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THE EMERGING ECONOMICS OF AGRICULTURE

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BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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WEDNESDAY, OCTOBER 5, 1983

THE EMERGING ECONOMICS OF AGRICULTURE

WEDNESDAY, OCTOBER 5, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the committee) presiding.

Present: Senators Jepsen and Abdnor.

Also present: Robert J. Tosterud and Dale T. Jahr, professional staff members.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator JEPSEN. The Joint Economic Committee will come to order.

This past month the Joint Economic Committee celebrated the second anniversary of its agricultural initiative.

During the past 24 months the Joint Economic Committee has held 26 public hearings, 4 on the issue of "The Importance of Agriculture to the U.S. Economy," 10 addressing the subject "The Changing Economics of Agriculture," and, to date, 12 hearings on the topic "Toward the Next Generation of Farm Policy."

This latest series of hearings will conclude in Bangor, Maine, on October 14, when Congresswoman Snowe chairs the committee's final regional farm policy hearing.

Over 150 witnesses have appeared before the committee and shared their views, ideas, and concerns about the economic condition and prospects for American agriculture.

With the active involvement and support of the committee's vice chairman, Representative Hamilton, the Joint Economic Committee initiative is bipartisan.

In addition, Representative de la Garza and Senator Helms lent their enthusiastic endorsement to this agricultural initiative by the Joint Economic Committee.

In fact, both of them gave supporting talks the day we had our first meeting. At the request of the members of the committee, the Congressional Budget Office, the Office of Technology Assessment and, of course, the Council for Agricultural Science and Technology, have begun independent farm policy studies.

At this time I want to publicly congratulate Senator Abdnor, chairman of the Subcommittee on Agriculture and Transportation, on his selection as an honorary trustee of the National Agricultural Forum. Under Senator Abdnor's guidance this new organization will analyze international agricultural trade issues and domestic farm programs and policy.

The Joint Economic Committee can take considerable pride and my colleagues and members can share in this pride, in its accomplishments and its comprehensive and continuing contribution to the public discussion of agricultural issues.

It is the first time in the history of this committee that it had as one of its first priorities the discussion of agricultural economic issues and farm policies.

Today the committee welcomes Mr. Charles Black, executive vice president of the Council for Agricultural Science and Technology, known as CAST, located at Iowa State University; Mr. Luther Tweeten of Oklahoma State University; and Mr. Bruce Gardner of the University of Maryland.

The purpose of today's hearing is for the Joint Economic Committee to formally receive and announce the findings of the CAST study "The Emerging Economics of Agriculture: Review and Policy Options."

This study was requested by Senator Abdnor, Representative Hamilton, and myself, only last March. CAST, true to its reputation, quickly assembled a 23-person task force to prepare the report. Mr. Tweeten and Mr. Gardner were chairman and vice chairman of the task force, respectively.

CAST and the members of its farm policy task force, are to be congratulated for an exceptionally comprehensive and timely report. In my judgment, the Congress will find it of considerable value as public policymakers begin to struggle for new directions in farm policies and programs.

Your appearance here today marks the beginning of phase 4 of the Joint Economic Committee's agricultural initiative—the evaluation of alternative choices in future farm policy. Obviously, our most difficult task lies before us.

Your report, which provides a wide spectrum of policy options, will be of great assistance to us on the Joint Economic Committee and the Congress as we address this most challenging phase of public policy development.

The future direction of U.S. agriculture is very controversial.

Some envision it as a highly protected, closed industry, subject to Government-mandated production controls. They contend that American farmers can only realize fair prices through a Government-sanctioned food and fiber production monopoly.

Others see it as more "market-oriented," with a minimum of public support or influence. With only their productivity and their inherent sacrificial tendencies to support them, farmers would be cut loose to do battle with the treasuries of the countries of the European Economic Community and the Canadian and Australian Grain Boards.

Obviously, our challenge is to search out the more reasonable grounds which lie between these two extremes.

I cannot emphasize enough the importance to policymaking of one's degree of optimism or pessimism regarding agriculture's future: Whether one is bearish or bullish with respect to our ability and-or willingness to face and overcome challenges. If we are bearish, we tend to minimize our losses; if we are bullish, we assume certain risks.

In this regard, I feel very strongly—and I have said it a dozen times before—that it was not by accident that the most productive land on the face of the Earth was placed in the stewardship of the most innovative and hard working of individuals. And these individuals were provided with a political and economic system that rewarded risktaking, sacrifice, and endless toil.

In a phrase, U.S. agriculture is as much an obligation as it is an opportunity.

But that does not mean exploitation. For to satisfy our obligation to United States and world consumers, we must recognize our obligation to the land.

I am, of course, bullish on American agriculture. I am bullish for two reasons.

First, I do believe there will be farm and foreign policy changes which will result in the rest of the world, particularly our highly subsidized and protected competitors, feeling the full competitive clout of the U.S. farmer.

Second, the United States is the only country which has both the science and natural resource base to explore and commercialize the next agricultural frontier.

While, as some contend, we may be approaching our environmental capacity in the volume of crop production, we have not nearly begun to explore the land's potential to produce varieties of foods and fibers.

Equally important, we must expand our national efforts to develop new uses for existing crops.

But, as we quicken our pace in this journey, conservation of our national agricultural resources must be first and foremost on our minds. This is a risk none of us can accept.

In this regard, Mr. Black, I am taking this opportunity to officially request that the board of directors of the Council for Agricultural Science and Technology give consideration to sponsoring a study evaluating the desirability and need to substantially increase the public and private funding of research to discover and develop new and alternative food crops and the exploration of new uses for existing crops.

The United States has the greatest variety and quality of climatic environments for food production in the world. In addition, we have the best agricultural scientific and technological base in the world. Therefore, the United States is the only country which can explore and commercialize production agriculture's next frontier.

I have said time and time again in my statements that the United States of America has a global responsibility, not only for the production, but for the distribution of food and fiber. The distribution of food and fiber will put things in the context of sponsoring and promoting free nations living at peace with each other. If we do not do it, the question that kind of gets right to the heart of things very quickly is if we do not, who will?

What better way to reestablish our dominance and leadership in world food production and make maximum use of our resources and capabilities than to develop a variety of crops with high, multiple-use demands which nobody else does, or perhaps even can, produce?

In addition, if the Reagan administration intends pursuing a more market-oriented farm policy, which will effectively increase the U.S. farmer's exposure to international competitive market forces, the administration has the obligation to better equip U.S. farmers to meet those challenges.

The public support of the development and commercialization of new crops to enhance the competitive position of U.S. farmers in international markets is vital.

Research goals, perhaps pursued within a national new foods foundation and institute, may encompass the development of: New crops to produce new foods; new crops as more efficient substitutes for existing crops; new crops capable of being grown on presently vast, unproductive lands and in hostile environments; new crops which yield food and other products which are presently imported; new crops specifically for export markets; new crops which are more efficiently harvested, processed, and stored; new crops which minimize negative environmental impact; and new crops with many alternative end-uses.

Perhaps the research goals of such an institute could be broadened to include the development of new products, new uses and new processing methods for fibers, livestocks, poultry, fish, and forestry.

I look forward to CAST's reaction.

Thank you all for coming. We are very anxious to hear your remarks.

Now I would yield to my most distinguished colleague, Senator Abdnor, who has been a great leader. I have recognized very early on, Senator, you for your work and congratulate you for your recent appointment. It is indeed an honor that we have an honorary trustee of the National Agricultural Forum with us.

OPENING STATEMENT OF SENATOR ABDNOR

Senator Abdnor. I am very flattered, Mr. Chairman, and thank you for your kind words.

I just want to welcome our panel here today. I know they have come from a long distance off to testify. But I also know they have some background and expertise in the studies that are going to make a tremendous impact on this committee and hopefully on the Agriculture Committees of the House and Senate.

I just want to say that 2 years ago when we began the agricultural initiative of the Joint Economic Committee, we assembled a number of agricultural economic indicators which revealed disturbing trends, net income, debt loads, prices, exports, land prices, production costs, stock levels, and all of these factors were very disturbing to me.

We questioned the effectiveness of traditional farm policy to reverse those trends. We even speculated on the possibilities of events which could lead to an America without agriculture.

Now I guess that would be the extreme, but that could be the result of continuous and increasingly expensive unilateral supply control programs by the United States. While all other world grain producers expand their production to fill the gap, we seem to be going the other way. The ultimate consequence of this is serious. We must get things moving in the right direction. If we do not, we are going to continually lower the farmer's gross income.

During the last 2 years, U.S. grain production as a percent of world grain production has declined from 22.2 percent to 16 percent.

During the last 2 years, while the United States has reduced its grain production by 94.3 million metric tons, the rest of the world has expanded its production by 81.1 million metric tons.

During the last 2 years, the U.S. share of world grain trade has fallen from 47.8 percent to 45 percent.

Since 1981, gross farm income has fallen from $167.1 billion to a seasonally adjusted annual rate of $161.9 billion for 1983.

I think these are alarming figures and facts. So in my judgment those who point to the recent dramatic increases in crop prices as evidence of a significant and lasting turn-around of the farm economy in some way may just be kidding themselves.

We must not confuse remission with recovery. We have to remember that these high prices are a direct and immediate result of a combination of the most massive supply control program in U.S. history, and one of the country's most severe droughts.

I can certainly, as a farmer from a farm area, appreciate the fact that we did have an infusion of income as a result of the PIK program. But we know that sort of thing cannot be a lasting program. And next year the probabilities are very high that we may have neither a PIK program nor a drought.

I contend that the supply control programs for 1984 will very likely provide insufficient incentives to farmers to significantly reduce output.

I can sense that out in the country where I come from, winter wheat farmers went right ahead and planted like there was no limit or control whatsoever. The farmers' latent need to plant and harvest is at a fever pitch.

Again, in my case, much of the wheat has already been planted. We can therefore reasonably anticipate record crops and the rebuilding of price-depressing carryover stocks if we are not careful.

If there is a more likely scenario, I am anxious to hear it. I guess that is why we asked these gentlemen here today, to hear your reaction to some of these problems. I have a great concern that the continuation of the status quo farm programs beyond 1984 will seriously, if not permanently, endanger this country's most important and perhaps its last international comparative advantage; tragically agriculture may join automobiles, textiles and steel and many other commodities on our endangered and therefore protected industries list.

I guess I can point out all of the problems without giving any answers. That is probably why we have you gentlemen here. With all the talk we have had about our problems, I am looking forward to hearing some of your thoughts and answers and background material that will help us solve these problems. We certainly welcome you here today.

Senator JEPSEN. Now, gentlemen, you may proceed in any order that you wish, left to right, or whatever.

STATEMENT OF CHARLES A. BLACK, EXECUTIVE VICE PRESIDENT, COUNCIL FOR AGRICULTURAL SCIENCE AND TECHNOLOGY (CAST), AMES, IOWA

Mr. BLACK. I am Charles Black, executive vice president of CAST, the Council for Agricultural Science and Technology, as you said, and I will start.

Our headquarters is in Ames, Iowa. We certainly appreciate your confidence in our organization's activities and you may be assured, Senator, that we will take your request back to our board of directors immediately when we get home.

As you may or may not know, CAST is a national organization of 25 scientific societies in food and agriculture. It is controlled by these societies. It is supported financially by the societies, several hundred sustaining members, and several thousand individual members.

We produce scientific educational publications dealing with issues of national importance in food and agriculture, mostly by means of multidisciplinary task forces of scientists who are nominated by their respective scientific societies.

In addition, CAST publishes an educational magazine entitled "Science of Food and Agriculture," which is sent free of charge to the heads of science departments in high schools across the country.

We are here today at your invitation to review the study "The Emerging Economics of Agriculture: Review and Policy Options," which you held up a moment ago. The report was prepared at your request by a task force of 23 scientists; it was chaired by Mr. Tweeten, who is on my immediate left. Mr. Tweeten is a regents professor in the Department of Agricultural Economics at Oklahoma State University. Vice chairman of the task force was Mr. Bruce Gardner, on my far left. He is a professor of agricultural resource economics at the University of Maryland.

These men are recognized by their peers in the American Agricultural Economics Association as leaders in the area of agricultural policy. They are leading academics in that area. And they are going to review the subject matter of the report for you here this morning.

In line with CAST's status as a nonlobbying educational organization, the task force report contains no recommendations. We expect Mr. Tweeten and Mr. Gardner to review what is in the report, and to indicate when they are departing from the report to give their personal views. But they are reporting for themselves as scientists, they are not expressing any policy position of any kind for CAST on this subject, because we do not have that. We expect them to give their opinions freely, if you ask for them, or if they think they will be useful.

We appreciate the opportunity to prepare this report, and to review it for you this morning. I will turn it over now to Mr. Tweeten and Mr. Gardner, the experts on the subject.

[The prepared statement of Mr. Black follows:]

PREPARED STATEMENT OF CHARLES A. BLACK

I am Charles Black, Executive Vice President of CAST, the Council for Agricultural Science and Technology. Our headquarters office is in the Memorial Union, Ames, Iowa.

CAST is a national organization of 25 scientific societies in food and agriculture. It is controlled by these societies through their representatives on the board of directors. It derives its financial support from these societies, its several hundred sustaining members, and several thousand individual members.

CAST produces scientific educational publications on current food and agricultural issues of national importance, mostly by means of multidisciplinary task forces of scientists who are nominated by their respective scientific societies. In addition, it publishes an educational magazine, "Science of Food and Agriculture," that is sent free of charge to heads of science departments in high school grades 9 through 12 nationwide.

Today we are here at your invitation to review a study called "The Emerging Economics of Agriculture: Review and Policy Options." This report was prepared at your request by a task force of 23 scientists chaired by Dr. Luther Tweeten, Regents Professor in the Department of Agricultural Economics at Oklahoma State University. The vice chairman was Dr. Bruce Gardner, Professor of Agricultural Policy in the Department of Agricultural and Resource Economics at the University of Maryland. These two men are recognized by their peers in the American Agricultural Economics Association as two of the top academic experts in agricultural policy. They are both here this morning and will review the subject matter and attempt to answer your questions.

In line with CAST's status as a nonlobbying, educational organization, the task force report contains no recommendations. We expect Drs. Tweeten and Gardner to review the report and to indicate when they are departing from the report to give their personal views. Nonetheless, they are speaking for themselves as scientists and not for CAST, and so we expect them to give their own opinions if you ask for them or if they think their opinions will be helpful.

We thank you for the opportunity to prepare the report and review it for you this morning. Dr. Tweeten will be first.

Senator JEPSEN. Mr. Tweeten, please proceed.

STATEMENT OF LUTHER TWEETEN, REGENTS PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, OKLAHOMA STATE UNIVERSITY, STILLWATER, AND CHAIRMAN, COUNCIL FOR AGRICULTURAL SCIENCE AND TECHNOLOGY (CAST) TASK FORCE REPORT

Mr. TWEETEN. Thank you. I have an eight and a half page prepared statement, which I will not cover completely——

Senator JEPSEN. Excuse me, Mr. Tweeten. I would advise all of the panel—I should have done this before—that any prepared statements you have will be entered into the record as if read, and you may proceed in any manner you so desire.

Mr. TWEETEN [continuing]. So I will just pick from the highlights of the prepared statement, which also highlights the report itself.

The summary, overview, and appendix of the task force report provides a succinct and I think quite readable synopsis, so I am not going to duplicate that here today.

I will highlight some points which are either points of controversy, of particular importance, or that require special interpretation.

First, I highlight three points emphasized in the setting portion of the CAST report.

Point No. 1, the changing characteristics of demand, supply, and productivity have enhanced the capability and need for U.S. agriculture to compete in international markets. Demand and supply quantity are becoming more sensitive to price, and that means that competitive pricing of our farm products is essential for maintaining and expanding markets, particularly in the international sphere.

Improvement in productivity enables large farms, which account for approximately half of all farm output and 5 percent of all farms, cover all resource costs of production at prices averaging approximately 50 to 55 percent of the 1910–14 parity.

The inherent comparative advantage of American farmers is severely eroded, however, when uncontrolled Federal budget deficits cause high interest rates, which in turn cause the dollar to be unduly strong in international markets.

The point here is that American agriculture has an inherent strong comparative advantage, but that can be masked by domestic policies which erase that comparative advantage.

Point No. 2, two principal economic problems of agriculture are instability and cash flow. In a paper which I presented to the American Agricultural Economics Association at Purdue University this last summer, I found that almost all of the variation in utilization of farm commodities from 1976 to 1981 was accounted for by exports. I also found that two-thirds of the variation in prices received by farmers was accounted for by changes in the general price level, rather than by changes in the real prices of the commodities themselves.

Thus, two principal sources of farming uncertainty at the national and international level, exports and the general price level, are not controlled specifically by commodity programs, but are influenced greatly by domestic monetary fiscal policy, both directly and through international linkages.

The point here is that commodity programs are very helpful to the instability problem, but other types of Federal policies are important if we are going to get at the root causes of this very serious problem in agricultural instability.

Turning to the cash flow problem in agriculture, cash outflow frequently exceeds cash inflow, even if total real rates of return on production resources are favorable. This cash flow problem arises because of life cycle financing patterns of the family farm, because of high real interest rates, and because of inflation.

I would go into more detail on those problems if you so desire in the questions later.

Commodity programs more successfully address the instability problem than the cash flow problem. In fact, high price supports raise land prices and add to cash flow problems of beginning farmers. Dealing with the cash flow problem requires low real interest rates and low inflation. And that in turn goes back to Federal monetary fiscal policy. So it is clear that the well-being of farm people depends heavily on Federal policies other than just commodity programs.

Point No. 3, production controls are becoming more costly and less effective tools to reduce farm output and raise farm income. Economists are not in full agreement among themselves on the effectiveness of supply controls in raising farm income, because they are not in full agreement regarding the responsiveness of exports to price.

There are three basic competing positions. Let me cite them. No. 1 is the position that both the shortrun and the longrun demand for farm output is elastic. Few agricultural economists hold that position. That position means that supply controls are counterproductive, not only in the long run, but also in the short run, because a cut in output does not raise prices enough to compensate, and receipts fall.

Senator JEPSEN. May I interrupt there? Can we just examine this a minute? You were touching on the law of supply and demand. I want to be sure I understood what I heard you say.

I heard you say that the law of supply and demand has not really worked like it theoretically was supposed to have worked under these circumstances. Is that right?

Mr. TWEETEN. I would put it differently. If demand is inelastic, production controls raise farm revenues. And that is what controls are trying to do to benefit farmers.

Senator JEPSEN. That is right. You are cutting down the supply, therefore the demand is increased, and therefore the price also. That should work. And you are saying that it has not worked.

Mr. TWEETEN. That will happen if demand is inelastic. If demand is elastic, when you cut production, prices do not rise enough to compensate, so you actually lose revenue.

Senator ABDNOR. What would we have if we had not done that? What would have happened if we had ignored these problems?

Mr. TWEETEN. You mean not control production?

Senator ABDNOR. Yes.

Mr. TWEETEN. I am not through with these three points. If any of you have further questions after I finish these three points——

Senator ABDNOR. All right, forgive me.

Mr. TWEETEN. We have not come to our CAST task force position yet.

The second position is that demand for farm output is inelastic both in the long and short run. I say up until fairly recently that has been the conventional wisdom of agricultural economists. So production controls are effective in raising farm receipts, both in the long and short run, that is, even if you run them for 5 or 10 years in a row, you are still adding to receipts.

The third position is that the demand for farm output is inelastic in the short run, but elastic in the long run. In other words, in the short run production controls can be a cost-effective means to raise farm revenue and make farmers better off. But in the long run they are counterproductive.

A good bit of empirical evidence backs that up. That is the position that the CAST task force has taken.

Now you might want to pursue your questions further.

Senator ABDNOR. No, I will wait until later.

Mr. TWEETEN. All right. Before going into what some of this background has to say about commodity programs, I want to point out some public perceptions that appear to be at variance with the research findings. I will treat these only briefly.

No. 1, it is the position of the task force that farming is not a chronic low-return or low-income industry. Since 1965 rates of return on farming resources have averaged at least as high as those in other sectors. In fact, if you just look at commercial farms, rates of return have averaged well above rates of return in other major investments.

Senator ABDNOR. What would that be?

Mr. TWEETEN. Well, it runs 10 or 15 percent rate of return over a long period of time. Now in real terms it runs less than that.

No. 2, farmland is not overpriced relative to expected earning capability from agriculture alone. The ratio of rent to land price over a long period of time tends to average about 4 percent. And that ratio has not shown a strong upward or downward trend, although it does vary from year to year.

Now a 4 percent rate of return which we are talking about here is not very favorable when you are paying 12 percent farm mortgage interest. The difference between the 4 percent and the 12 percent comes as capital gain. In the past that capital gain has more than rewarded for the additional interest costs, but inflation raises immediate costs and defers returns. That creates very severe cash-flow problems. That also raises the question about what is happening in the 1980's.

It is the view of the task force that many of the elements that are at work in the 1980's have been transitory elements. That is, in the early part of the 1980's we had highly favorable weather, we had an unduly high value of the dollar, we had an unduly high real interest rate, almost three times the normal level, and we do not think that these are permanent characteristics.

No. 3, farmers do not increase output when product prices fall or costs rise.

Sure, some farmers do, but on the whole, the empirical findings are that farmers minimize losses or increase profits by cutting down production when prices fall or production costs rise. The data indicate that the farming industry as a whole cuts back output when incentives are reduced.

However, some public involvement in the farming industry may be required at least until international economic conditions and U.S. exports revive to a further extent.

So now with that background——

Senator ABDNOR. May I stop you there? Do your facts really back that up? We are talking about cutting dairy prices by $1.50, and we are producing more dairy products.

Mr. TWEETEN. The price cuts will result in reduced output; farmers will cut back their production in response to reduced prices. It will not occur as rapidly as we would like to see it.

Senator ABDNOR. It is in the short run?

Mr. TWEETEN. It takes a good while. That is one of the frustrating things.

Senator ABDNOR. Would not that mean they would go broke? When you are losing money, you are going to——

Mr. TWEETEN. Farming is a high risk business. That is what I mentioned earlier—the major problem that the commodity programs address is this instability problem. Certainly it is a hardship for many farmers, and there are going to be some who will go broke, but most of them will survive.

But the problem is what is the best alternative to bring the farm economy into balance and to get it in a more healthy economic situation.

As a preface to the following remarks about commodity programs, I want to reiterate some things Mr. Black has mentioned. That is that CAST does not make recommendations, and the following comments should not be construed as an advocacy. However, the review of the emerging economics of agriculture made some options appear more attractive than they appeared 25 years ago.

No. 1, the rising dependence on international markets and rising responsiveness of demand quantity to price seriously undermines the case for mandatory control programs for grains, soybeans, and cotton. Our farmers could lose over half of their grain market in time under mandatory controls.

No. 2, the attractiveness of market-oriented commodity programs is enhanced by several emerging developments. One is the greater responsiveness of markets to commodity prices, making competitive pricing of our farm output essential to retain and expand markets. Another development is the rising share of farm output produced by adequate sized commercial farms capable of competing in international markets without subsidies. Another is the rising share of farm numbers accounted for by part-time operators, who produce so little farm output that they benefit little from commodity programs, and who have sufficient off-farm income to preclude the need for commodity program benefits. Another development is higher farm program costs, coupled with a need to reduce overall Federal outlays. Bruce Gardner will address some of these issues and give appropriate responses, specifically talking about basically a free market, with some government supplementation to improve the working of forward pricing, provide income insurance, and augment the private storage system.

No. 3, the case for direct payment programs without production controls or nonrecourse loans is enhanced by their ability to focus benefits on farms most at risk while allowing all farms to compete freely for markets. Moderate-sized full-time family farms are most at risk. Direct payments can focus on such farms at relatively low cost to the taxpayers. Recognition that extended supply control programs and price supports are counterproductive also enhances the attractiveness of direct payments without supply control.

The disadvantages are the payment limitations would not be easily enforced, and food supplies might be unduly variable. The latter problem could be reduced with supplementary payments to farmers to hold buffer stocks—a farmer owned reserve without an acquisition or release price. In other words, you could have a direct payment program without production controls but with a government reserve policy run on the side.

The payment limitations are circumvented when land owners divide holdings to be eligible for full payments. This action could be turned to the advantage of family farms, however, by making payments only to operators responsible for the day-to-day operation of farms. The structural objective of having more family farms could be fostered when landowners break up large units into smaller units, each with an individual operator to obtain full access to payments.

No. 4, existing commodity programs have several shortcomings, but carry substantial inertia and may be extended with modifications.

If the target prices are retained, the Secretary of Agriculture can have discretion in setting loan rates. To hold down Treasury costs, he is constrained in setting loan rates too low by high deficiency payments and in setting loan rates too high by storage and diversion payments caused by excess production and stocks generated by high supports.

If the target price is dropped, then the loan rate might be set at some percentage, say 75, of a 7-year moving average of market prices, dropping the high and low year. Long-term diversion programs featuring crop easements might be introduced to remove erosion-prone acres from production on a somewhat permanent basis.

Other options discussed in the task force report to reduce costs to taxpayers and promote efficient resource allocation include reducing or eliminating target prices. If continued, target prices might be held no higher than the nonland cost of production. Incentives to overproduce could be reduced by more fully divorcing additions to established yield and base acreage from the target price.

One option is a 5-year moving average of market price as the target price, but with an upper limit based on the nonland cost of production. Another option is a base acreage established by 5-year average cropping history to reduce "sod-busting."

Another option to reduce Government cost is a whole- or part-farm bid system of land diversion, accepting only bids that remove the most production per program dollar.

Additional possible modifications in existing programs are discussed in the task force report. And that ends my testimony.

Senator Jepsen. Thank you, Mr. Tweeten.

[The prepared statement of Mr. Tweeten follows:]

PREPARED STATEMENT OF LUTHER TWEETEN

Comments Regarding The Emerging Economics of Agriculture: Review and Policy Options (Council for Agricultural Science and Technology, Task Force Report) to the Subcommittee on Agriculture and Transportation of the Joint Economic Committee (JEC) of the U. S. Congress on October 5, 1983 by Luther Tweeten, Regents Professor, Department of Agricultural Economics, Oklahoma State University, Stillwater, and Chairman of the CAST Task Force.

The Council for Agricultural Science and Technology (CAST) Task Force Report had two objectives: (1) to review and comment on The Changing Economics of Agrculture: Challenge and Preparation for the 1980s, a staff study prepared by Drs. Robert Tosterud and Dale Jahr for the Subcommittee on Agriculture and Transportation of the JEC; and (2) to examine public policy options in light of the JEC staff report and the CAST Task Force report. The Summary, Overview and Appendix of the CAST report provide a succinct and readable synopsis which I will not duplicate. Rather I will highlight issues which are either points of controversy, are of particular importance, or require special interpretation.

First, I highlight three points emphasized in the setting of the CAST report.

1. Changing characteristics of demand, supply and productivity have enhanced the capability of U.S. agriculture to compete in international markets. Demand and supply quantity are becoming more sensitive to price, and price is becoming less sensitive to random and

unpredictable changes in quantity. Competitive pricing of our farm products is essential to maintain and expand markets.

Improvements in productivity and in risk management and marketing strategies enable large farms which account for half of all farm output to cover all resource costs of production at prices averaging just over 50 percent of 1910-14 parity. The CAST Task Force agreed with the JEC staff report in noting that large numbers of farmers quite capable of competing have been shielded from international markets by production controls and commodity price supports. The inherent comparative advantage of American farmers is severely eroded, however, when uncontrolled federal budget deficits cause high real interest rates which in turn cause the dollar to be unduly strong in international markets.

2. Two principal economic problems of agriculture are instability and cash flow. According to recent estimates (Tweeten, American Journal of Agricultural Economics, Vol. 65, December 1983), most of the variation in utilization of farm output from 1976 to 1981 arose from exports. Commodity stock and domestic utilization adjustments helped to buffer the impact of unstable exports on prices received by farmers. That is one reason why changes in the general price level (rather than changes in real commodity prices) accounted for two-thirds of the variation in prices received by farmers from 1976 to 1981. Thus two principal sources of farming uncertainty at the national and international level -- exports and the general price level -- are not controlled specifically by commodity programs but are influenced greatly by domestic monetary-fiscal policy both directly and through international linkages.

In farming, cash outflow frequently exceeds cash inflow even if total real rates of return on production resources are favorable. This cash-flow problem arises because of life cycle financing patterns of family farms, because of high real interest rates and because of inflation. Inflation raises cash outflow for mortgage payments and defers returns which are realized as capital gain only when assets are sold. The normal current rate of return on farm equity capital is about 4 percent. This causes no cash-flow problem if expected inflation is minimal so that the interest rate is also 4 percent. But if expected inflation is 9 percent, the mortgage interest rate is about 13 percent. When land is sold, capital gains are realized to cover the difference between the mortgage interest rate and the current return on land of 4 percent. Before land is sold, however, the cash-flow squeeze imposes special hardships on family farms without much off-farm income.

Commodity programs more successfully address the instability problem than the cash-flow problem. In fact, high price supports raise land prices and hence add to cash-flow problems of beginning farmers. Dealing with the cash-flow problem requires low real interest rates and low inflation rates. These rates can be held down only by balancing full-employment federal budgets and restraining the growth in money supply. Farmers have diversified into off-farm sources of income to cope with instability and cash-flow problems. Because off-farm jobs depend on monetary-fiscal policy as well as rural development policy, it is clear that the well-being of farm people depends heavily on federal policies other than just commodity programs.

3. <u>Production controls are becoming more costly and less effective tools to reduce farm output and raise farm income</u>. Economists are not in full agreement among themselves on the effectiveness of supply control in raising farm income because they are not in full agreement on responsiveness of exports to price. The three competing positions are:

(a) Supply controls reduce farm revenue even if imposed for only 1-2 years because short-run demand for farm output is elastic -- price rises less than quantity declines with supply control.

(b) Supply controls and high rigid price supports are the most cost-effective means to raise farm income for extended periods because demand for farm output is inelastic even in the long run.

(c) Supply controls in the form of programs such as Payment-in-Kind (PIK) raise farm income if practiced only one or two years because demand for farm output is inelastic in the short run. But persistent supply controls and permanent high rigid price supports reduce farm income because demand for farm output is elastic in the long run.

The Task Force took the last position (c). Supply control can be a cost-effective tool to raise farm income at minimal cost to taxpayers in the short run. But supply control is a counterproductive long-run solution to farm economic ills. Programs such as PIK can be more cost-effective than other voluntary means to raise farm income if stocks have accumulated to highly excessive levels. But PIK needs to be avoided when possible: (1) preferably by averting excessive accumulation of stocks through lower support prices to encourage consumption and reduce production at home and abroad, or (2) by anticipating excess stocks and paying farmers in cash not to produce before reserves accumulate to huge levels.

The CAST report highlights several areas where public perceptions are at variance with research findings.

1. Farming is not a chronic low-return or low-income industry. Since 1965, rates of return on farming resources have averaged at least as high as those in other sectors. Rates of return on production resources of commercial farms have averaged well above returns on major investment alternatives. What is perceived as a problem of low returns on commercial farms is in part a cash-flow problem characterizing industries with a high proportion of resources tied up in durable assets. With inflation, the agricultural industry receives a high proportion of returns as capital gains rather than as current earnings as noted above.

The problem of low returns in the 1980s is a transitory situation brought about by unusually favorable weather, by worldwide economic recession and by a budget deficit-monetary restraint policy which caused high real interest rates, a high value of the dollar in international exchange and reduced exports. Inappropriate federal policies can extend the farm recession which will be alleviated by (a) revival of the world economy, (b) a more normal value of the dollar and real interest rate and (c) support prices set at competitive levels.

2. Farmland is not overpriced relative to expected earning capability from agriculture alone. According to historic data, the ratio of land rent (earnings) to land price shows no strong trend over time. Rents determine land prices and have kept pace with land

prices. Nominal land returns can be expected to average 4 percentage points plus the inflation rate in the future as in the past. That is precisely the behavior predicted by economic theory in a well functioning land market where rational and informed market participants correctly anticipate that land earnings from agricultural uses alone will keep pace with inflation. This conclusion does not rule out lower current returns to farmland nationwide in some years. And it does not rule out perennially lower returns near cities where consumptive use and potential urban development raise land values. It also does not rule out higher than average returns to farmland on adequate-sized, well-managed farms. ¶Markets work in agriculture. The government need not intervene chronically in farming to prop up returns to land, labor or other resources.

3. <u>Farmers do not increase output when product prices fall or costs rise</u>. On the whole, farmers minimize losses or increase profits by cutting output when commodity prices fall or production costs rise. Some farmers may raise output when product prices fall, but data indicate that the industry as a whole cuts back when incentives are reduced.

Modest progress is apparent in restoring economic vitality to the farming industry through worldwide economic recovery without substantial inflation, through a more normal value of the dollar in international exchange and drawdown of excessive stocks (a situation being realized for feed grains and soybeans but not for wheat). Some public involvement in the farming industry may be required at least until international economic conditions and U.S. exports revive further. More nearly normal real interest rates and foreign exchange rates also would create an environment more conducive to ending farm commodity programs. Restoring our reputation as a reliable exporter also would give a lift to farm commodity prices.

Numerous commodity program alternatives were evaluated in the CAST report. CAST does not make recommendations, and the following comments should not be construed as advocacy. However, the review of the emerging economics of agriculture makes some options appear more attractive than they appeared 25 years ago.

1. The rising dependence on international markets and rising responsiveness of demand quantity to price seriously undermine the case for mandatory control programs for grains, soybeans and cotton. Our farmers could lose over half of their grain market in time under mandatory controls.

2. The attractiveness of market oriented commodity programs is enhanced by several emerging developments. One is the greater responsiveness of markets to commodity prices, making competitive pricing of our farm output essential to retain and expand markets. Another development is the rising share of farm output produced by adequate-size commercial farms capable of competing in international markets without subsidies. Another is the rising share of farm numbers accounted for by part-time operators who produce so little farm output they benefit little from commodity programs and who obtain sufficient off-farm income to preclude the need for commodity program benefits. Another development is higher farm program costs coupled with the need to reduce overall federal outlays. Bruce Gardner discusses minimal public interventions to make private markets work: forward pricing, income insurance and augmented private storage.

3. <u>The case for direct payment type programs is enhanced by their ability to focus benefits on farms most at risk while allowing all farms to compete freely for markets.</u> Moderate-size full-time family farms are most at risk; direct payments can focus on such farms at relatively low cost to taxpayers. Recognition that extended supply control programs and price supports are counterproductive also enhance attractiveness of direct payments without supply control. Disadvantages are that payment limitations would not be easily enforced and food supplies might be unduly variable. The latter problem could be reduced with supplementary payments to farmers to hold buffer stocks — a Farmer Owned Reserve without an acquisition or release price. Payment limitations are circumvented when landowners divide holdings to be elgible for full payments. This action could be turned to the advantage of family farms. By making payments only to operators responsible for the day-to-day management of farms, the structural objective of having more family farms would be fostered when landowners break up large units into smaller units, each with an operator.

4. <u>Existing commodity programs have several shortcomings but carry substantial inertia and may be extended with modifications.</u> If the target price is retained, the Secretary of Agriculture can have discretion in setting loan rates. To hold down Treasury costs, he is restrained in setting loan rates too low by high deficiency payments and in setting loan rates too high by storage and diversion payments caused by excess production and stocks generated by high supports. If the target price is dropped, then the loan rate might be set at some percentage (say 75) of a 7-year moving average of market prices,

dropping the high and low year. Long-term diversion programs featuring crop easements might be introduced to remove erosion-prone acres from production.

Other options discussed in the Task Force report to reduce cost to taxpayers and promote more efficient resource allocation include reducing or eliminating target prices. If continued, target prices might be held no higher than the nonland cost of production. Incentives to overproduce could be reduced by more fully divorcing additions to established yield and base acreage from the target price. One option is a five-year moving average of market price as the target price but with an upper limit based on the nonland cost of production. Another option is a base acreage established by five-year average cropping history to reduce "sod-busting."Another option to reduce government cost is a whole- or part-farm bid system of land diversion, accepting only bids that remove the most production per program dollar. Additional possible modifications in existing programs are discussed in the Task Force report.

Senator JEPSEN. Before we get into the questions, I think I would ask Mr. Gardner if he would give his testimony, and then we will move to the questioning.

STATEMENT OF BRUCE GARDNER, PROFESSOR, AGRICULTURAL AND RESOURCE ECONOMICS, UNIVERSITY OF MARYLAND, COLLEGE PARK, AND VICE CHAIRMAN, COUNCIL FOR AGRICULTURAL SCIENCE AND TECHNOLOGY (CAST) TASK FORCE REPORT

Mr. GARDNER. While the task force did not attempt to provide policy recommendations, we did consider the pros and cons of several policy options.

For the past 50 years U.S. agricultural policy can be viewed as a series of experiments, testing alternative means of supporting and stabilizing farm commodity prices and the incomes of farmers. The issue today is what directions this experimentation should now follow. I would like to discuss some possibilities for following a general direction of moving away from attempts to support market prices above the levels they would attain in an unregulated market.

This is only part of the set of options that the CAST task force considered. But this is the part I am going to focus on in my remarks.

The reason for considering this general approach is primarily the problems that have arisen in practically all of the earlier policy experiments that attempted to establish producer prices that are inconsistent with market realities. Of course these policies have been a response to economic difficulties for farmers that recurred during periods of low farm prices and incomes. The difficulties of that that have arisen are that attempts to support farm prices have led to overproduction relative to demand, and that the resulting pressure to impose production controls of one kind or another that have proved either ineffective or of very dubious wisdom from the point of view of the national interest. Attempts to move toward direct payments to farmers in place of supporting market prices have had some appeal, but have created their own problems of budgetary costs and incentives to overproduce.

The difficulties of managing the commodity markets are especially apparent in the experience of the last 3 years. The Agriculture and Food Act of 1981 established a set of incentive prices which did not seem unduly inappropriate at the time they were enacted. But that act's price guarantees encourage production greater than the available demand for grains and cotton at the market support prices that existed under the farmer-owned reserve, and CCC loan programs.

Similarly, the dairy support prices were too high to be consistent with market realities. The resulting accumulation of stock and high budget costs led directly to the PIK program for grains and cotton, and the severe difficulties that the dairy program now faces. PIK, in turn, is now revealing the pitfalls of a production control approach. We now find ourselves with stocks of feed grains and soybeans that constitute a complete turnaround from the situation a year ago, and leave us, in my opinion, dangerously exposed to the risks of low yields next year.

But what are the alternatives? The task force did not consider a complete elimination of all price support efforts, that is, an end to the 50 years of experimentation in farm commodity policy. We thought this would be unrealistic and unwise, although it is an attractive long-term goal of policy to have a self-reliant and unregulated agriculture.

We considered several approaches to making commodity policy more nearly consistent with market realities. Three options considered were: (1) Increased reliance on price and income stabilization through futures markets; (2) the introduction of an explicit program of farm income protection insurance; and (3) a pure stabilization program in commodity markets through stockpiling.

All three have advantages that should be seriously considered.

First, they all give farmers more freedom to produce what they want, when they want to, and avoid governmental direction of production and land-use decisions. They would greatly reduce the Federal Government's budgetary exposure for supporting prices and deficiency payments. They would increase the competitiveness of U.S. commodities in foreign markets. Farmers would have choices of various risk management or insurance contracts, which they would have to purchase but which would be better suited to their individual circumstances than current programs are, and which would not involve strings attached, such as set-aside requirements, recordkeeping burdens, and so forth.

At the same time, all the alternatives we could think of also have disadvantages. Some of the drawbacks are quite serious.

First, a futures market approach would not be viable for small farmers and could not permit hedging more than 1 year in advance unless longer term contracts were offered.

Moreover, futures prices themselves are often unstable, so that farmers would not know very far in advance what prices they could expect to receive.

Approaches to dealing with these disadvantages might involve governmental stabilization of futures prices, the offering of longer term contracts, and a possible educational effort and assistance to farmers in using futures to reduce risks. But these activities involve complex difficulties of their own, and are no near-term panacea.

No futures transaction can eliminate the risk of low production due to natural hazards. This leads to the second option, a more general income insurance approach.

The general idea is that the farmer could purchase an insurance policy that would make indemnity payments if either low prices or low output caused farmers' receipts to fall below insured levels.

This concept has been studied by a task force on farm income protection insurance mandated by Congress in the Agriculture and Food Act of 1981. The report of this task force, which was presented to the relevant committees of Congress in June of this year, finds many problems with implementing farm income insurance, but considers it worth more detailed exploration through a pilot program.

Even without such a comprehensive insurance program, its basic elements could be provided on the price side by the use of put options by farmers—that is, a contract giving a farmer the right but not the responsibility to sell at a prearranged price—and on the output side by the use of crop insurance as already in place under Federal Crop Insurance Corporation programs.

Neither the futures market nor the income insurance approach deals with instability in the commodity markets themselves. They would stabilize farmers' incomes, but not commodity prices or food costs. Therefore, a third option that could be used in pursuit of the stabilization objectives is a pure buffer stock program, or some equivalent to that. This is a quite old idea, and was the basis for the Federal Farm Board which preceded the New Deal programs which are the ancestors of the policies we have today.

The Federal Farm Board failed in the 1930's because it could not support farm income in an extended low-price period. But that would not be its function today. In conjunction with insurance programs to prevent disastrously low farm incomes, the stockpiling approach would be merely supplemental to help insure against extremely sharp price increases as we saw in the early 1970's. The existence of such stocks would also serve to stabilize commodity and futures prices. The disadvantages of a buffer stock are that it tends to crowd out private storage by farmers and others in the grain trade, that it would maintain the situation in which the U.S. carries most of the stocks for the world grain trade, and that in low-price periods, political pressures would be strong to convert the stabilization scheme back into a price-support program.

For example, there would be pressure to impose production controls rather than reducing the buying price for the buffer stock.

I would like to mention one other option that the CAST task force report discusses briefly. This is in an effort to support farm prices and incomes by further development of foreign markets for U.S. products. This approach receives a lot of attention from farmers and farm groups, as well as the Department of Agriculture. It might be considered as part of a market-oriented policy. However, it does not seem likely to be a useful approach so long as our support prices are high relative to the world market price levels that would exist absent our policies. We can convince more buyers to consider our products, but it is folly to expect foreign buyers to pay more for U.S. products than they have to pay to get comparable products elsewhere.

Therefore, foreign market development efforts will be futile if they are not accompanied by greater market orientation of domestic policy.

On the other hand, if we have greater market orientation of domestic policy, it is not clear that Federal expenditures in developing foreign markets would be necessary or warranted.

Senator JEPSEN. Thank you. The idea of the insurance approach, which was your second option, where the farmer could purchase an insurance policy, which would make indemnity payments if either low prices or low output caused farmers' receipts to fall below the insured levels. As an insurance man, it is ideal, it is kind of a Utopia. But as was found, I think, in the report, and maybe you have something additional to add, and if so, I would like to hear it, that is kind of tough insurance to provide.

Mr. GARDNER. You mean on the price side? The output insurance is not tough to provide, because we do have the Federal crop insurance program. But when you are insuring price, you do have some severe difficulties. We know about these difficulties, because there have been past attempts to provide price insurance in the early 20th century, and they failed.

Senator JEPSEN. You see, the basic nature of insurance is that you pool sums of money from large numbers of people to provide for something that is a risk.

In this instance, if the low prices came into being, everybody would have to be paid off.

Has there been any company that has offered to research this, look at it?

Mr. GARDNER. On this farm income production task force there were a number of people from crop insurance, and other insurance companies, and this was a concern for them. It would require some kind of reinsurance. You need some sort of reinsurance scheme, because no private company, as you say, could carry the risk of a nationwide low price that would make it liable for billions of dollars in indemnities.

Senator JEPSEN. My question is in your experience and in your contacts and meetings, have you ever found anyone, reinsurance or otherwise, who said they could insure or guarantee profits or insure against low prices? I am just curious to know if anyone ever ventured even a little bit to say it could be done.

Mr. GARDNER. Some companies have offered it. In the beginning of the 20th century, there was a company in North Dakota that offered insurance polices which would guarantee the farmer who bought it. $7 an acre for his wheat. If he did not get the $7 an acre because of either low yield or high price, the farmer would be paid off. That company went bankrupt or went out of business after 1 year. It was not a successful experiment.

Other people have tried it. That is why I do not think any private insurance company could offer this on its own. It is a policy decision that would have to involve the Government, you know. This is not a free market, completely free market approach.

Senator JEPSEN. I was just using this to see if indeed it was a viable option. Ideologically it sounds great, but as a person with an insurance background, it sounds impractical. If this is the case, I do not think it is something we should pursue.

Mr. TWEETEN. Aside from the administrative problems, there is a problem. With crop insurance local damage averages out over the country. But in the case of insuring price, you have a nationwide phenomena and that is very difficult to cope with on an actuarial basis.

Furthermore, it would be very difficult to make that acceptable to the farming industry—why should they opt for an insurance program in which they would have to pay premiums, when currently they are covered without paying premiums?

The final point is that the Federal Government has had only limited success in all-risk crop insurance. It seems to me the problems of administration would be even greater in a revenue insurance program.

So all of these are serious drawbacks of that proposal.

Senator JEPSEN. The problem I find in government administration is a lack of accountability and the bureaucracy. The private sector and commonsense, if brought to bear—and I do not mean this as a blanket criticism—but it is very frustrating for a person such as myself basically coming from the private sector and still hoping never to lose both that attitude and that priority, to try and deal with the bureaucracy even in just very, very simple commonsense type of things. For example, the administration by the SCS of the policy allowing cattle to graze on certain PIK acreage. On the day that policy was announced, I was standing in the field with about 150 farmers at noon. It was about 24 hours after the policy was announced. I asked the local SCS people why are these cattle or livestock not moving to these set-aside acres that were just released for grazing? The response was because they did not have the forms completed. I said, "Can't you go ahead? You mean because the program was moved up 20 days, from September 1 to August 10, you cannot allow grazing because you have no forms? Have you ever thought of going ahead and turning out the livestock, opening up the gates and letting them go in and fill in the forms afterwards?" They thought then that that would be a pretty good idea.

Unbelievable. But the administration of an insurance program to cover low prices is not what concerns me. I am still optimistic you can make some headway in developing an administration of the program that will not stay around very long. But the economics of it is what bothers me, as an insurance person. I do not see anyone ever being able to compute a premium for that, unless you want the Government providing it.

Mr. TWEETEN. I think there is no question but, to make a program like that work, the Government would have to provide a substantial amount of subsidy in terms of administration and perhaps premium. And that raises returns to production of corn, or soybeans, or whatever, and that in turn raises the question of incentives to overproduce. So, an insurance program of this type could encourage overproduction if there is sufficient Government subsidy involved.

Senator JEPSEN. There is not much difference from a guaranteed loan price.

Mr. TWEETEN. Very similar.

Mr. GARDNER. It is more similar to the target price. The target price is something like this.

Senator JEPSEN. And they have apparently failed. The results of our farm programs have been depressed prices and huge surpluses. That is the problem.

Now exploring a little bit, Mr. Tweeten, in your prepared statement, you elaborate on your payment limitations and say that they will be circumvented when landowners divide holdings to be eligible for full payments. You say you would make payments to only those who operate the farms, which would then direct the benefits generally to the more moderate sized, full-time family farms.

That is a principle that sounds great, I am all for it, but how are you going to do that? There are a lot of folks that rent, and that is the way they get started. What happens to them?

Mr. TWEETEN. There are various ways you could administer a program like that. Suppose you had a payment limit of say $10,000 per recipient. Let us say that payment relates to the total payments to any one landowner. What would that landowner do to circumvent that limit? He would divide up his land, a part for his spouse, a part for his children, and he would divide it in enough ways that he would be eligible for program benefits that would accrue without the limitations.

Suppose instead you put the payment limitation on the day-to-day operator and provide the payment to the day-to-day operator? How would a landlord handle that? He would handle it by breaking up his farming operations into a lot of different operators.

Now it is true they would be renters, but at least they would be day-to-day operators and at least in the minds of many people who are concerned about structural issues, part of the name of the game is to have more farms, more farm operations, and more operator families. And so it is a way of turning this problem of circumventing the payment limitations feature into a structural advantage.

There is no way of avoiding farmers circumventing the limitation. The only question is, Can you use that positively rather than negatively to further structural objectives?

Senator JEPSEN. One last question before I yield to Senator Abdnor.

Your report discusses four possible dairy policy options. I would appreciate either one or all three of you sharing with this committee your personal views on a future dairy program on the basis of your research.

Mr. TWEETEN. I will start and I think Bruce Gardner will have something to add to this.

It seems to me in the case of dairy, we need to face two realities. That is, there are two basic approaches to dairy policy that will work. One is a market-oriented policy, where you do not control production, but you allow prices to fall to market clearing levels. The other is some kind of production control policy—call it a base policy, and support prices.

The difficulty with the past dairy program is we have tried to run a combination of the two. We have not had restrictions on output, but we have had supported prices. That is basically an untenable and nonsustainable program, at least without substantial accumulation of surpluses and large Treasury costs. I am not making a recommendation, but I say that basically there are two routes to go: Either production controls and support prices, or market-clearing prices and no controls.

Now there is a program which—and I am not speaking for CAST now but for myself—which I find attractive, and that is to establish a base on some proportion of the historic production of the dairy farmer. It might be on the portion that goes into fluid consumption purposes. The market order system would administer some price that would be above market-clearing levels on that portion, but allow the farmer to produce as much as he wants. He would sell the marginal output in the market for whatever the market would bear. There would be no Government purchases and no production controls, but there would be that base for the fluid market for which he would get a higher price.

This would basically get the Government out of the dairy business, but it would give the dairy producer some security by higher steady prices on this base portion.

Senator JEPSEN. The base portion would be arrived at again by how?

Mr. TWEETEN. It would be based on historic production. It might be just the fluid base. We currently have a fluid portion and a manufactured portion. Currently the producer gets a blended price of the two.

Senator JEPSEN. Historic production assumes the producer has been in business for awhile. The less-than-5-year man, or new young farmer trying to get into the dairy business would not have the historic production.

Mr. TWEETEN. There are drawbacks to this procedure. With any kind of production control feature, how does a young guy get in? One possibility, of course, would be to make these bases negotiable, so the young farmer would have to purchase a base. That constitutes a barrier to entry, which is contrary to some of our structural goals, but it is a way of satisfying a number of the objectives that we would like to see in dairy policy and do it with minimum Government involvement and minimum Government cost.

Bruce Gardner might want to comment on that. He is chairman of a committee dealing with dairy policy.

Mr. GARDNER. I would like to add one thing. Since we have agricultural economists here today, I think what has happened in dairy policy is a real illustration, among other things, of the weakness of agricultural economics as a science, because if you think about the discussions we had when we set up, or when Congress set up the dairy price supports that exist now, there was a lot of discussion among economists about what would be the price support level. People were looking for prices that would bring supply and demand into balance.

In looking at the past prices, the past history of the dairy program, people said things like: "About 75 percent parity prices would get supply and demand into balance." Other people argued for higher prices.

This is really a scientific question; it is a question of what the supply and demand figures look like. I do not think that when we established the support prices we have now that agricultural economists thought they would cause the kind of difficulty we have, the oversupply. But we are finding now that with 75-percent parity, all of the milk you possibly could want is being produced.

Senator JEPSEN. But the bottom line is the problem in the dairy industry. We have had a 32-percent decrease in consumption in the last 10 years, and a 12-percent increase in production. You put those two together and you do not have to be an economist to figure out what the problem is.

Mr. GARDNER. The problem is in forecasting, finding out what will happen before it happens.

Senator JEPSEN. Senator Abdnor.

Senator ABDNOR. Thank you, Mr. Chairman. I have listened to all of this with a great deal of interest. Lord only knows, I am not a farm economist, but there are a lot of things that bother me.

One is that I have been a farmer all of my life, and I have a hard time accepting the fact that farm returns have been as high as those in other sectors. Maybe because my land got inflated all at once, I am supposed to be worth something. Like one guy at the Federal Reserve, I told him you would have a heck of a hard time meeting appreciation. It might sound good, but I do not know where else the return comes from. I know if you take the price of the land, what it is worth, take the machinery costs you have to have to farm, take all of the operating costs you have, and even forgetting the labor, many farmers are not making much of a return according to the figures we have put together over the years. That bothers me a little bit.

I might also say that while all of these new thoughts and ways to go are fine, I don't think we are taking up the basic problems that raise havoc with all of our programs.

We were talking about the dairy industry a moment ago. I think what has happened to some extent is that the only place any young farmer could get started is to add a few more cows to his dad's herd, and go in with him a little bit. He could not get into farming in any other way.

There were hearings this year. I ran into one guy out in Idaho who milked 6,000 cows three times a day. I bet if you would check the facts, you would find that cows have increased because the young farmers could not get started in any other way. Some decide to get big, and I guess that is all right, and maybe this is where all of this overproduction is coming from.

But let me go back a minute. While we are talking about some of the problems, I was wondering if any of these approaches will work if we do not start considering some of the other problems we have to face. Look at interest rates. They are certainly an improvement over what they were 2 years ago, but still I think those rates are awfully high. Sometimes I get a feeling when we give farmers FHA guaranteed loans they are paying too much interest to the banks yet for a guaranteed loan. I do not know what is so risky for a bank to have to charge from 12 to 15 percent for their money out in my country. That is a pretty expensive loan to try to go into farming with any program. Inflation has already done more damage than any program we can ever think of. But that is hopefully behind us for a while.

We know that in any program to keep farmers in business we are going to have to find some overseas sales. And something must be done about the American dollar. If our products are going to cost 20 percent more than any other country, everything else being equal, how do we overcome that?

Look at unfair competition. Right now we are trying to get a decent price for our soybeans, and the European Common Market is talking about putting a tax on them. We are over there fighting that, and that will not be any help to us, it will be a blow for the farmers. We have unfair competition in any foreign sale we try to make. We took them on, and we tried an experiment when we sold wheat flour to Egypt; we made a sale, but it was an expensive one. If you expect any farmer to raise wheat for the price that that wheat sold for, there would not be any around my part of the country, I can tell you that.

Over and above that we have the embargo problem. How do we know what foreign governments are going to do next?

John Block told me himself several times in my hearings that had we never had any Russian embargo, our wheat supply would be in a lot different situation. But we had it, are we going to have it again?

I am just wondering if any program will be very effective with all of these factors we have staring us in the face. I do not know if it is always the program, but maybe some of the other things that go on.

You talk about expensive farm programs. I just got through voting for a $21 billion employment bill, and that is expensive too, and nobody bothers about that. The Federal Government just thinks the way to take care of that is to plow several billion more dollars for another so many weeks into that program. And I am not condemning it, but

I hope people realize that what we are doing here in farming has probably had a greater return to the country by giving them cheaper food than has ever been enjoyed by any other country in the world.

So maybe we have got a problem with all these programs, but our biggest trouble is that the Government seems to be more concerned not about irritating the farmers, but irritating the public and making them pay more for their food than if they did have a decent program.

My question is, I guess, Will any program work as long as we have all of these obstacles in our path?

Mr. TWEETEN. I would like to respond just briefly to that. Many of the obstacles you talk about really trace to Washington.

Mr. GARDNER. That is right.

Mr. TWEETEN. It is critical that the United States establish itself as a reliable supplier of farm commodities abroad. If we did, we would have a larger market today. Certainly, if you look at the share of the United States and Soviet market, it is very small compared with what it was a few years ago. If we would have had that market, we would have had better sales and smaller surpluses.

Second, it seems to me that the single most important thing that the Congress could do to help create a viable farming economy without substantial commodity program involvement is to take deliberate steps toward a balanced full employment budget. That would reduce the value of the dollar in the international market, and would reduce real interest rates. Virtually no industry can continue to survive economically with these current real high interest rates.

Those are some things that can be done. But what we are doing is to make two wrongs, when we could correct one of those wrongs and have two rights. Because we have an overvalued dollar, and because we have a depressed world economy due to improper U.S. monetary fiscal policy, then the temptation is to propose very generous commodity programs, which are a factor in unbalancing the Federal budget. And that is the way we get into these difficulties.

Let us start to get out of these difficulties by moving toward a more balanced full employment Federal budget.

Senator ABDNOR. When we do that, we have to take on a lot of other things, other than the agricultural program and its problems. I sit on the Senate Committee on Appropriations, and if you take defense in with the other entitlements, our Appropriations Committee has control over 7 cents out of every dollar we spend.

So, I mean, I guess it all ties together. But going back to Congress, this Congress is going to have to have the fortitude to face up to some of these things and make some drastic changes that will be very difficult.

I hate to see it come just on agriculture and let all the rest of it continue on.

Senator Bob Dole told us yesterday that by 1988 we will be another one point some trillion in debt. And we will have another $100 billion a year interest on top of what we are paying already.

This is the kind of thing that affects farming and everything else. But overall it is a big problem, and one of the results of it makes the agriculture program a very expensive program and throws everything out of whack.

I guess there also is not any quick or easy answer to these problems. We have to correct a lot of things to make some of these other things work.

Thank you.

Senator JEPSEN. Not many farmers are getting paid for unemployment, though.

Senator ABDNOR. That is right. I try to explain to the people—I have farmers going to work, where it is costing them money to go to work in some years, let alone breaking even.

I wish I had a quick answer.

Senator JEPSEN. In fact, in regard to agricultural economics, which I have heard described this morning, it is very unscientific.

Mr. TWEETEN. That was Bruce Gardner's opinion, not mine. That is not the CAST opinion, either.

Senator JEPSEN. To be more specific, and I did make a note of it, he said agricultural economics is the least scientific of all economics. Is that not right?

Mr. GARDNER. I do not think I went quite that far. What I wanted to say is it is not as scientific as we may like to think it is sometimes; we have made some mistakes in agricultural economics. It is not very good at forecasting.

Mr. TWEETEN. But again it happens that Bruce Gardner and my path crossed back in 1978, when we had a national farm summit in College Station, Tex., I was chairman of a task force there which recommended that dairy price supports be reduced. At that time they were 82.5 percent of parity. We said then there would be surpluses. We had a number of agricultural economists who had been on retainer of the dairy industry who were very difficult with us.

Senator JEPSEN. It sounds like the retainers might have affected their economics.

Mr. TWEETEN. I think it did.

Senator JEPSEN. $16 million every 24 hours. That is what we are putting away to buy dairy surpluses. And that does not count the extra money we have had to provide for building some warehouses and all of that that goes with it.

I might say to the gentlemen that I am probably the only Senator in the U.S. Senate who has a direct interest in dairy, since my brother and his son farm our family farm and we do have, among everything else, a dairy. But it goes back to the basic thing, we have a 32-percent decrease in consumption, and a 12-percent increase in production. And those are the facts, and you have to keep them in mind. So we can go along with these formulas, say they are not erroneous, they are not faulty. But the milk order system that provides for say $15.10 in Iowa, where you have 10 degrees below zero weather, mud, all kinds of other things to deal with, compared to say $19 in Florida, where you have none of these elements to deal with, maybe we should look at that system also.

Mr. GARDNER. The cows like it better in Iowa. That is why they give more milk.

Mr. TWEETEN. Many of the assumptions that held when these dairy programs originated are no longer valid—the most prominent being that you cannot turn the milk of a cow on and off like a spigot. But you can in a sense turn its milk on and off like a spigot now through reconstituted milk, sterile milk, and other such technologies that are now available. So we need to reexamine the whole rationale under which we set up those original programs.

Senator JEPSEN. I think we also need to talk about, on the positive side, the consumption end of milk. You pay $2.50—and that is a bargain I guess– here in the District of Columbia, for a martini, which does not help your brain cells very much, and 16 to 18 cents for a glass of milk, which is about three times as much liquid as you get in one martini. Yet there is some resistence to milk now because folks have been running around Washington for some years with mouthings that milk is bad for you, you have to be careful about dairy products because of your heart, so people have gradually reduced their consumption of milk. Now I find about 3 weeks ago reports from maybe even a more scientific group saying that we have in a certain age group in our society a calcium deficiency and people ought to be drinking more milk to keep their teeth from falling out, your fingernails will look better. These are some things that we have basically known for years.

But this has been quite critical, to the point where that had something to do with this consumption figure. And red meats are not exempt from that, and a few other things also.

So we get to the Government again, because it is primarily a government-related agency that came up with those types of know-it-all knowledge. This has had a dramatic effect on the consumption of dairy products, especially since they can be projected to the media at the taxpayers' expense through ads.

That may be coming full cycle now again because, as I indicated, I think we are going to hear more about selling and consuming dairy products now because they are healthy. They do help you keep your teeth, your fingernails, and a few other things that the body needs.

Getting back to the basics of economics. In your prepared statement, Mr. Tweeten, you discuss the cash-flow problem, and you say that if the expected inflation rate is 9 percent, the mortgage interest rate is about 13 percent.

That differential is historically correct.

You say that inflation is at such and such a rate and interest rates are so and so. Like, for example, we have about a 2.5 to 2.8 percent annual real rate of inflation, and it has been down long enough so that by all rationale and past history, people should say OK, it will stay there, it has been down quite awhile.

Mr. TWEETEN. Our interest rates should be 6 or 7 percent under normal conditions.

Senator JEPSEN. Absolutely, but they are not.

Mr. TWEETEN. Why are they not?

Senator JEPSEN. Because of the lack of confidence and expectancy of the financial community as to what will happen.

Mr. TWEETEN. And why is that?

Senator JEPSEN. Partially because of not knowing what the Government is going to do next. You have it.

And one of the reasons is, of course, this is one of the best kept secrets we have had. Surveys show that—and we have made them nationally—the majority of people in this country do not realize that inflation is less than it was a couple of years ago.

The fact is that in the first 3 months of 1980 inflation was batting along at 18-plus percent. And the fact is that in the first 3 months of this year it was flat on the deck. So, I say it is one of the best kept secrets we have had in the country.

Mr. TWEETEN. But I would argue the participants in financial markets are some of the most informed people in the country. I think they know inflation is down, but I think they also know they cannot be confident that inflation will be kept down.

Senator JEPSEN. That is correct.

Mr. TWEETEN. The thinking is that the Federal Reserve is not going to be able to keep a tight money policy in the face of huge Federal deficits.

Senator JEPSEN. Senator Abdnor has to leave, so I would like to get back to him.

Senator ABDNOR. I am sorry, I have to excuse myself, but on the cover of your CAST report you have a picture of barges, and that is what I have to now go to. I happen to be chairman of the Water Resources Subcommittee of the Environment and Public Works Committee, and I have an omnibus water bill. The barge people are upset over something called "user fees." I guess I have stalled them for quite a while.

I do want to thank all three of you gentlemen—some of you have come from a long way off—for the great contribution and input you have given to this committee. I hope it carries over into some of our other committees that set the programs, while we do not have the power to introduce legislation, we do have some direct thoughts on it.

But we appreciate the valuable input and the valuable help you have given us by being here today. I just wanted to thank you before I have to leave.

Mr. TWEETEN. We want to thank you for the opportunity to be here.

Senator ABDNOR. Thank you.

Senator JEPSEN. Secretary Block recently announced the 1984 feed grain program. It will be a 10 percent set-aside.

Does anybody want to volunteer what kind of farmer participation you think we will get with that?

Mr. GARDNER. Very little.

Mr. TWEETEN. Well, it would be a mistake to get very much participation. As I understand the legislation, if there is no program, all farmers will be eligible for deficiency payments and loan rates. So, if you take a cynical view, the Secretary of Agriculture wants to set up an unattractive program to get very little participation, and to exclude most farmers from the benefits of farm commodity programs.

We do not need a diversion program for the coming years; however, we do need a strong outlook information program to make farmers aware of the kinds of prices they can anticipate if they plant fence row to fence row.

On the other hand, the wheat program, in my judgment, is not adequate. Participation rates are going to be low, and we are going to add substantial amounts to already burdensome surpluses under normal weather circumstances.

Senator JEPSEN. Does anyone else have any comments on that? [No response.]

There is a feeling that the farm community will plant every square inch, and there is concern about that.

Then they will start the full cycle again, which you just essentially described, I think, with wheat surpluses. Information needs to be given to tell farmers what they might expect by way of local prices if they produce too much.

What if you were given the authority to draft and implement immediately action to get us through the 1984 harvest, in other words, the next 13 months or so, what would you advocate be done on the basis of your study?

Mr. TWEETEN. You mean for feed grains?

Senator JEPSEN. Or farm programs in general.

Mr. TWEETEN. In the case of feed grains, first of all, I presume that there will not be much opportunity to change the basic structure of the programs; that is, they are already set by legislation.

Senator JEPSEN. Start by saying what is the perfect solution, forget about what might not be possible. What is the perfect solution.

Mr. TWEETEN. First of all, I want to emphasize strictly that this is Luther Tweeten talking and not CAST.

Senator JEPSEN. Yes.

Mr. TWEETEN. It does seem to me this is a propitious time to switch to a direct payment program, without controls. Surpluses are worked off, and you can focus benefits on middle-sized and small farmers. You can be highly price competitive in international markets. It has a lot of the features that we are looking for in commodity programs. And you cannot initiate a program like that at a time when huge surpluses are hanging over the market.

This would be a good time to do it.

Senator JEPSEN. Could you describe the direct payments for me?

Mr. TWEETEN. Well, there are various ways it can be run. One is through the target price deficiency payment program. Set a target price for corn of probably say $3.50 a bushel. That target price would be available on, let us say, 70 percent of the farmer's typical base. Maybe that would be on just the domestic portion. Payment would be the shortfall of market price below the target price on the basic production. On additional production he would get the market price and nothing more.

Furthermore, there would be payment limitations, perhaps $20,000 per recipient, and it would go to the day-to-day operator of the farm. That would confine payments to the moderated-sized and smaller farmers. You would have no production controls, no loans and no loan price support. Prices would be determined in the markets. The deficiency payment would be based on the difference between the market price—in, say, the first 5 months of the marketing year—and this target price. But only on, say, 70 percent of the base.

That is one way to run that program. It would be quite similar to the current program, except you do away with the nonrecourse loan, the loan support rate and production controls.

One of the shortcomings is you might have more variability than people like. You could run a farmer-owned reserve program on the side. A limit would be set on how much a farmer could put into that reserve. In the case of corn and feed grains, that limit might be 40 million tons. Once that reserve is full, you could not add to it. If there is a vacancy in that reserve, it would be prorated according to the farmer's production base, so that farmers widespread would get a chance to participate in the program.

Senator JEPSEN. Yes, Mr. Gardner.

Mr. GARDNER. I would like to say something. I disagree a little bit with what has been said here.

Let me make a couple of points. First, with respect to the PIK program and where it put us today, we are saying we have worked off the stocks now. I just do not know how much comfort to take in that. I do not take that much comfort in it. I think you possibly will be back in a surplus situation in the feed grains, very quickly.

Part of the problem, I think, is the PIK program, because it was billed as something just to get us through a short-term period of low prices, after which we could look for a longer term solution.

Now we are saying we need outlook information to tell farmers, Beware, if you produce too much next year, you will have low prices; but what farmers will do is infer that if that occurs, we will have another PIK program, and that will be a tremendous bonanza, as was PIK.

So I think we sent a signal to produce more by having PIK. We can send the farmers all of the outlook information we want and it will not make that much difference.

I do not think in the grains we have a situation like that of a dairy, where things are really very far out of balance. In the case of grains in general, I think if we had our target prices say 10 to 15 percent below what they are now, we would be close to what market prices would be in the absence of programs, and that would take a lot of pressure off that might reassert itself in the next year or so.

If I could get my program for the next year—it is too late now, but talking about the ideal situation—I would like to see the target prices cut 10 to 15 percent for grains and cotton and the loan rates cut a little bit, and keep the other parts of the program the way they are.

Senator JEPSEN. Let us talk about soil conservation. Do you have any ideas of what we might do about soil conservation?

Mr. TWEETEN. There are some obvious things we could be doing. First of all, we could be focusing the funds that we are currently spending much more on the areas that are experiencing high erosion rates. Instead, we are spreading those funds all over the country. We ought to focus on the problems.

Second, in terms of commodity programs, their ability to deal with the soil conservation program is somewhat limited. However, I think there is some oppportunity. If the Nation is controlling production, we could use a long-term diversion program. It might be a crop easement. By this I mean the Government would actually purchase the rights to produce crops on erosion-prone land. The farmer could graze it, hay it, use it for other purposes, but he could not produce crops on it.

That would be another useful step in cutting down erosion in some of the more erosion-prone areas of the country.

Senator JEPSEN. I could not agree with you more. This program has essentially been pushing the Department of Agriculture and finally got them to say that is what we are going to work on and do. I think it is time to do this.

But in the long term, how about adding maybe a little bit of the PIK philosophy, paying in bushels of grain?

Mr. TWEETEN. Yes, I think that would be a possibility.

Incidentally, I want to diagree a little bit with Bruce Gardner, since he has disagreed with me.

It seems to me the PIK program was a wise program. It was basically a costless program. If your only alternative is to store those commodities for 3 or 4 years and get a salvage value out of those commodities that was nowhere nearly enough to cover even the storage, then PIK was basically paying farmers with commodities that have no value to the Government.

So under the circumstances, PIK was a very low-cost program. It was not administered very well, but it was a very low-cost program.

My criticism of PIK, in addition to the administration of it, is you should never get into a position where you have to use it. And you can avoid that situation in two ways. One is you have your support prices low enough so that stocks do not accumulate to three times the needed level, as we have in the case of wheat.

The second thing is that if you do see the stocks are likely to accumulate to unreasonable levels, you pay farmers in cash not to produce before it is done; that is, if you are not willing to go the other route and have low enough support prices to cut production.

Senator JEPSEN. The PIK program, specifically the one in 1983, may be an example of the Lord's working in mysterious ways, because it literally saved thousands of farmers this year from bankruptcy. Thousands. These farmers took advantage of what economic plans were available to them, one of which was PIK and the other was crop insurance in most places where it was available. Those programs turned out to be a pretty good combination. Producers, who were under a true production basis—there were some exceptions that the formula did not give a fair shake to, like livestock producers—had the tools available to them this year to prudently provide a good business operation for any contingency.

One of the problems with economics is that it may be less scientific than others in the agricultural area. Agriculture has always had two problems to deal with, both of them seemingly uncontrollable; one the weather, and the other the Government. And none of us can really do much about the first. But there are still those of us who are optimistic that we can do something about the second, and are trying to.

But those are the two factors that have really come to bear, the weather for the most part being unique to agricultural people as a risk, an uncontrollable one, although you can provide for contingencies with all-risk crop insurance. But when you have year-in and year-out different farm programs, and you have the agricultural community being unilaterally singled out to suffer the machinations of foreign policy, its difficult to plan.

The lack of being able to plan is one of the biggest problems we have. The long-term soil conservation set-aside, that provides for some long-term planning, long term being anything longer than 1 year, is very desirable.

Mr. Black, you have been listening to our exchanges. Do you have anything, as we are about to close here, which you would like to say?

Mr. BLACK. I am strictly a noneconomist. I never got as far as the first course in economics. But last summer, after Mr. Tweeten spent a day in Ames with me working on this report, I said to him, you know, I have obtained a great deal of respect for the law of supply and demand. We get into all kinds of trouble when we try to evade that law. He said, yes, it is insidious.

Senator JEPSEN. Yes. Do you have any closing remarks, Mr. Tweeten?

Mr. TWEETEN. No. I just want to say again that I appreciate very much the opportunity to be here today.

Senator JEPSEN. Mr. Gardner.

Mr. GARDNER. No, I would just second the thanks for the opportunity to be here.

Senator JEPSEN. I would advise and respectfully ask that if there are further questions as we have a chance to review and work on this CAST report, that we might write to you for some observations or opinions, and we would appreciate hearing from you on those.

We are studying, as I indicated in my opening statement, every avenue in developing a farm policy for the next generation. That is a kind of descriptive term with which I label this, rather than talking about the 1985 farm bill. It is difficult to get the Congress to focus on the next generation when their eyes are focused on the next election.

I have chosen to use the Joint Economic Committee to develop farm policy, first, because I am chairman, and second, because it does have a broad latitude and resources at its command in the finance and economics area, and can call on experts in all fields.

I think agriculture is everybody's business. And when you talk about public information policy, that is one of the things we have to do, especially those of us whose constituency comes primarily from agricultural areas. We have to tell the agriculture story. We have to bring everybody in this country in on the inputs of developing the next generation of farm policy or we will not have the consensus which is necessary in a democracy to maintain support for it.

We have had some 26 hearings to date, this makes the 27th, over the last couple of years, just on agriculture by this committee. We have heard people from the consumer area, the environmentalists, soil conservation, the finance industry, regulatory people, the SCS, the Government, and I could go on and on. I think we have had them all.

We are going around the second time trying to get some more input. I did so initially with the blessings of Representative de la Garza, who opened the main hearings, lending his support, and Senator Helms the same way.

As we move into the mechanics of grinding out the 1985 farm program or farm policy, which I consider to be the policy for the next generation, we hope for the first time in the history of this committee to be able to give to both the Agriculture Committee in the House and in the Senate a great deal of both information and input. Frankly, we intend to try to mould some means of doing that before we move into that area.

You gentlemen have contributed a lot to this committee today and I thank you for it, and we would appreciate it if at any time any thoughts come to you as we move along, try to keep the reports coming in.

I thank you for coming, thank you for what you have done, and God speed you safely home.

Thank you very much. The committee stands adjourned.

[Whereupon, at 12 noon, the committee adjourned, subject to the call of the Chair.]

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