The Continuing Plight of Agriculture

Why Federal farm policy fails.

by Dennis Bechara

Mr. Bechara, an attorney, is a frequent contributor to *The Freeman*. This article is based on a lecture which he delivered in November, 1985, during a FEE seminar held in the Washington, D.C. area.

On December 23, 1985, President Reagan signed into law the Food Security Act of 1985, commonly known as the "farm bill." This statute will affect the state of American agriculture for the next five years. During the past year, the precarious condition of the agricultural sector has been a hotly debated issue. Although the enactment of the 1985 farm bill is designed to confront and resolve the crisis, the unfortunate fact remains that the same failed tools which were utilized in the past will continue to be used in the future. It should not surprise us if more surpluses and low farm prices continue to plague the farm sector in the immediate future.

Why is our agricultural sector in such a precarious state? Is more government intervention the answer to the problem? Before analyzing our current crisis, it will be instructive to review our past agricultural policies, for our present attitudes toward the farm sector may be explained by our historical development as a country. Only if we fully understand the root of our policies will we be in a position to improve the lot of agriculture.

One of the fundamental differences between the development of the United States and the evolution of Europe is the abundance of land in this country. As the government acquired more land rights in the West, it became the national policy to settle the West and actually to give land to those who were willing to carve a family farm out of the wilderness. The Homestead Act of 1862 is perhaps the watershed of this era of open lands. It has been estimated that over one billion acres of land were thus given to farmers during the settlement of the West.

Although most of the family-size farms essentially provided sustenance to the families that operated them, farmers were able to grow enough crops out of which they hoped to acquire other goods that they needed. The problem, however, was that as a result of the Federal farm policies, which encouraged anyone who wanted to enter farming to do so, a perennial surplus of production always loomed on the horizon.

As the newly settled farmers attempted to set up their operations, they faced innumerable obstacles. A significant one was the need for capital to finance their operations. Consequently, farmers, in general, became a debtor class. Politically, this meant that traditionally they

favored a policy of easy credit and easy money. Perhaps because of the dispersed land ownership pattern that evolved as the West was settled, farmers also tended to regard any concentration of economic power with suspicion. They therefore generally favored both the regulation of railroads and the dismantling of large corporate utilities. Granges were partly responsible for the regulation of railroads on a state-by-state basis. These state laws, in turn, prompted Congress to enact the Interstate Commerce Act in 1887 which regulated railroads on a national scale.

Prior to the First World War, there was a farm surplus problem. However, as a result of the outbreak of the war, and the subsequent American participation in it, the federal government encouraged further agricultural production. Easy credit policies were enacted, and the justification for the overproduction was epitomized in the slogan "Food Will Win the War." Predictably, at the end of the war, farm prices fell, reflecting the government-encouraged surplus production. As protection to the farmers, Congress proceeded to enact higher tariffs on farm commodities through the McCumber Act of 1922. But farm prices remained low. Farming was perhaps the one bleak point in the economic boom of the 1920s. No matter what the government did, farm prices remained low.

The Birth of "Parity"

The year 1922 saw the birth of the concept of "parity." This concept first appeared in a booklet written that year by George N. Peek and Hugh S. Johnson entitled "Equality for Agriculture." The thesis of this booklet was that farmers were entitled to receive a "fair" price for their commodities. The fairness of the price was connected to the level of prices received during the golden era of agriculture, which were the ten years that preceded the First World War.

Congress, reflecting the thinking of the farm sector, enacted a proposal which embodied these ideas. The proposals were known as the McNary-Haugen bills. These bills would have restructured domestic distribution of farm commodities, so as to raise the prices to the much-heralded "parity" level. The excess which could not be marketed domestically, however, would have, in effect, been dumped on the international market while the U.S. consumer would have paid for this subsidy. These bills did not become law, and in 1927, when President Coolidge vetoed the latest version of these bills, he justified his veto utilizing rather prophetic language. In his veto message, the President said:

> Government price-fixing, once started, has alike no justice and no end. It is an economic folly from which this country has every right to be spared . . . There is no reason why other industries —copper, coal, lumber, textiles, and others—in every occasional difficulty should not receive the same treatment by the government. Such action would establish bureaucracy on such a scale as to dominate not only the economic life but the moral, social, and political future of our people. The main policy of this bill runs counter to the well-considered principle, that a healthy economic condition is best maintained through a free play of competition, by undertaking to permit a legalized restraint of trade


Current attitudes toward the farm sector may be explained by our historical development as a country.

AMERICAN FARM BUREAU FEDERATION

> in these commodities and establish a species of monopoly under government protection, supported by the unlimited power of the farm board to levy fees and enter into contracts. For many generations such practices have been denounced by law as repugnant to the public welfare. It cannot be that they would now be found to be beneficial to agriculture.

Agriculture in the 1920s experienced an unsurpassed productive capacity as the result of both technological advances and governmental policies. Naturally, farm prices fell due to this surge in productivity, and the signals that the low prices communicated to society were that there were too many resources invested in agriculture. The adjustment process has proven painful to many farmers. In 1790, 96 per cent of the population was engaged in farming. By 1927, the farming sector had decreased to 27 per cent. The farming sector is now one-tenth of what it was 50 years ago—2.5 per cent. Low farm prices were a symptom that indicated to society that its resources were misallocated and that a migration away from agriculture was the desired goal. In spite of all the government policies enacted to halt this migration, the trend has continued.

During Herbert Hoover's administration, prices received by farmers fell to historically depressed proportions. Farm income fell by more than half between 1929 and 1932. As a palliative, a new government agency was organized to take care of falling prices. This was the Federal Farm Board which was organized as a result of the Agricultural Marketing Act of 1929. Endowed with a revolving fund of $500 million, the Federal Farm Board set about to stabilize the prices of wheat and cotton. The price of a bushel of wheat was $1.04 in 1929, but in spite of the purchasing activities of this agency, the price of wheat fell to 39 cents per bushel by 1931. The Board accumulated such large stocks of wheat, that at one point it controlled 80 per cent of the country's supply. Cotton fared no better. After having incurred heavy losses, Congress refused the agency any further funds and it ceased operations. Protectionism, however, seemed to be the course of action to follow, and the Smoot-Hawley Tariff of 1930 only succeeded in engendering further retaliatory tariffs that impeded world trade.

With the advent of the Roosevelt administration, a host of new statutes were enacted which were designed to treat the economic emergency caused by the Great Depression. Each sector of the economy provided its own explanation for the cause of the crisis. Agriculture too had an explanation for its problems: there was just too much production. So the Agricultural Adjustment Act of 1933 was enacted. This is the prototype of the legislation that in many ways is still in effect today.

Raising Income by Reducing Production

The cornerstone of the Agricultural Adjustment Act of 1933 was to raise farm income by reducing production. Farmers were paid to reduce the acreage under cultivation and were guaranteed a minimum price on certain commodities. The crops that were to be controlled by this statute were the so-called "basic" commodities: wheat, corn, cotton, peanuts, rice, and tobacco. Although these commodities generated about one-fifth of farm income, they earned the lion's share of government funds spent in order to support prices.

One of the oddities of the price support system has been that it is designed to subsidize the volume of production, not the farmers' needs. Thus, small farmers have consistently received very few benefits from the price support system, whereas large farmers have benefited proportionally more. At the present time, one-third of all farms in the United States produce approximately 85 per cent of all farm sales. Therefore, two-thirds of all farmers receive insignificant government assistance from the price support system.

The implementation of the farm policy of the New Deal was mainly based on acreage reductions rather than on price supports, since these supports were set at a low level. However, with time, the support prices began to be increased to reach levels above the market-clearing point, so that stocks of surplus commodities began to appear. Land which produced subsidized crops was cultivated more intensely to increase the yield per acre. Other land that would have produced subsidized crops had it not been for the acre reduction requirement was cultivated for various additional crops. This, in turn, created surpluses in other areas.

The mechanics of the price support system have not changed very much since their inception in 1933. The Department of Agriculture, through an agency called the Commodity Credit Corporation (CCC), issues nonrecourse loans to farmers who produce the subsidized commodities. If the price of the commodity rises above the loan rate, the farmer is free to sell the commodity and is obligated to repay the loan. Therefore, the loan rate becomes a minimum price. If, on the other hand, the price of the commodity falls below the loan rate, the farmer simply relinquishes the commodity over to the CCC and the loan is considered paid in full. Thus, whenever the loan rate is set above market-clearing levels, the CCC ends up holding the surplus production.

The Agriculture and Consumer Protection Act of 1973 introduced the concept of "deficiency payments," which consists of an additional subsidy representing the difference between the lower loan rate and the higher price support or price target. Farmers are entitled to a deficiency payment whenever the selling price of the regulated commodity falls below the price support point. Although designed to avert the chronic overproduction of agricultural commodities, this mechanism has proven ineffective in reaching its goals.

The 1985 farm bill has continued the use of both nonrecourse loans and deficiency payments. The only change is that the loan rate has been lowered in an attempt to control chronic overproduction. The purpose of the lower loan rate is to encourage farmers to sell their products in the marketplace, rather than forfeiting them to the CCC. The anticipated lower farm income is supposed to be offset, however, by the deficiency payment. Therefore, since the farmer will still receive a subsidy, regardless of the market price of the commodity, it is doubtful that surpluses will be eliminated.

The export boom of the 1970s once more temporarily eliminated the perennial surplus problem. The government relaxed all production controls, and 55 million acres of cropland were added to production in order to meet this demand. Financial institutions, in turn, issued credit based on the assumption that land prices, which were increasing, provided sufficient collateral. Farm debt, which stood at $50 billion in 1970, increased to $214 billion by 1985. But after 1981 several factors radically altered the picture. Interest rates increased, a world recession reduced exports and other countries began to increase their productive capacity. In addition to this, the value of the dollar increased, making farm products even more expensive in world markets.

The Present Crisis

Notwithstanding the massive subsidies farmers receive from the federal government, the farm economy is presently facing a severe crisis. Farm income has decreased by about a third during the past four years. In spite of this, the costs of the price support and market subsidies that form part of our national farm policy have ballooned to unprecedented levels. When the 1981 farm bill was enacted, it was expected to cost the taxpayers no more than $12 billion. Instead, the actual costs incurred amounted to over $60 billion. Similarly, in 1981, farm exports reached the unprecedented height of $44 billion, which represented approximately 60 per cent of the world's agricultural market. Our share of the market has subsequently declined to approximately 50 per cent and our exports were $32 billion in 1984.

The 1981 price support legislation enacted rigid and high price supports which only encouraged other countries to further increase their production. Therefore, land values began to decline. Since the value of the collateral no longer supported more credit, financial institutions have reduced lending. Since 1981, around 200,000 farmers have gone out of business.

Because Federal price supports have been above market clearing levels, the government has acquired large stocks of surplus production. As a temporary solution, in 1983 the "Payment in Kind" (PIK) program was designed. Farmers who participated in the scheme were given comparable amounts of crops. Eighty-three million acres of cropland were idled, and the government surplus disappeared. But sales of fertilizer, machinery, feed and other products necessary for farming were reduced. Experts at Georgia State University estimated that the PIK program cost 200,000 jobs. This estimate does not include the actual amount of crops given away, worth approximately $10 billion.

The 1985 farm bill continues substantially the policies of the past. The outcome of these past policies has consistently been overproduction. In response to the surplus problem, Congress has established four mechanisms to combat surpluses. These are the acreage reduction programs, marketing agreements, voluntary land retirement, and import quotas. The 1985 bill continues this trend.

The acreage reduction program goes hand-in-hand with the price support mechanism. Essentially, if a farmer wishes to participate in the subsidy program, he or she is required to limit the acreage apportioned to the cultivation of the subsidized commodities.

Marketing Orders

Marketing orders represent another mechanism for dealing with the recurrent surplus problem. The marketing order scheme has its origins in the Capper-Volstead Act of 1922 which allowed the formation of agricultural cooperatives. This statute exempted agricultural cooperatives from the coverage of antitrust legislation. Even though the cooperatives were free to cartelize production, they were never able to effectively influence prices because not all producers agreed to join them. In other words, the forces of the market prevented the formation of monopolies. Therefore, further statutory intervention was required, which culminated in the Agricultural Marketing Agreement Act of 1937.

This statute authorized the Secretary of Agriculture to set up marketing orders for milk, vegetables, fruits and other minor products. Presently, there are 47 marketing orders in effect, covering a variety of crops worth around $5 billion a year. After a marketing order is adopted by the Secretary of Agriculture, a referendum of producers is held. If the order is ratified, it then comes into effect. The order may be amended from time to time by the Secretary, who usually follows the recommendation of producer administrative committees. Some of the marketing orders are not particularly important. For example, the market-support variety requires producers to contribute to an advertising fund. However, most of the marketing orders are designed to restrict supply in various ways. Some are concerned with setting quality standards. Others restrict the amount of products the farmer may bring to market, or determine how much fresh produce handlers may ship, or require producers to put part of their crop in storage until market conditions improve so as not to lower the market price. Any excess must be diverted for other uses, or simply left to waste.

Predictably, the effect of marketing orders is to increase prices. In addition, resources are misallocated since supply-control orders, by raising prices, encourage more production of the commodity. This, in turn, produces more waste, since more commodities are then diverted

to other uses or left to rot. It has been estimated, for example, that up to 30 per cent fewer acres would be needed to produce the amount of California and Arizona oranges which ultimately are marketed. Innovation is also reduced, since there is no incentive to reduce costs of production because a producer's sales are limited by the orders. An example of an innovation that has been frustrated is the development of a special shrink wrap that would allow lemons to be wrapped fresh for periods of about six months. It has also been estimated that 25 per cent of the lemon crop is wasted.

Voluntary land retirement has been a traditional method whose purpose has been to reduce agricultural production. In many instances, the additional purpose of fostering soil conservation has also been utilized as a means of limiting farm acreage. By the 1960s, 60 million acres had been removed from production. Ironically, the price support system and the disaster payment programs have encouraged farming in areas that have been subject to unusual environmental risks. For example, in the semi-arid climate of the Great Plains, ranchers may be tempted to cultivate some of the subsidized crops. After the prairie grasses are eliminated and a crop cultivated, the rancher may be required to set aside part of his land in order to receive the subsidies. This only exposes that soil to the dangers of erosion. The 1985 farm bill has recognized the deleterious effect of the price support system to certain erodible lands, and the eligibility of those lands in the subsidy program has been restricted.

Import Quotas

Import quotas are the fourth method which has traditionally been used to combat surpluses. Sugar is one of the products that has consistently been protected from foreign competition. The domestic price of sugar is approximately four times the world price. Foreign-grown sugar may only be imported in limited quantities and from certain countries. The sugar quota allowed from foreign countries has decreased significantly over the past four years. In 1981 we imported 5 million tons of sugar, whereas by 1985 the amount was decreased to 1 million. This has foreign policy repercussions, since most sugar-producing countries are less-developed countries that urgently need foreign exchange to support their economies.

In spite of these four methods of reducing surplus production, high price supports have consistently provided the incentive to engage in overproduction. If the price supports did not exist, farmers would guide production based upon market prices. When market prices are low, the signal communicated to producers is that production should be reduced, and farmers will act accordingly. With the present system, however, farmers can disregard the market signals and overproduce, confident that the government will guarantee a support price. The surplus production only succeeds in lowering market prices, which, in turn, becomes the political justification for keeping the price support system in effect.

One of the justifications for price supports and marketing orders is that agriculture is a different type of industry. There are many aspects of the agricultural cycle that are beyond the control of farmers. Natural disasters, insect infestations and droughts are examples of the difficulties with which farmers have to contend. But there is a large segment of agriculture, over half of the sector, which operates without the benefit of price supports. Livestock, as well as many fruits and vegetables, have successfully operated without these supports.

The free market has the capability of protecting farmers against unforeseen price fluctuations through the trading of agricultural options. This system enables farmers to sell a commodity sometime in the future at a predetermined price. Since 1936, however, this system had not been allowed to operate in most of the major domestic commodities. But as a result of the enactment of the Futures Trading Act in 1982, the trading of agricultural options in the regulated commodities has been allowed. The first trading of these contracts began in October of 1984. It should be pointed out, however, that with the price support system in place, the prospects of these contracts are limited.

The current agricultural programs have inconsistent and conflicting effects. Some of the programs—like easy credit to buy and operate a farm, or research activities or irrigation projects—lower the costs of production. Other programs—some of the ones discussed in this article—tend to increase prices. Our legislated programs are encouraging overproduction, which has the unwanted effect of decreasing prices and reducing farm income. The surplus production which the federal government normally holds has been partially sold in the international markets. Foreign countries have increased their productive capacity, and this alternative no longer is viable in the long run. Our farm policy should not be based on sheer hope that some future event will take care of overproduction.

Circumstances have changed over the past fifty years. Farm income, as a percentage of the income generated in urban areas, has increased. The farm sector, on the average, earns about four-fifths of the earnings in the non-rural sector. Politics should be eliminated from our farm policy. It is not unknown for politicians to encourage the raising of price supports at strategically convenient times in order to gain votes. It is time we stop the present contradictory and negative farm programs. The longer we hesitate in embracing the free market, the worse it will be for all. □

Unemployment Compensation

Unemployment compensation harms everyone—including those it is supposed to help.

by Hans F. Sennholz

Dr. Sennholz heads the department of economics at Grove City College in Pennsylvania. He is a noted writer and lecturer on economic, political, and monetary affairs. His latest book is *Money and Freedom*.

To compensate workers for wages lost during periods of unemployment, most countries have systems of unemployment insurance. They are compulsory, in the sense that government enforces coverage and uses the taxing power to finance the expenditures. Previous contributions by or on behalf of the workers largely determine benefit eligibility and amounts according to formulas stipulated by law.

The primary purpose of the system is economic assistance and compensation of employees for wage loss during periods of economic decline and depression. The economic effects of such periods are compounded by sociological effects that are reflected in physical and mental ill health, rising crime rates, divorce rates, and even suicide rates. Unemployment compensation seeks to alleviate the ill effects.

The American system is a federal-state system that was forced upon the states by the Social Security Act of 1935. The Act levied an unemployment tax on employers, but offered a 90 per cent offset (1) for employer payments of state payroll taxes for unemployment benefits or (2) for reductions in such state taxation under a program of experience ratings. The law left the states free to determine their own benefit levels and duration of benefits. Consequently, benefit provisions and tax rates differ widely among the states.

The system is a form of public charity that springs from a new conception of social welfare. The public now accepts the concept that government must bear the ultimate responsibility for public relief, including unemployment assistance. This new attitude brought forth extensive social legislation and led the way to the "welfare" or "social service" state. The American system followed in the footsteps of earlier systems in Scandinavian countries, some Commonwealth countries and Great Britain, which in turn were influenced by the labor legislation of Bismarck Germany in the 1870s.[1]

The social service state has few genuine critics. Its countless supporters are guided by a great number of motives that continue to lend intellectual support to the system. Their first and foremost motive, we are led to believe, is *charity* toward their fellow men. They wax eloquent about their feelings of benevolence, good will and affection,