt to limit commodity production by inducing farmers to voluntarily constrain their production in a manner prescribed by the government. Farmers who comply with the constraints are eligible to receive price supports or other financial incentives from the federal government. Such programs are usually administered through the United States Department of Agriculture (USDA).

Crops Crop price support programs are intended to supplement farm income and limit the acreage planted in many field crops. Crops covered under price support programs include wheat, corn, sorghum, barley, oats, rye, rice, soybeans, peanuts, cotton, sugar, and tobacco.

For most field crops, the programs attempt to limit production by reducing the program participant's "base acreage," which is determined from the number of acres he has historically devoted to the production of the crop. The USDA then requires the participant to limit acres planted of the crop to some portion of the base acreage. For peanuts, tobacco, and rice, however, production control limits a participant's total production.

Price supports are most often structured in two tiers. The first is a nonrecourse loan and the second a deficiency payment. The mechanics of these two supports can be best explained by example.

Chart 1 shows the market price, target price, and nonrecourse loan price for corn from 1981 to 1987. At harvest each year, farmers may sell their crop at the market price, if they desire. Farmers meeting

USDA's production limitation requirements have a second option, a nonrecourse loan, available. Those who take the loan must store their crop as collateral, placing the crop in a government-approved storage facility. Borrowers are required to repay the loans plus interest at the maturity date (usually nine months from the date the loan is made) or forfeit the collateral and keep the loan proceeds. No penalty is associated with the nonpayment of nonrecourse loans beyond collateral forfeiture.

The market effects of nonrecourse loans are straightforward. If market prices remain below loan prices, farmers will forfeit their collateral and keep the loan—effectively selling their crop to the government. If market prices rise far enough above loan prices to cover the loan principal plus accrued interest, however, farmers will pay off their nonrecourse loans and sell their crops on the open market. With large farmer participation, loan programs may apply to a significant portion of the available grain stocks. If so, the nonrecourse loan price which acts as a "trigger" price at which farmers are likely to redeem crops and resell on the market, can have a substantial influence on the market price.

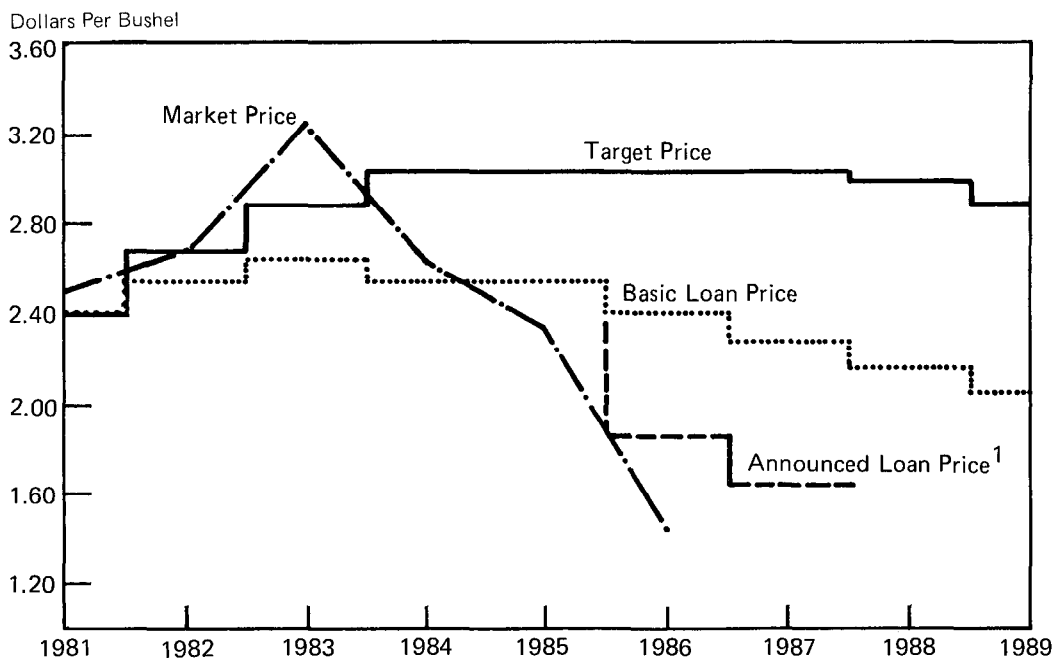
Total price support compensation is not dictated so much by the loan price as by the target price, which is legislated. When market prices and basic loan prices fall below the target price, eligible farmers receive a deficiency payment equal to the difference between the target price and the market price or between the target price and basic loan price, whichever is less. Payment can be made in either cash or commodity certificates. Commodity certificates may be used to redeem agricultural commodities owned by the government or sold for cash.

Crop loan prices were sharply reduced in the 1985 Farm Bill. Further, the Secretary of Agriculture has an option to reduce loan prices further if market conditions dictate. The Secretary has exercised this option as indicated in Chart 1 by the dotted line labeled the announced loan price. Target prices, however, have remained relatively stable, being fixed from 1984 to 1987 and projected to decline gradually thereafter.

Livestock Fewer price support programs are available to livestock producers. The dairy industry is the most notable example, operating under a marketing order program. Under the program, the government purchases or "removes" excess dairy products (those not consumed in the open market) at a set price. The government price remains fixed so long as removals remain within a range determined by the dairy program. If the removals exceed the

Chart 1

CORN: Target Price, Loan Price, and Market Price



¹Set by the Secretary of Agriculture within mandated limits.

Source: Department of Agriculture.

government limit, dairy price supports fall. If removals are below the limit, program provisions are in place to increase support price levels.

Beef producers have effective price support through restrictions on the quantity of imported meat that comes into the United States. Import limits are normally exercised through voluntary agreements among major suppliers. In addition, the federal government adds to domestic demand through beef purchases.

Perhaps the most important policies to livestock producers are the crop price supports. Since these programs often influence the price of grain, livestock producers' costs generally fall when loan prices are low and rise as loan prices rise.

Export Incentives

In addition to commodity programs, the 1985 Farm Bill establishes incentives for foreign nations to purchase American farm commodities (see Box 2). These programs are intended to reduce surplus stocks by encouraging additional foreign demand.

A primary incentive included in the export programs is providing credit assistance for foreign purchases of American farm products. Additionally, stocks of government-held grain and dairy products are to be made available to exporters and others to

counter "unfair" trade practices, to offset high domestic price supports and unfavorable movements in the exchange value of the dollar, and to expand markets. Promotional programs, designed to provide information to foreign nations, are also provided for under the bill.

Public Law 480 is another conduit for exports. This law allows a qualifying nation to receive United States food grain stocks and dairy products free or at favorable long-term financing if the recipient qualifies under the law.

Food Stamps

As a corollary to the export subsidies, the food stamp program is aimed at subsidizing domestic consumption of agricultural products. This program, along with programs such as the school lunch program, however, has a relatively small effect on total domestic demand for agricultural products.

Credit Programs

Agricultural credit policy is channeled through two programs: the Farmers Home Administration (FmHA), a government agency, and the Farm Credit System (FCS), a government-sponsored agency. The programs are similar in that they originated in the

Box 2
AGRICULTURAL TRADE POLICY

Figure 2a illustrates the mechanics of agricultural trade. The figure divides the world into two parts, the domestic market and the "rest of the world." In the absence of government intervention, at price "A" the quantity supplied exceeds the quantity demanded in the United States and the quantity supplied falls short of that demanded in the rest of the world. The world market equilibrium is reached when the quantity of exports from the United States ($c - b$) equals the quantity of imports by the rest of the world ($e - d$).

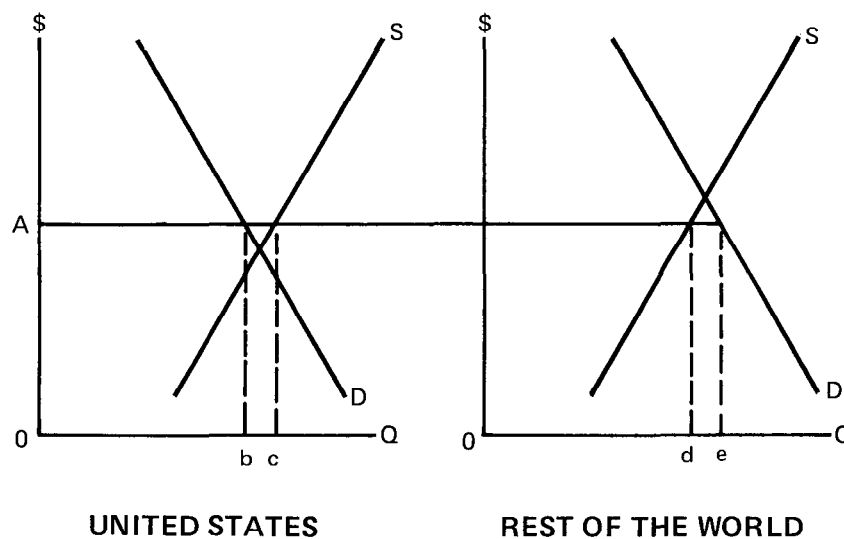
Domestic agricultural policy can negatively affect the position of United States farmers in world trade. In the early 1980s, for instance, restrictions on production and

domestic price supports pushed domestic prices up and lowered agricultural exports from the United States. Figure 2b demonstrates how the agricultural trade position is affected by domestic price support programs, represented by price B.

At B, the now larger domestic surplus ($c - b$) exceeds the quantity demanded by the rest of the world ($e - d$). The domestic surplus must be absorbed by the United States government if price B is to be maintained.

Current agricultural trade policy attempts to increase the usage of American farm products by encouraging foreign consumption. The 1985 Farm Bill provides a number of incentives to nations wishing to buy farm

Figure 2a



1930s and both are charged with making loanable funds available to the agricultural sector. Their specific areas of responsibility and methods used to achieve their objectives differ in many respects, however.

FmHA initially provided credit to small farmers to help them adjust to economic changes. Under this proposal, those receiving credit were normally poor credit risks. In recent years, FmHA credit has increasingly been made available to larger farmers. Still,

many borrowers remain poor credit risks, and FmHA loans usually carry more favorable terms than commercial alternatives.

FCS is a member-owned cooperative system consisting of twelve regional banks with numerous branches. The FCS seeks creditworthy farm borrowers for a variety of loan terms. The system has three lending arms. The Federal Land Banks make long-term loans usually collateralized by real estate. The Federal Intermediate Credit Banks and Produc

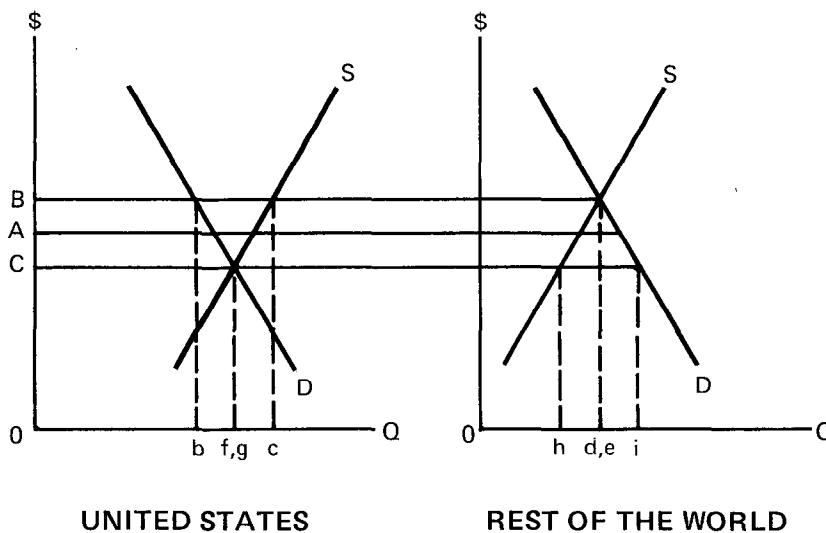
commodities. In general, these incentives lower the effective cost of these commodities on the world market.

Trade incentives can take many forms. Credit concessions, in-kind commodities, subsidized prices, and other types of export enhancement programs effectively lower the price of U.S. farm commodities to foreign buyers. The lower export price could expand the United States' share of the world market if other nations do not offset our actions. In Figure 2b, an export subsidy program might try to lower the export price to C overseas while the domestic price is maintained at B. If at price C the quantity demanded for import

(i-h) by the rest of the world exceeds the quantity available for export from current production in the United States at price B (c-b), the difference must come from a drawdown of U.S. surplus stocks. Ideally, such a drawdown should eventually place upward pressure on domestic U.S. commodity prices.

Two problems arise with this approach. First, the reduction of stocks is costly. Subsidies can push the export price below the cost of production, leaving the taxpayer to fund the difference. Second, if foreign nations match United States export prices due to subsidy or comparative advantage, the programs may not result in increased market share. The drawdown of stocks, then, might not occur as expected.

Figure 2b



tion Credit Associations provide short- and intermediate-term credit. The Central Bank for Cooperatives provides loans to farmer cooperatives. FCS raises funds through the issuance of bonds and lends the proceeds to the agricultural sector.

The economic difficulties of agriculture over the past few years have contributed to weak earnings for the FCS. In 1985 Congress put in place a federal line of credit that may be used to cover temporary liquidity problems of the FCS should the need arise.

THE COST OF FARM POLICY

Farm policy affects domestic farmers, consumers, foreign policymakers, and others. When policy changes, these groups benefit and lose to different extents. As a result, it is difficult to fully measure the net welfare effects of farm policy.

A relatively simple method by which part of the cost of farm policy may be measured is to examine the annual budget USDA devotes to direct

agricultural programs for price supports and product promotions. In the early 1980s, the direct budget costs (those borne directly by the taxpayer) totaled \$3 billion to \$5 billion per year. In 1987, the cost is projected to reach about \$30 billion, or about \$700 for every nonfarm family in the United States.

The cost of farm policy is thus of great concern to Congress, taxpaying households, and farmers. The high cost impedes Congressional efforts to reduce the federal budget deficits. Households, who bear the cost of farm policy, are questioning this wealth transfer with a more critical eye. Farmers themselves are divided over the effectiveness of the farm policies. Certain farmers have come to believe that the policies allow inefficient producers to remain in agriculture and they argue that too many farmers contribute to the problem of mounting agricultural surpluses. Many farmers also express concern that their incomes depend increasingly on federal dollars. With 25 percent of farm net cash income coming from direct government payments in 1986, recipients fear that shifts in agricultural policy could result in sharp reductions in farm income.

THE EFFECTIVENESS OF FARM POLICY

As noted earlier, the primary goals of agricultural policy are to reduce the accumulation of surplus stocks of farm commodities and to support farm income. The success of policy in accomplishing these objectives is open to question.

Commodity Stocks

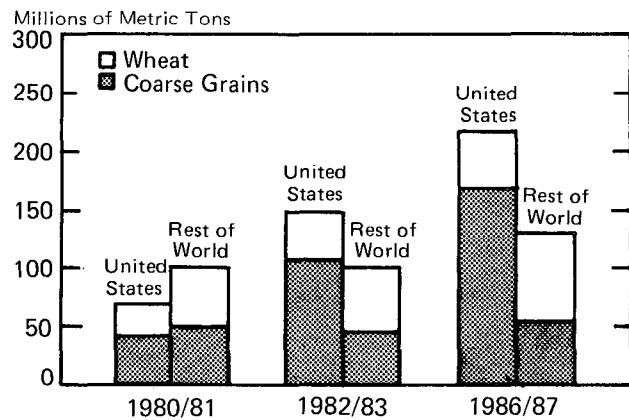
As shown by Chart 2, carryover stocks have been rising in recent years despite acreage reduction programs. The increases have occurred because agricultural production levels have been maintained while exports have fallen sharply.

Domestic grain production has remained at relatively high levels because set-aside acreage has often been offset by increased yields. For example, thirteen million acres of corn were set aside in 1986, but total production was 8.2 billion bushels, the second highest harvest ever. Weak corn exports compounded the problem of large production, leaving ending stocks at 5.7 billion bushels, far above the previous record of 4 billion bushels set in 1985. Other major crops show a similar, though often not as dramatic, pattern.

Despite the policy's current emphasis on exports, both the volume and value of commodities sold abroad have fallen in recent years. Reasons advanced for the declines include increased production abroad, unfair trade policies, and high domestic

Chart 2

CARRYOVER STOCKS OF COARSE GRAINS AND WHEAT



Note: Data are for crop years; 1986/87 data are preliminary estimates.

Source: Department of Agriculture.

prices. Export sales of wheat and corn concluded early this year coupled with the likelihood of reduced plantings may be sufficient to slow further stock accumulations in 1987. However, these developments do not appear sufficient enough to reduce current stock surpluses. Because surplus grain stocks have not yet been lessened, policy has to be judged deficient in this area.

Income Supports

A second major goal of the 1985 Farm Bill is the support of farm income. As can be observed from the table, farm cash receipts from marketings declined sharply in 1986 and are expected to decrease further this year. The decrease comes entirely out of crop cash receipts as livestock cash receipts are actually increasing over the period.

This pattern is influenced by the price support mechanisms. Crop cash receipts are based on sales at the prevailing market price or government loan price. Since market prices and loan prices fell sharply, it is not surprising that crop cash receipts also fell.

Farm income has been supported, however, despite the decline in cash receipts. As noted earlier, farmers' total price support compensation includes deficiency payments and the loan price. It was also pointed out that deficiency payments grow when loan

FARM INCOME AND CASH FLOW STATEMENT

Item	1983	1984	1985	1986P	1987F
	Billion dollars				
1. Farm receipts	140.9	146.4	148.5	139	131-133
Crops (incl net CCC loans)	67.0	69.2	72.7	63	54-56
Livestock	69.5	72.9	69.4	71	71-73
Farm related	4.4	4.3	6.4	5	4-6
2. Direct Government payments	9.3	8.4	7.7	12	15-17
Cash payments	4.1	4.0	7.6	8	7-9
Value of PIK commodities	5.2	4.5	0.1	4	7-9
3. Total gross farm income	152.4	174.4	166.6	158	154-156
4. Gross cash income	150.2	154.9	156.2	151	146-148
5. Nonmoney income	13.2	13.3	11.5	10	8-10
6. Value of inventory change	-10.9	6.3	-1.1	-3	-4-0
7. Cash expenses	113.0	115.6	112.1	102	96-98
8. Total expenses	139.5	141.7	136.1	125	119-121
9. Net cash income	37.1	39.3	44.0	49	48-52
10. Net farm income	13.0	32.7	30.5	33	33-37
Deflated (1982\$)	12.5	30.3	27.3	29	27-30
11. Off-farm income	37.0	37.9	40.8	43	43-45
12. Loan changes: Real estate	2.5	-0.8	-5.6	-8	(-8)-(-4)
13. Nonreal estate	1.0	-0.8	-9.2	-10	(-9)-(-5)
14. Rental income plus monetary chng.	5.7	7.8	8.0	17	5-7
15. Capital expenditures	13.0	12.5	10.1	8	6-8
16. Net cash flow	33.3	33.0	27.1	30	34-38

P-preliminary. F-forecast.

Source: U.S. Department of Agriculture

prices drop and target prices remain relatively unchanged. The effect of bigger deficiency payments can be seen in line 2 of the table, direct government payments. Between 1985 and 1987 (projected), direct government payments almost doubled, from \$7.7 billion to \$15 billion.

The effect of higher direct government payments and lower costs of production has meant higher income levels to farmers (lines 9 and 10). It appears, therefore, that income is being maintained by higher government payments and not by a greater reliance on market forces as early architects of the 1985 Farm Bill had hoped.

WHERE DO WE GO FROM HERE?

Aware of the high costs of current farm policy and concerned about the impacts of policy on agricultural problems, Congress is expected to focus a great deal of attention on farm policy later this year. Policy areas to be considered will likely include those denoted by the terms *decoupling*, *targeting*, *trade negotiation*, and *resource conservation*.

Decoupling refers to the elimination of the linkage between farm income programs and commodity production. Present programs require the removal of cropland but provide income based directly or

indirectly on the total quantity of production. Farmers are thus encouraged to strive for higher yields on fewer acres and, in the process, may counteract the program's intended goal of reducing production.

Under decoupling, the government would make direct cash payments to farmers to support their incomes, but the payments would be disassociated from production. Therefore the market would determine supply and demand of commodities. Surplus stocks should not occur under such a system.

Targeting refers to an identification mechanism that would replace production as a means of determining the distribution of government payments to farmers. Under targeting, criteria would be developed to determine the eligibility for and amount of payments to particular farmers. This procedure would allow the government to encourage or discourage specific activities within agriculture.

Trade negotiation would attempt to dismantle, through international cooperation, protection in the global marketplace. Nations that reduce agricultural trade subsidies often lose their markets to other nations that continue subsidies. Only through international cooperation can these subsidies be eliminated and world prices be adjusted to reflect true market prices.

Resource conservation programs would encourage the removal of erodible and dry farmland which has been

brought into agricultural production due to high commodity price supports. Farmers would be paid "rent" by the government to remove eligible land over a long-term basis, usually ten years. USDA is aware that the concurrent offers of price supports and retirement of land may place managers of government programs in a position where they bid against themselves. Congress must consider a solution to this problem in its debates on resource conservation programs.

CONCLUSION

The present structure of agricultural policy grew out of programs implemented during the 1930s. These programs may be inappropriate now. If so, current policy may be ineffective in solving problems facing the agricultural sector. Policy costs have soared, yet primary goals remain only partially met. With this in mind, Congress will likely consider modifications that may divert domestic agricultural policy from the traditional path it has followed.

Congressional modifications of the type discussed in this article will likely add to the expense of farm programs in the short run. If, however, they achieve the desired results, namely a reduction in surplus stocks and maintenance of farm income, they may prove to be a bargain in the long run.

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