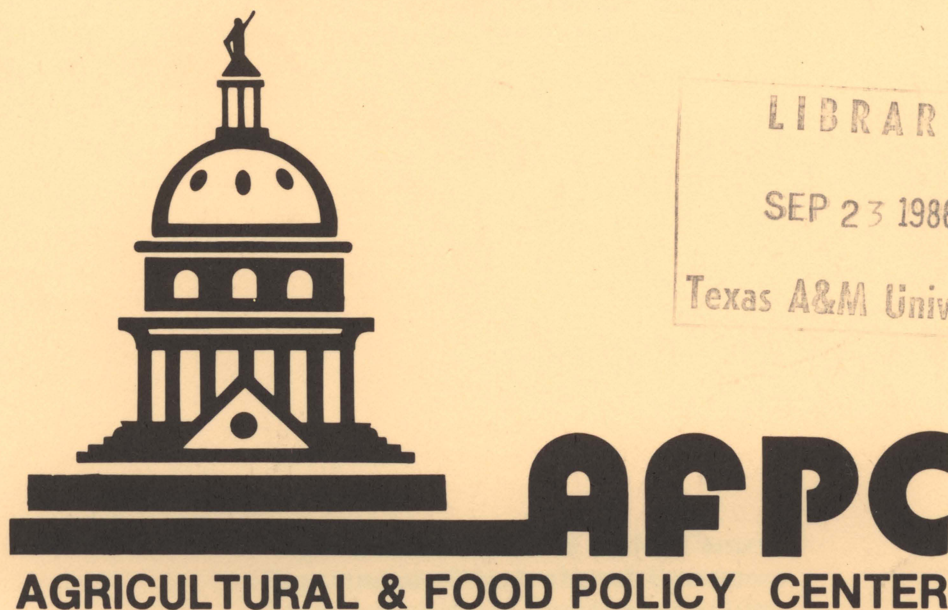
TDOC
Z TA245.7
B873
NO.1548

B-1548
August 1986

Policy Tools for U.S. Agriculture



LIBRARY
SEP 23 1986
Texas A&M University

The Texas Agricultural Experiment Station/Neville P. Clarke, Director/The Texas A&M University System/College Station, Texas
in cooperation with
Texas Agricultural Extension Service/Zerle L. Carpenter, Director/The Texas A&M University System/College Station, Texas

[Blank Page in Original Bulletin]

POLICY TOOLS FOR U.S. AGRICULTURE

Ronald D. Knutson
Extension Economist and Professor of Agricultural Policy

James W. Richardson
Professor of Agricultural Policy

Danny A. Klinefelter
Extension Economist—Management

Mechel S. Paggi
Extension Economist and Assistant Professor of International Trade

Edward G. Smith
Extension Economist—Grain Marketing and Policy

Agricultural and Food Policy Center
Department of Agricultural Economics
Texas Agricultural Experiment Station
Texas Agricultural Extension Service
Texas A&M University

[Blank Page in Original Bulletin]

S|117|E22|B-1548|1986|Aug.

Foreword

This document summarizes policy tools in U.S. agriculture. In the 50 years since the Agricultural Adjustment Act of 1933 a wide array of farm programs has evolved. It is important for the public to recognize that, due to numerous factors, wide variations in agricultural production create income instability for farmers and ranchers as well as uncertainty in supplies and prices for processors and consumers. Individually, farmers and ranchers are not able to control the numerous variables that affect agriculture. Consequently, farm policy is an important function for the U.S. government. The form and degree of government involvement in policy is the subject of continuous debate.

In this document, government policy tools impacting agriculture are individually reviewed, with regard to implementation, procedures, and the impacts on prices and supplies. It updates a previous publication of the same title dated August 1984. New policy concepts included in the 1985 farm bill or discussed in the debate surrounding its enactment are added. In addition, a new section has been added that recognizes the important role of credit policy as a dimension of farm policy. The international section has been strengthened. The macroeconomic tools (monetary and fiscal policy) were eliminated as a result of feedback suggesting they were too general to be useful. In the next edition or in a separate publication a macroeconomic section will be developed which includes alternative federal income tax and monetary policy tools. The purpose of this publication is not to advocate particular farm programs or policies, but rather to summarize the array of techniques and methods which have been utilized or considered for improving economic equity and stability in agriculture. This publication should be a useful guide and reference for those individuals or organizations involved in agricultural and food policy development, for those considering the broader domestic and international dimensions of U.S. agriculture, or for those interested in policy alternatives that could be used singularly or combined.

Keywords: Domestic farm policy, commodity programs, international trade policy, market development programs, credit policy.

Introduction

Agricultural policy is a broad term used to encompass government programs that directly affect the prices and incomes received by farmers. In developing agricultural policy, producers and agribusiness leaders, their organizations, and government policy makers must sort through a myriad of potential policy tools.

Each policy tool or government program is intended to deal with a specific farm problem in a specific way. For example, target prices raise farm income through direct payments from the government while support prices raise income by setting a floor on market prices. Some policy tools are more effective than others in accomplishing the objectives for which they are intended. For example, quotas that dictate the volume a producer can market are more efficient than acreage reduction programs in controlling production. Often policy tools have side effects that need to be considered before selections are made. For example, when price supports are set above world market prices, exports fall.

This publication provides brief descriptions of individual policy tools that are most directly related to agriculture and the U.S. Department of Agriculture (USDA). The report is designed to be a comprehensive list of those policy tools that are used currently, have been used in the past, are used in other countries, or have been proposed for use in the United States. These tools are divided into four general categories:

- **Domestic farm programs**—designed to raise or stabilize farm prices and incomes.
- **International trade policies**—designed to create a more favorable trading environment for U.S. farm products.
- **Marketing programs**—designed to improve farmers' position in domestic and foreign markets.
- **Credit programs**—designed to assure agriculture an adequate supply of debt capital at a reasonable cost.

A single-page summary describes each policy tool with respect to the following:

- The policy area in which the tool falls.
- What the policy tool is.
- The primary objective of its use.
- When it has been used.
- Experience with its use.
- Consequences of its use.

The following publications offer comprehensive discussions of the policies described here.

- Armbruster, W. J., D. R. Henderson, and R. D. Knutson. *Federal Marketing Programs in Agriculture: Issues and Options.* Danville: The Interstate Printers & Publishers, Inc. 1983.
- Christiansen, M. K., editor. *Speaking of Trade: Its Effect on Agriculture.* Agricultural Extension Service, University of Minnesota, Special Report No. 72. 1978.
- Gardner, B. L. *The Governing of Agriculture.* Lawrence: The Regents Press of Kansas. 1981.
- Glaser, R. K. *Provisions of the Food Security Act of 1985.* USDA/ERS, Agr. Info. Bul. 498, 1986.
- Knutson, R. D., J. B. Penn, and W. T. Boehm. *Agricultural and Food Policy.* Englewood Cliffs: Prentice-Hall, Inc. 1983.
- Paarlberg, D. *Farm and Food Policy: Issues of the 1980's.* Lincoln: University of Nebraska Press. 1980.
- Tweeten, L. *Foundations of Farm Policy.* Lincoln: University of Nebraska Press. 1979.

TABLE OF CONTENTS

Domestic Farm Programs

- Supply Control
  - —Acreage Reduction, Set-Aside, and Diversion 2
  - —Marketing Quotas 3
  - —Long-Term Land Retirement, Conservation Reserve Program 4
  - —Dairy Buyout, Termination Program, and Diversion Program 5
  - —Acreage Allotment 6
  - —Cross-Compliance, Limited Cross-Compliance 7
  - —Offsetting Compliance 8
  - —Payment In Kind (PIK) 9
  - —Generic PIK 10
  - —Sodbuster, Swampbuster 11

- Price Support
  - —Commodity Credit Corporation (CCC) Loan, Nonrecourse Loan 12
  - —Commodity Purchase Program 13
  - —Farmer Owned Reserve (FOR) 14

- Income Support
  - —Marketing Loan, Findley Loan, and Marketing Certificates 15
  - —Target Prices, Deficiency Payments 16
  - —Disaster Program 17
  - —Payment Limit 18
  - —Federal Multi-Peril Crop Insurance (FCIC) 19
  - —Income Insurance 20
  - —Cost-Sharing Programs, Assessment Programs 21

International Trade Programs

- Trade Barrier Reduction
  - —GATT (General Agreement on Tariffs and Trade) 23
  - —Generalized System of Preferences (GSP) 24

- Export Subsidies
  - —Monetary Export Subsidies 25
  - —Two-Price Plan 26
  - —Blended Credit 27
  - —Direct Export Credit 28
  - —Export Credit Guarantees 29
  - —Public Law (P.L.) 480 (Food for Peace) 30
  - —Export PIK, Bonus Incentive Commodity Export Program (BICEP) 31

- Domestic Industry Protection
  - —Import Quotas 32
  - —Import Tariffs, Countervailing Duties 33
  - —Nontariff Trade Barrier 34
  - —Voluntary Export Restraint 35
  - —Variable Levy 36
  - —Cargo Preference 37

- Embargoes
  - —Export Embargoes 38
  - —Sanctity of Contracts 39

- Trade Agreements
  - —Long-Term Bilateral Trade Agreements 40
  - —International Commodity Agreements 41
  - —Barter/Counter Trade 42

TABLE OF CONTENTS
(Continued)

Marketing Programs

- Demand Expansion and Food Assistance
  - —Commodity Distribution 44
  - —School Lunch 45
  - —Women, Infants, and Children (WIC) Program 46
  - —Food Stamps 47
  - —Cashing Out, Welfare Reform 48
  - —Foreign Market Development, Cooperative Programs 49
  - —Domestic Market Development 50
  - —Checkoff Programs 51

- Market Organization and Control
  - —Cooperatives, Capper-Volstead 52
  - —Marketing Orders 53
  - —Marketing Boards 54

- Market Facilitators
  - —Market News Price Reporting 55
  - —Crop and Livestock Production Reports 56
  - —Export Sales Reporting 57
  - —Grades and Standards 58

Credit Programs

- Debt or Payment Restructuring
  - —Principal and Interest Deferrals 60
  - —Interest Buy-Down 61
  - —Principal Buy-Down 62
  - —Principal and Interest Waivers 63
  - —Two-Tier Debt Restructuring 64
  - —Farm Credit Capital Corporation 65

- Government Loans
  - —Direct Government Loans 66
  - —Guaranteed Loans 67
  - —Economic Emergency Loan Program 68
  - —Emergency Disaster Loan Program 69

- Government Regulation and Intervention
  - —Farm Credit Administration (FCA) 70
  - —Foreclosure Moratorium 71
  - —Warehousing Farm Assets, Agricultural Conservation Program 72

- Secondary Financial Markets
  - —Secondary Markets for Agricultural Loans 73

DOMESTIC FARM PROGRAMS

Policy Tool: **Acreage Reduction, Set-Aside, and Diversion**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: Acreage reduction consists of an acreage set-aside and/or acreage diversion that is generally voluntary. Acreage set-aside programs require that participating farmers idle a percentage of their crop base acres to be eligible for other program benefits. Acreage diversion programs pay producers a given amount per acre to idle a percentage of their base acres. A farmer's base acres are determined by the production history of the crop.

Objective: To reduce the quantity produced and thus the supply of a given commodity.

When Used: Acreage set-asides and diversions were used extensively during the 1960s and since 1977. These programs are generally used when prices are depressed due to a stock buildup.

Experience: Acreage reduction programs have been only modestly effective in reducing supply over the long run. These programs have usually been used when high loan rates, target prices, or temporarily high market prices encourage farmers to expand production. Program participation, normally a function of the level of producer benefits, has been particularly high for cotton, rice, and wheat during the 1980s. To encourage participation, diversion payments may be added to other farm program benefits.

Consequences:

- To the extent that acreage reduction programs decrease production, they reduce supply and stocks and raise prices domestically.
- Effective acreage reduction programs reduce the volume of supply available for export.
- Slippage reduces the effectiveness of the program. (Slippage is that portion of reduced acreage which does not result in correspondingly lower production e.g., due to removing the poorest land.)
- Diversion programs can result in large treasury outlays.
- Payment limitations and offsetting compliance discourage participation by large-scale operators who farm large acreages for multiple landlords.
- Failure to require cross compliance encourages producers to participate for one crop but not for others—reducing the effectiveness of the overall program.
- Acreage reduction programs tend to restrict a farmer's ability to shift acreage in response to changes in relative crop prices.
- Effective acreage reduction programs increase prices for commodities, cost of production for livestock producers, and food and fiber prices.

Policy Tool: **Marketing Quotas**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: A marketing quota is a mandatory mechanism to determine the quantity of a commodity that can be marketed. The national quota, set by the Secretary of Agriculture, is based on expected domestic and export demands and is usually below normal production levels. Each producer is given a portion of the national quota based on past production. Certificates may be issued to producers holding quotas that give producers the right to market a given quantity of product. The certificate may have a value determined through market exchange.

Objective: To restrict production by controlling the quantity farmers are allowed to market.

When Used: Since marketing quotas are mandatory for all producers growing the quota crop, quotas must be approved by a referendum. Farmers historically have approved a quota only when a crisis existed. Quotas have generally been used in conjunction with allotments and relatively high price supports. Marketing quotas have been used regularly for peanuts and tobacco. The 1985 farm bill authorized the use of marketing quotas for wheat, which if proclaimed by the Secretary and approved in referendum by 60 percent of the eligible producers, would be put into effect for the 1987-90 crop years.

Experience: Marketing quotas are the most effective means of controlling production. They were initially imposed after acreage allotments proved to be ineffective in controlling production. Marketing quotas have effectively reduced production and stock levels but only when the national quota was set at levels consistent with demand at politically acceptable prices. At the time of writing, the marketing quota authority contained in the 1985 farm bill had not been exercised by the Secretary.

Consequences:

- Once a quota is in place, there is pressure to increase the national quota, thus counteracting its purpose.
- Like other supply control programs, marketing quotas usually reduce the volume of exports for the quota crop.
- Marketing quotas are more efficient in reducing supply and raising price than acreage reduction programs because there is almost zero slippage.
- Marketing quotas are associated with low treasury costs unless the quota is so high that Commodity Credit Corporation (CCC) stocks accumulate.
- Marketing quotas tend to acquire a value that reflects the capitalized added net returns producers receive from the program. This value may either be directly associated with the quota or, if tied to a land base, capitalized into the value of the land resulting in increased land prices.
- Single crop marketing quotas for major crops (e.g., wheat) adversely affect prices of crops planted on the idled acres (e.g., corn and sorghum).
- Increased prices for commodities increase cost of production for livestock producers and food prices over time.

Policy Tool: **Long-Term Land Retirement, Conservation Reserve Program**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: Long-term land retirement is a multiple year voluntary program that removes cropland from the production of farm commodities. Requirements are generally imposed which require that a soil-conserving cover crop, including trees, be planted. The government generally pays the landowner an annual rental rate plus a portion of the cost of establishing the cover crop.

Objective: To remove from production cropland that is resulting in surpluses or is subject to erosion.

When Used: The program was first authorized in the 1956 farm bill as the Soil Bank Program. In 1965 Congress re-established a land retirement program and called it the Cropland Adjustment Program. Funding was authorized for continuation of a long-term land retirement program in 1970, but was discontinued during the world food crisis of the 1970s. The 1985 farm bill contained authorization to retire up to 45 million acres of highly erosive land from production. Land retirement is politically acceptable to consumers and producers when surplus stocks and low prices are a chronic problem. If needed, the land can readily be put back into production, as it was in the early 1970s. In the 1985 farm bill, farm organizations and environmentalists combined efforts to achieve the dual objectives of surplus control and soil conservation.

Experience: Earlier land retirement programs removed large quantities of cropland from production. Cropland under long-term agreement was put into a conserving use (usually grassland or forestry). The least productive lands tended to be enrolled in the program. Because of the regional concentration of enrollment, the program was blamed for the demise of numerous rural communities. In 1985, sealed bids submitted by farmers owning eligible cropland were used to decide which land would be retired. This bidding process proved to be highly controversial.

Consequences:

- Long-term land retirement is a supply control and conservation strategy that may cost less than paying storage and interest on surplus commodities.
- Long-term land retirement programs can adversely affect local agribusiness and rural communities.
- Increased prices for commodities increase production costs for livestock producers and food prices over time.
- Land retirement can be used to encourage conservation of cropland, reforestation, and enhance wildlife preservation practices.
- Long-term land retirement reduces farmers' flexibility.
- Retired land, properly cared for, may result in greater productivity when put back into use.
- Slippage is generally high because the least productive land is removed from production. Slippage may be reduced somewhat if whole farms are removed from production.

Policy Tool: **Dairy Buyout, Termination Program, and Diversion Program**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: The dairy buyout program (termination program) paid dairy farmers to slaughter or export their cows and discontinue milking operations for at least 5 years. Farmers submit competitive bids in a buyout program. In the diversion program, the government paid farmers $10/cwt of base production to reduce production by slaughter, reduced feeding, or modified breeding schedules.

Objective: To reduce milk production, control stocks, and cut government costs.

When Used: The dairy diversion program was first used in 1984 after dairy program costs exceeded $2 billion annually and the government was purchasing over 10 percent of the milk supply. The buyout program was initiated in 1986 after the diversion program proved unsuccessful at reducing production.

Experience: The diversion program was less than 50 percent effective at reducing production. Participation was highest in those states which were already decreasing production. Nonparticipants reacted by increasing production. After the program ended, production sharply increased to record levels. The maximum bid accepted in the dairy buyout program ($22.50/cwt over 5 years) was more than twice as high as the diversion program. Evidence of cow trading to circumvent the intent of the program was extensive. Branding of cows destined for slaughter or export was objected to by animal rights advocates. Beef producers sought legal remedies to assure beef prices would not be unduly depressed.

Consequences:

- Slippage proved to be at least as big a problem in dairy as in crops—acres cannot move at night but cows can.
- Participation was highest in those regions having the lowest returns over variable costs.
- Farmers who were contemplating going out of business anyway were most likely to participate.
- Buyouts and/or diversions create strong incentives for nonparticipants to increase production. As a result, production declines tend to be temporary.
- Diversion and/or buyout programs, without price support reduction, do not create long-term incentives to reduce production.
- Increased dairy slaughter raises beef supply and depresses meat prices.
- Animal rights activists become very concerned about branding and the conditions surrounding the animal slaughter.

Policy Tool: **Acreage Allotment**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: Acreage allotment is a mandatory mechanism to reduce the quantity supplied. Acreage allotments require that producers plant within a specified number of acres. The number of acres alloted to each farm is set at a given percentage of the farm's production history. The percentage is based on the national allotments estimated to meet supply objectives.

Objective: To reduce the quantity produced and thus the supply of a given commodity.

When Used: Acreage allotments were used extensively during the 1950s and 1960s for the basic commodities. Allotments still exist for tobacco. Allotments have also been used as a means of allocating target price benefits (e.g., with rice from 1976-81).

Experience: When acreage allotments were used in the absence of marketing quotas, farmers responded by farming the allotted acreage more intensely, thus increasing yields. The result was a tendency for production to return to pre-allotment levels, therefore necessitating further restrictions on allotment size. In some commodities, such as tobacco, marketing quotas were imposed to more effectively control production.

Consequences:
- Acreage allotments raise domestic prices by reducing production and supply.
- Benefits from acreage allotment programs are bid into the price of land and/or the allotments.
- High cash outlays to purchase allotments act as a barrier to entry for young farmers.
- Acreage allotments restrict the ability of farmers to change their crop mix in response to changes in relative crop prices.
- When allotments are imposed on one crop, surpluses may arise in other crops as farmers use non-allotment acres to produce other crops. Thus allotments are often imposed on those additional crops.

Policy Tool: **Cross-Compliance, Limited Cross-Compliance**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: A provision requiring a farm to be in compliance with the terms and conditions of all other commodity programs applicable to the farm as a condition of program eligibility for any single commodity. For example, if a farm produced two program crops, cotton and wheat, the farm could not be in compliance and receive benefits from the wheat program without also meeting the program requirements for cotton. Limited cross-compliance differs from cross-compliance in that a producer does not have to abide by the acreage reduction requirements for other program crops in the farm, but cannot plant in excess of the established crop acreage base for the other crops.

Objective: Cross-compliance has multiple objectives including: reducing production, reducing government program expenditures, and reducing a commodity program's adverse impacts on other commodities.

When Used: Strict cross-compliance provisions have not been enforced since the 1960s. Limited cross-compliance authority was implemented in the late 1970s and is currently authorized in the 1985 farm bill.

Experience: While theoretically cross-compliance is essential to implementing an effective acreage reduction program for agriculture in general (across crops), farmers and their organizations have strongly resisted the implementation of cross-compliance. Even though the 1985 farm bill specifically mandated limited cross-compliance, Congress was forced to modify these provisions in "technical amendments" to make cross-compliance an optional decision for the Secretary.

Consequences:

- The cross compliance provision improves effectiveness of production controls across program commodities.
- The provision prevents spillover of surplus acreages and resources to other program commodities.
- Cross-compliance has the potential for reducing government cost.
- Implementation of the provision can result in less program participation, especially if payment limits are a constraint.
- Cross-compliance is strongly resisted by farmers and their organizations.
- Cross-compliance restricts a farmer's ability to shift acreage in response to changes in relative crop prices.

Policy Tool: **Offsetting Compliance**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: A farm program provision requiring each producer to be in compliance with the program terms for the same crop on all farms as a condition of program eligibility. For example, if a farmer produced corn on three farms he would have to meet the terms and conditions of the corn program on each farm before being eligible for any corn program benefits.

Objective: To aid in production control and reduce government program expenditures.

When Used: Offsetting compliance provisions were used as recently as the late 1970s. The 1985 farm bill allows the Secretary, at least implicitly, the authority to require offsetting compliance in wheat and feedgrains. The bill explicitly prohibits offsetting compliance provisions from being used in cotton and rice.

Experience: While theoretically offsetting compliance is essential to implementing effective acreage reduction programs, it is not politically or pragmatically attractive. Politically, as in the case with cross-compliance, farmers and their organizations have strongly resisted offsetting compliance. Pragmatically, the multiple landlord-tenant relationships that exist throughout commercial agriculture make equitable implementation of this provision virtually impossible.

Consequences:

- The provision improves effectiveness of production controls within a commodity.
- Offsetting compliance has the potential for reducing government cost.
- Implementation can result in less program participation, especially if payment limits are a constraint.
- Offsetting compliance is strongly resisted by farmers and their organizations.
- Offsetting compliance restricts a farmer's ability to shift acreage in response to changes in relative crop prices.
- The provision is difficult to implement with multiple landlord-tenant relationships.

Policy Tool: **Payment in Kind (PIK)**

Policy Area: **Domestic Farm Programs, Supply Control, Price and Income Support**

What It Is: PIK is an acreage diversion program with the diversion payment in the form of a commodity rather than in cash. In-kind payments may also be used in lieu of deficiency or other government payments as a means of price and income support.

Objective: To reduce both production and stocks of commodities in the farmer owned reserve (FOR) and in the CCC loan and/or to reduce direct treasury outlays (government costs).

When Used: PIK was used in the early 1960s for 1 year; in 1983 for wheat, cotton, corn, sorghum, and rice; and again in 1984 for wheat. The 1985 farm bill authorized the use of PIK to pay for the cost of virtually any program (14 different programs by one count). The program has been used when government controlled stocks reach such unacceptably high levels that a PIK program is feasible.

Experience: PIK is one way to reduce stocks controlled by the government and the cost of government storage. Problems occur when the government is required to pay out more PIK commodity than it owns, as was the case for cotton and rice in 1983. An attempt was made to resolve many of the logistics problems incurred in early PIK programs by issuing generic PIK certificates under the 1985 farm program (see generic PIK). A decision that PIK commodities were not subject to the payment limit encouraged participation of large volume producers. In addition, PIK certificates are not subject to budget cuts under Gramm-Rudman.

Consequences:

- PIK provides an off-budget method for paying producers to divert cropland.
- PIK reduces government owned stocks.
- PIK helps maintain market supplies while curtailing production resulting in a price stabilizing effect.
- Program effectiveness in increasing prices depends on farmer participation, slippage, and initial level of stocks.
- PIK increases the marketable supplies when it is released from CCC stocks or loan.
- Local communities, agribusiness firms, and livestock producers are adversely affected by PIK production control programs if signup is high.
- Instead of adjusting excess resources out of crop production, PIK's artificially high prices may actually encourage them to stay.

Policy Tool: **Generic PIK**

Policy Area: **Domestic Farm Programs, Supply Control, Price and Income Support**

What It Is: A negotiable commodity certificate which can be redeemed by the holder for his farmer-owned loan, any uncommitted commodities in CCC inventories, or cash. The certificates are issued to complying producers in lieu of cash payments for a variety of provisions in the 1985 farm bill. The certificate is issued for a dollar amount, therefore, the amount of commodity which can be redeemed is determined by the daily redemption price as determined by the CCC. The negotiability of the certificate allows for the sale and resale of the certificate up to its stated expiration date.

Objective: To improve on the economic and logistical problems encountered in earlier PIK programs which were applied to individual commodities available only in designated locations.

When Used: First implemented in the 1986 farm programs after the 1985 farm bill; substantially expanded the authority for PIK.

Experience: Negotiable commodity certificates are not tied to a specific location or CCC commodity. The program offers more flexibility than past PIK programs. The negotiable aspect of the generic certificate allows market forces to dictate the allocation of commodities currently in CCC inventories. The market forces were evident early in the 1986 program implementation as generic certificates were being purchased at prices exceeding their par value.

Consequences:

- Generic certificates may be used in lieu of cash for a variety of the programs to be initiated in the 1985 farm bill. Multiple expiration dates can become confusing.
- Flexibility as to commodity and location allows producers operating in traditional surplus-producing regions to benefit pricewise at the expense of producers in deficit regions.
- Market prices tend to weaken as commodities are released from government inventories.
- Generic certificates offer considerable flexibility for the seller and buyer and thus may result in bids in excess of par value.
- The provision allows an off-budget mechanism for the release of many CCC held inventories.
- Since certificates are generic, increased incentives to participate in one program, for example cotton, may have an adverse impact on the market prices for an alternate commodity, for example dairy products, if market forces dictate the release of that commodity. This cross-commodity price impact has not received a lot of public attention, but may induce program restrictions in the future.

Policy Tool: **Sodbuster, Swampbuster**

Policy Area: **Domestic Farm Programs, Supply Control**

What It Is: Sodbuster makes new, highly erodible lands brought into production ineligible for farm program benefits. Swampbuster denies program benefits for wetlands brought into production. Provisions in the 1985 farm bill indicate that a producer would be ineligible to participate in the farm program for existing cropland if fragile land is brought into crop production. Prior to the 1985 farm bill only new land put into crop production was excluded from the farm program.

Objective: To discourage the breakout of new fragile lands for agricultural production.

When Used: Enacted as a provision of the 1985 farm bill with the support of both environmentalists and farm organizations.

Experience: Not used over sufficient time period to draw conclusions, however, research suggests that the 1985 farm bill provisions could bring a halt to clearing and draining of fragile lands by producers who currently participate in the farm program.

Consequences:

- Sodbuster and swampbuster discourage new lands from being brought into production in the face of surpluses as a result of high price and/or income supports.
- The provision conserves land and water resources.
- Sodbuster and swampbuster prevent further buildup of surplus production.
- The provision restricts increases in the supply of crop land, thus supporting prices of land in production.
- The provision reduces current values of affected land that could be brought into crop production.

Policy Tool: **Commodity Credit Corporation (CCC) Loan, Nonrecourse Loan**

Policy Area: **Domestic Farm Programs, Price Support**

What It Is: The CCC makes nonrecourse loans at established loan rates to farmers for wheat, feed grains, cotton, sugar, wool, tobacco, and honey. The loan, plus interest and storage, can be repaid within 9 to 12 months and the commodity sold on the cash market. If it is not profitable for the farmer to repay the loan, the CCC has no recourse but to accept the commodity in full payment of the loan. Commodity loans, therefore, are frequently referred to as a price support, since national season average prices generally do not fall below set loan levels. Local prices, on the other hand, can fall below the loan rate for part of the marketing year.

Objective: To add price stability to the market by releasing CCC stocks when prices were high and withdrawing stocks from the market when prices were low. A second objective was to encourage orderly marketing of commodities throughout the marketing year by preventing a market glut at harvest.

When Used: The CCC loan program has existed continuously since 1938 for cotton, wheat, and feedgrains. During World War II, the loan rates for basic commodities were set at 100 percent of parity to encourage production of crops already in surplus. In other years, the loan rates were set low to avoid encouraging production.

Experience: CCC loans were effective at stabilizing prices of feed grains during the 1960s when the price of corn was bounded by the loan rate and the CCC release price (110 percent of loan). At various times political pressure has caused loan rates to be set above equilibrium market prices; as a result (a) the loan rates acted as a supply incentive for producers, (b) the CCC acquired large stocks of grains and cotton, and (c) the volume of exports declined as commodities were priced out of the world market. As a result of these effects, the marketing loan (see next tool) was authorized in the Food and Agriculture Act of 1985. In addition, loan rates are to be established for 1987-90 based on a moving average formula of previous prices. The formula was included in the 1985 farm bill to keep loan rates competitive with world prices.

Consequences:

- Loan rates with reasonable release levels act as a price stabilizing force in the market and thus reduce price risk for producers leading to greater production.
- The CCC loan program extends the marketing period for producers 9 to 12 months, even longer with extensions.
- The CCC loan reduces price risk for farmers thus encouraging excess resources to remain in agriculture.
- High loan rates can effectively price U.S. commodities out of the world market necessitating an export subsidy or direct aid to export surplus CCC stocks.
- Loan rates based on the cost of production tend to increase without regard to the market clearing price and thus can become a production incentive.

Policy Tool: **Commodity Purchase Program**

Policy Area: **Domestic Farm Programs, Price and Income Support, Demand Expansion and Assistance**

What It Is: Gives the CCC, acting through the Secretary of Agriculture, the authority to purchase commodities for government storage and/or distribution.

Objective: To support the price of commodities.

When Used: Market purchases of commodities occur regularly under the operation of the price support programs for commodities such as butter, nonfat dry milk, and cheese. Regular purchases of commodities in surplus also occur in association with commodity distribution and school lunch programs. Special purchases have been mandated in particular instances such as to remove excess supplies of meat from the market during the dairy buyout program. Prior to elections, special purchases of products such as corn have been made to support prices.

Experience: Commodities purchased under special programs (other than price support program purchases) are generally those having the greatest political muscle. The program is frequently used to achieve specific political ends and/or to alleviate temporary surplus conditions. Commodity purchases are generally not effective in dealing with long-run surplus conditions or price suppression. Government commodity give-aways under the welfare program have largely been replaced by food stamps.

Consequences:

- Increased purchases temporarily raise market prices.
- When purchased commodities are distributed, commercial sales of the commodity are reduced.
- Storage costs for commodities purchased are very high unless rapidly distributed.
- Related processing industries such as packers or milk processors are frequently important beneficiaries.
- Government commodity give aways were plagued with inequities, fraud, and corruption.

Policy Tool: **Farmer Owned Reserve (FOR)**

Policy Area: **Domestic Farm Programs, Price Support**

What It Is: The FOR is a 3-year CCC loan for wheat and feed grains. The 1977 farm bill established the FOR as a 3-year extension of the CCC loan after time expires in the regular loan. Reserve stocks remain in the producers hands until the Secretary of Agriculture authorizes release or the extension expires.

Objective: To stabilize grain prices and provide producers a longer time period to sell their grain. A secondary objective was to establish a food reserve of grains, thus stabilizing grain supplies and making the United States a more dependable supplier.

When Used: The FOR has been in use since 1978 for wheat and feedgrains. The program was modified in 1980 to allow direct entry, thus avoiding the regular CCC loan. In addition, producers were given a direct entry loan price higher than the regular loan rate in 1980, 1981, and 1982. Stocks in the reserve are eligible for release when cash prices reach a level determined in advance by the Secretary of Agriculture.

Experience: The FOR attracts large quantities of stocks when the entry price is set above the equilibrium market price. Since its inception in 1977, corn prices have reached the FOR release level twice. When that happened, corn stocks were released and prices stabilized at the release level. Research has shown that the FOR reduces the quantity of stocks held by the private sector and causes season average prices to be at either the entry price or the release price depending on the supply-demand balance.

Consequences:

- FOR often results in the accumulation of stocks which in turn result in substantial storage and interest costs.
- FOR provides farmers 3 years to market their grain out of the reserve at the release level price.
- Political pressure groups attempt to set the FOR entry price above equilibrium market price, thus creating, in effect, an income support program.
- In the face of declining export demand, there are no provisions to reduce the FOR entry or release price.
- FOR works best when there is a relative supply-demand balance, thus allowing prices to move in a range between the entry loan rate and the release price.
- High loan levels and release prices encourage U.S. and foreign production and discourage U.S. exports.
- FOR supports prices only when producer participation is high and adequate storage is available.

Policy Tool: **Marketing Loan, Findley Loan, and Marketing Certificates**

Policy Area: **Domestic Farm Programs, Price and Income Support, Demand Expansion and Food Assistance**

What It Is: Marketing loan is a nonrecourse loan with a repayment rate which may be less than the announced loan rate. The difference between the loan rate and the repayment rate is treated as an unlimited income support payment to producers. The payment is referred to as the Findley loan payment. The repayment rate is generally some percentage of the loan rate or the world market price. Marketing certification can be issued to first handlers if repayment levels continue above world market price.

Objective: To provide flexibility for the price support loan rate and, thereby, reduce interference of the regular nonrecourse loan with competitive price levels.

When Used: Marketing loans were first authorized in the 1985 farm bill. While authorized for all commodities, marketing loans, repaid at the world price, were only implemented in rice. On other commodities loan rate reductions at 20 percent of the regular loan rate were implemented. The cotton and rice programs for 1986 call for the use of marketing certificates equal to the difference between the repayment level and world price when needed to remain competitive.

Experience: With high levels of government stocks, market prices fell to the repayment level. Whereas rice exports were extremely low in 1985 without the marketing loan, in 1986 stocks appeared to move into commercial channels. Foreign country competitors objected strongly to increased price competition from U.S. commodities in world markets. Participation of large farms in acreage reduction programs increased sharply.

Consequences:

- Marketing loan repayment rates become the market floor price when not used in conjunction with marketing certificates.
- Prices become more unstable.
- Commodities become available for export at competitive world prices, thus increasing exports.
- Without a payment limit on the difference between the loan and the repayment rate, large farms have greater incentive to participate in the program.
- Government costs increase sharply in the presence of large surplus stocks.
- Competing exporting countries' farm program costs increase and/or their producer returns decline.
- Domestic users gain access to U.S. commodities at world competitive prices.

Policy Tool: **Target Prices, Deficiency Payments**

Policy Area: **Domestic Farm Policy, Income Support**

What It Is: In the United States, deficiency payments are paid to farmers to make up the difference between a price determined to achieve a politically acceptable income level (target price) and the higher of the average market price or the loan rate. Deficiency payments are made on each farm's actual planted acres and farm program yield. The farm program yield is based on each farm's yield history. Target prices were set initially to reflect an average cost of production.

Objective: Deficiency payments were initiated to raise and stabilize farmer incomes to the level of the nonfarm population, while allowing farm prices to be competitive in the export market.

When Used: Target prices were authorized for cotton in 1970 and for cotton, wheat, corn, sorghum, and oats in the 1973 farm bill. Deficiency payments are paid on eligible crops if the average cash price is less than the target price. The 1985 farm bill added the marketing loan and/or Findley loan provisions which separated the deficiency payment into two components: (1) the difference between the target price and the loan rate which is subject to the payment limit, and (2) the difference between the regular loan rate and the repayment rate which is not subject to the payment limit (see marketing loan and payment limits).

Experience: Initially, target prices were set to reflect changes in the cost of production and yield. Much debate ensued over what constituted the cost of production. A 1977 change in the target price formula removed the possibility of reducing target prices to reflect yield increases. The 1981 farm program set target prices for cotton, wheat, and corn for 1982-85 without regard to inflation, crop yields, or production costs. Excess production and high government costs resulted. The 1985 farm bill calls for a reduction in target prices by 1990. Large government payments resulting from the marketing and Findley loan reductions resulted in much publicity and controversy.

Consequences:

- Target prices set above market clearing levels stimulate production, reduce market prices, and thereby reduce food and feed costs.
- By reducing market prices, target prices allow U. S. farm products to be more competitive in the world market while supporting farm income, e.g., an implicit export subsidy. This is a major advantage over support prices for raising producer income.
- Setting target prices above the expected market price can result in large Treasury outlays.
- Deficiency payments provide income support up to $50,000 to large-scale producers and little support to small-scale operators because payments are based on production.
- Deficiency payments reduce income risk for producers and increase their ability to obtain financing.
- Deficiency payments resulting from the marketing and Findley loan can lead to large government payments overall and to individual farmers.

Policy Tool: **Disaster Program**

Policy Area: **Domestic Farm Programs, Income Support**

What It Is: Low yield and prevented plantings payments are paid to producers who, through no fault of their own, are unable to plant their crop or harvest a normal yield.

Objective: To reduce yield and planting risk faced by producers by providing them a relatively free (program compliance necessary) crop insurance program.

When Used: Disaster payments were first authorized by the 1973 farm bill. Disaster payment benefits were available from 1973-81 to producers who were in compliance with other program provisions. Low yield payments were made to producers who were prevented from harvesting less than 66 percent (75 percent for cotton) of their normal yield. In 1982, the provisions of the disaster program were dropped, except for extreme emergencies, to reduce government costs and encourage participation in the federal multi-peril crop insurance (FCIC).

Experience: Disaster programs were very expensive and encouraged expanded production of crops in high risk areas. Low yield and prevented plantings payments were received mainly by dryland producers in the Great Plains and producers in the Delta States.

Consequences:

- High treasury costs are associated with disaster programs.
- Disaster programs provide producers income assistance when they need it the most, namely, after a natural disaster.
- Availability of the disaster program increases producer participation in voluntary acreage reduction programs.
- Disaster programs encourages the production of high risk crops in low rainfall and floodplain areas.
- In latter years, disaster payments were subject to a $100,000 payment limitation, thus discouraging program participation by large-scale operators.
- Benefits from the program are bid into the market value of marginally productive, high-risk cropland.
- The disaster program transfers production risk from producers to taxpayers.

Policy Tool: **Payment Limit**

Policy Area: **Domestic Farm Programs, Income Support**

What It Is: Payment limits set a maximum on the amount of deficiency payments and/or disaster payments that a person can receive from the government.

Objective: To limit the level of government benefits received by a single farmer, and to reduce the image of farmers becoming wealthy from farm programs.

When Used: With the establishment of direct payments to farmers in the late 1960s questions arose as to the magnitude of benefits received by large scale farms, predominantly rice, wheat, and cotton. As a result of this controversy, the 1970 farm bill set the payment limit at $55,000. In 1973 the limit was reduced to $20,000, after which it was escalated to $40,000 in 1977 and subsequently to $50,000. The 1985 farm bill payment limit remains at $50,000 with the emergency disaster program limited to $100,000. However, the marketing and Findley loan removed the limit on subsidies below the regular loan rate (see marketing loan and target prices).

Experience: As the difference between the target price and the loan rate has widened, an increasingly large number of farmers have become subject to the payment limit. The combination of pressures to reduce government costs by more strict enforcement of the payment limit combined with more farmers becoming subject to the limit has made payment limits more controversial. At the same time, farmer efforts to find legal loopholes in payment limit regulations have accelerated. The marketing and Findley loan materially reduced the controversy surrounding the payment limit.

Consequences:

- Strict enforcement of the payment limit reduces large-scale farmers' incentives to participate in farm programs.
- The wider the difference between the target price and the loan rate, the greater the number of farmers who are adversely affected by the payment limit.
- A larger number of farmers affected by the payment limit was one of the factors leading to the marketing loan provisions.
- Acreage reduction programs are less effective at reducing supply in the presence of payment limits.

Policy Tool: **Federal Multi-Peril Crop Insurance (FCIC)**

Policy Area: **Domestic Farm Programs, Income Support**

What It Is: FCIC is a subsidized low-yield insurance program for farmers.

Objective: To provide federally subsidized crop insurance to producers unable to obtain adequate crop insurance on their own; also to replace the low-yield and prevented plantings disaster program for grains and cotton with an insurance program available to all producers of major crops.

When Used: FCIC for wheat was first authorized under the 1938 Federal Crop Insurance Act. Federal crop insurance was available only for wheat from 1938 through 1941 when it was expanded to cotton. The program was suspended in 1943 because of low producer participation but revived in 1945 with a reduction in counties insured. After 1948 the program was extended to more counties and crops, including vegetables and fruits. The program was substantially modified in the 1980 farm bill to provide a 30-percent federal cost subsidy. In 1981 the program was expanded to all counties in the United States and to most major crops.

Experience: Federal crop insurance has not garnered high levels of producer participation. Participation has been the highest in high-risk, nonirrigated, low-rainfall areas. Problems have been encountered in developing an actuarially sound premium structure and in adequately marketing the program to producers. Experience indicates FCIC has a high cost of administration relative to commercial insurance.

Consequences:

- Limited acceptance by farmers leads to adverse loss experience and political pressure for disaster payments.
- Low participation by producers results in high loss ratios and high Treasury costs.
- The program provides more extensive coverage than commercial hail insurance at subsidized rates.
- High premiums discourage widespread producer participation and low participation requires high premiums to make the program actuarially sound.

Policy Tool: **Income Insurance**

Policy Area: **Domestic Farm Programs, Income Support**

What It Is: Income insurance would involve an expansion of the FCIC all-risk crop insurance to include both yield and price risk, i.e., total crop receipts.

Objective: To stabilize farm incomes from the adverse effects of natural disasters and low prices and thus replace all supply control and price support programs with a comprehensive farm income insurance program.

When Used: An income insurance program for farmers has not been used in the United States. The 1981 farm bill authorized an investigation into the feasibility of a federally subsidized income insurance program for farmers.

Experience: None

Consequences:

- An actuarially sound farm income insurance program may reduce current Treasury outlays but, as with FCIC, such a program would be difficult to develop.
- Producers' premiums would likely be unacceptably high, and since the policy replaces a "free" risk protection program, producers would likely oppose the program.
- Participation by farmers would likely be very low, like federal crop insurance.
- Political pressure to reduce premiums below their actuarially sound levels would be substantial. Premiums set too low would lead to excessive government costs and could cause the program to act as a supply incentive even in the face of surpluses.
- The program could be flexible enough to be used for both expanding and contracting supplies and for shifting production (acreage) from one crop to another.
- The program could discourage production in high risk areas.
- Research indicates that the high correlation between crop prices and yields among regions would cause the program to fail since losses caused by either low yields or low prices would be widespread and catastrophic for the Treasury.

Policy Tool: **Cost-Sharing Programs, Assessment Programs**

Policy Area: **Domestic Farm Programs, Income Support**

What It Is: A cost-sharing or assessment program is a means by which the costs of farm programs are shared between producers and the government. The producers' share of the cost is covered through an assessment per unit of product marketed. The magnitude of the assessment per unit depends on the degree of cost sharing (50-percent cost sharing would involve a higher checkoff than if producers shared only 30 percent of the cost) and the size of the commodity surplus. The higher the assessment, the lower the effective level of price or income support for the commodity.

Objective: To make the level of income support more responsive to the magnitude of the surplus and to help defray a portion of government program costs.

When Used: The 1981 farm bill provided a cost-sharing program for tobacco. A 1982 farm bill amendment provided for a cost-sharing program in dairy. For both tobacco and milk, cost-sharing programs were implemented only after a serious political threat that the whole government price support program for these commodities might be withdrawn. The dairy cost-sharing program was reinstated in the 1985 farm bill to pay for a portion of the costs of the dairy buyout program (see dairy buyout). In the case of the dairy buyout, producers who continue to produce milk are taxed to cover a portion of the costs for the buyout program.

Experience: Producer resistance has been substantial to the "tax" under each program. Tobacco cost sharing was eliminated in the 1985 farm bill. Dairymen chose an even higher assessment to avoid price support cuts that would have been imposed by Gramm-Rudman. With high government costs for virtually all commodity programs, producer cost sharing could be a required feature of future farm policy legislation.

Consequences:

- The cost-sharing concept provides an automatic adjustment to the level of income support for farmers as government expenditures rise.
- The political hassle of adjusting income support downward when supports are initially set too high is avoided.
- The assessment reduces government costs and, thereby, increases the political acceptability of farm programs by urban congressmen and taxpayers.
- The assessment makes the level of income support more responsive to market forces.
- The assessment puts the burden of program costs on producers whereas a price support reduction puts the burden on cooperatives, processors and exporters who traditionally hold inventories.

INTERNATIONAL TRADE PROGRAMS

Policy Tool: **GATT (General Agreement on Tariffs and Trade)**

Policy Area: **International Trade Programs, Trade Barrier Reduction**

What It Is: GATT is a multilateral United Nations treaty among more than 80 governments, including the United States. GATT contains a code of principles and provides a forum for consultation and dispute settlement. Five principles govern GATT:

1. Trade must be nondiscriminatory.
2. Domestic industries should be protected by tariffs as opposed to nontariff barriers (quotas).
3. Tariffs agreed upon are binding, with provision for compensation if violated.
4. Consultations are provided to settle disputes.
5. GATT procedures may be waived on agreement of the members with provision for compensation. Barriers in existence when GATT was established (1947) are legal until negotiated away.

Objective: To liberalize and expand trade among nations through negotiated reductions in trade barriers. These actions are designed to prevent the development of rounds of retaliatory trade barriers.

When Used: GATT came into existence October 30, 1947. Trade barrier reductions have been accomplished in three rounds of negotiation—the Dillon Round (1960-61), which provided for European Economic Community (EEC) duty-free entrance for soybeans and cotton; the Kennedy Round (1963-67), which resulted in tariff reductions on a wide range of farm products; and the Tokyo Round (1973-79), which reduced nontariff barriers on a limited number of commodities. A new round of negotiation is expected to begin in late 1986. Agriculture is sure to be a central focus of this new round of trade negotiation, with the contribution of domestic farm programs to the erection of trade barriers being the focal point of attention. Major topics to be discussed are the further reduction in agricultural trade barriers and subsidies. Trade in services and preservation of intellectual property rights will also be topics of discussion.

Experience: While experiencing initial success, the most difficult problems that remain in securing trade barrier reductions are those rooted in the domestic farm policies of the participating countries. Classic examples include the EEC Common Agricultural Policy (CAP) and the aggressive trade stance in the 1985 farm bill.

Consequences:

- GATT increased overall trade among nations, thus expanding opportunities for exports.
- GATT provides a forum for settling disputes.
- GATT establishes a code of fair trade.
- GATT restricts the latitude of participating countries in subsidizing exports and engaging in other practices. Thus in the short run GATT places participants at a disadvantage.
- It is difficult to enforce the GATT principles against the major country members.
- GATT has been more effective at reducing trade barriers in industrial products than in agriculture due to the problems created by domestic farm programs.

Policy Tool: **Generalized System of Preferences (GSP)**

Policy Area: **International Trade Programs, Trade Barrier Reduction**

What It Is: The GSP is a program permitting duty-free entry of certain imports from designated developing countries.

Objective: To assist in economic development, encourage diversification, and expand production of certain developing countries.

When Used: Title V of the Trade Act of 1974 sets forth criteria for country and product eligibility as well as for limitations on preferential treatment. Developing countries not eligible for GSP include communist countries, the developing country which extends preferential treatment to the products of a competing developed country, most OPEC countries, countries that nationalize U.S. property without compensation, countries that do not cooperate in narcotic control, or countries that have aided international terrorism. Import-sensitive articles or commodities such as textiles are excluded from GSP.

Experience: Developing countries purchase over one-third of all agricultural exports and have been the fastest growing market for farm products. GSP has helped developing countries to buy U.S. products, although U.S. producers of some commodities have been adversely affected.

Consequences:

- GSP expands developing country exports to the United States.
- GSP increases economic growth in developing countries.
- GSP increases export earnings for developing countries so they can import more.
- GSP helps in maintaining favorable foreign relations with free world developing countries.
- GSP is a low cost means of providing aid to developing countries.
- GSP adversely impacts U.S. farmers who produce the commodities extended preferential import treatment.

Policy Tool: **Monetary Export Subsidies**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: Monetary subsidies to exporters in dollars per unit of commodity sold.

Objective: To make the U.S. commodity price competitive in the world market and thus expand markets.

When Used: Export subsidies can be used to export agricultural commodities when U.S. price supports are above world prices. Overt monetary subsidies of exports are seldom made because they clearly violate the provisions of GATT. Under those provisions the United States could be required to pay damages to the countries injured by such subsidies. EEC subsidies do not violate GATT since they were in place as a part of CAP at the time GATT was negotiated. The last major U.S. direct monetary export subsidy was in the 1972 Russian grain deal when a subsidy of approximately $0.60 per bushel of wheat was provided. The marketing certificate program authorized for cotton and rice in the 1985 farm bill are similar to an export subsidy (see marketing loan). Political considerations are obviously involved in the use of export subsidies.

Experience: Export subsidies are overt methods of subsidizing exports. As such, they are readily determined to be in violation of GATT and invite retaliation from competitors if they increase U.S. market share.

Consequences:

- The effective export price is lowered to make U.S. commodity prices competitive in the world market. The result is to expand exports.
- Domestic farm prices may be increased.
- Monetary subsidies run a high risk of inviting retaliation.
- Monetary subsidies violate GATT.
- CCC stocks are reduced as a result of increased exports.
- Long-run price relief is provided for U.S. producers in the face of low world prices.
- Monetary subsidies can be expensive in terms of both money and image.

Policy Tool: **Two-Price Plan**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: A two-price plan discriminates between the domestic and the foreign market by charging a higher price for domestic sales than for foreign sales. Exports are, therefore, indirectly subsidized by the higher domestic price.

Objective: To raise the level of producer returns while preventing the accumulation of large surplus commodity stocks.

When Used: Before World War II and the negotiation of GATT, two-price plans were used extensively to support farm income. Since the negotiation of GATT, the operation of two-price plans in the United States has been restricted largely to marketing orders and peanuts.

Experience: Two-price plans, in essence, make the world market a residual and less profitable market. Advocating reduced trade barriers and operating two-price plans are obviously inconsistent.

Consequences:
- Producer income increases if the demand in the domestic market is more price responsive than in the export market.
- Surplus stocks do not accumulate in the face of high domestic price supports.
- Lower export market prices create the potential for price warring conditions.
- The world market tends to become unprofitable when two-price plans are used extensively.
- Controversial methods of being competitive would draw public media attention.
- Domestic market is placed at a disadvantage relative to the foreign buyers.
- Import restrictions are necessary to prevent the reimportation of the lower priced foreign sales or processed products made from the sales (see import quotas).

Policy Tool: **Blended Credit**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: Blended credit is a non-price form of export subsidy which combines direct government export credit and credit guarantees in a single package to reduce the effective interest rate. Government export credit is provided in a program known as GSM-5. The credit guarantee program is known as GSM-102.

Objective: To make U.S. credit terms competitive with those offered by other exporting countries.

When Used: Blended credit is available only when appropriations are provided by the Congress. Tight budgets have made blended credit available only to a limited number of countries and commodities. Countries are selected based on magnitude of surpluses and competitive need, as well as diplomatic and domestic political considerations. The blended credit program was most recently initiated in October 1982.

Experience: During the period used, blended credit facilitated the opening of markets for U.S. commodities in competition with other countries. It is particularly useful for those developing country markets where credit and credit guarantees are critical.

Consequences:

- The United States is made more competitive in the face of other countries' subsidized export credit programs.
- A basis is provided for penetrating new export markets—particularly in developing country markets.
- Compared to other forms of export subsidies, blended credit runs less risk of creating retaliatory trade war conditions.
- Expansion of subsidized credit encourages other countries to expand their export subsidy programs, thus creating the potential for increased treasury cost over time.
- If successful in expanding exports, blended credit raises prices in the United States thus raising domestic food costs and production costs for livestock producers.

Policy Tool: **Direct Export Credit**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: Direct export credit refers to the CCC GSM-5 program which provides financing for U.S. agricultural exports with terms up to 36 months.

Objective: To provide financing to countries and/or foreign buyers unable to secure credit and without which the sale of U.S. agricultural commodities would not be made.

When Used: The GSM-5 program was used extensively through the period 1956-1979. Since the beginning of the GSM-102 credit guarantee program in 1980, much less focus has been placed on the direct credit program. In the 1985 farm bill, no funds were authorized for the GSM-5 program.

Experience: Since 1956, the GSM-5 program has been responsible for the export sales of between $1.4 million to $1.6 billion annually of U.S. agricultural commodities. Beginning with the GSM-102 credit guarantee program in 1980, the GSM-5 program declined in importance. In 1985, $325 million was authorized for GSM-5 while $5 billion went to GSM-102. For 1986 and beyond, no funding was allocated for GSM-5 in the 1985 farm bill. As a result those sales that would not have been made otherwise will be lost.

Consequences:

- U.S. markets in countries with severe debt problems have been maintained.
- Government costs are higher than they would be without program funding.
- Credit guarantee programs are needed to compete with similar programs offered by other exporting countries.
- A basis for expanding markets in developing countries is provided.
- If credit sales expand total exports, domestic food costs and livestock production costs are greater than they would be without the programs.

Policy Tool: **Export Credit Guarantees**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: Export credit guarantees are U.S. government assurances for U.S. banks which provide financing for foreign buyers to purchase U.S. agricultural products. The CCC insures up to 98 percent of the freight on board (f.o.b.) value of an export sale in the event that a foreign bank fails to make payment, for any reason, under a letter of credit agreement.

Objective: To assist U.S. exporters in making sales they would not make otherwise and to compete with export enhancement programs provided by other exporters.

When Used: Export credit guarantees were introduced in 1979 and have been an integral part of U.S. agricultural trade policy ever since. The 1985 farm bill continues authorization for the GSM-102 program with credit terms up to 3 years. It further provides funding for an intermediate credit program, GSM-301, which provides credit terms of between 3 to 10 years and includes financing for infrastructure. Previously only one project, a grain silo in Israel (1980), had been undertaken.

Experience: The only credit guarantee program currently in operation, GSM-102, has been successful in maintaining U.S. sales to countries with severe debt problems. This success has occured only through continued increase in federal appropriations, increasing from $671 million in 1980 to authorization for up to $5 billion annually through 1990.

Consequences:

- U.S. agricultural exports have declined less than they would have in the absence of such programs.
- Long-term developments of markets are promoted.
- U.S. exporters are more competitive with programs of other exporters.
- Export credit guarantees are less obvious than other export subsidies and less likely to produce retaliation from other exporters.
- Export credit guarantees decrease government direct credit budget exposure.
- Export credit guarantees allow U.S. banks to make loans which would not be financially prudent under ordinary circumstances.
- Export credit guarantees may expose the U.S. government to large liabilities in the event of major defaults by foreign purchasers.

Policy Tool: **Public Law (P.L.) 480 (Food for Peace)**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: P.L. 480 provides for concessional sales of commodities that contain substantial U.S. subsidies. Exports are made under three P.L. 480 programs:

- Title I involves sales for dollars under low interest rates with up to 40 years repayment.
- Title II involves emergency food relief directed to nutritionally vulnerable groups.
- Title III involves commodity aid as part of a development package. Multiyear commitments are tied to specific development actions.

Objective: To dispose of surplus commodities, develop markets, provide emergency food aid, and assist friendly nations in development.

When Used: Authorized by the Agricultural Trade Development Act of 1954, P.L. 480 was used to export as much as one-third of the export sales during the 1950s and 1960s when loan rates were generally maintained above world prices. Since then P.L. 480 sales have generally been in the $1 to 2 billion range. Countries are selected for assistance based on diplomatic and political considerations as well as need. Commodities selected are influenced by the magnitude of surplus stocks. The Secretary of State makes the final decision on who gets P.L. 480 aid.

Experience: P.L. 480 is credited with having built such important commercial markets for farm products as Japan, South Korea, Taiwan, Brazil, and Spain. The need to get commodities moving through P.L. 480 is frequently frustrated by foreign policy considerations.

Consequences:

- A government alternative to exports is provided when the United States is not price competitive in the world market.
- Commodity aid is combined with development assistance, thus being more politically acceptable.
- Government stocks of commodities are reduced.
- Long-term development of markets is promoted.
- P.L. 480 provides the State Department with a diplomatic tool that can be used in foreign policy negotiations.
- P.L. 480 sales may displace commercial sales.
- Assistance in alleviating hunger and starvation is provided.
- Too much commodity aid can be a disincentive for production in developing countries and can make them overly dependent on imports.

Policy Tool: **Export PIK, Bonus Incentive Commodity Export Program (BICEP)**

Policy Area: **International Trade Programs, Export Subsidies**

What It Is: Under export PIK, the government provides an in-kind export commodity bonus for each regular commercial purchase of a specified amount. For example, if a country purchases 1 million metric tons of wheat, it might receive an additional 100,000 metric tons of PIK wheat from CCC stocks. The 100,000 metric ton bonus is the export PIK.

Objective: To make the United States commodity price competitive in the world market and thus expand export markets.

When Used: Export PIK was first used in a 1983 flour sale to Egypt. The 1985 farm bill contains provisions for export PIK to support both targeted export assistance programs and export market enhancement programs. In general, the use of export PIK is limited to those surplus commodities held in CCC inventories.

Experience: Export PIK was used to virtually capture the 1983 Egyptian flour market for the United States. Other flour exporting countries, such as France, were upset, although no overt retaliatory steps were taken against the United States. Recent activity has continued to focus on wheat and flour sales in the North African regions. In addition CCC soybean and corn stocks have been used to subsidize frozen poultry sales.

Consequences:

- The United States is competitive in the world market, despite reduced demand and loan rates that may be above world market clearing levels.
- Export PIK is less overt than direct monetary export subsidies and thus not as likely to invite either retaliation or GATT sanction.
- Government stocks of commodities are reduced.
- An export alternative is provided by export PIK as long as the CCC owns sufficient stocks.
- Export PIK is a violation of at least the spirit of GATT.
- Widespread use of export PIK could invite public image problems and undermine the GATT negotiations.
- Commercial sales may be offset by bonus commodities.
- Increased demand for export PIK subsidized commodities places upward price pressure on domestic consumers.

Policy Tool: **Import Quotas**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: Import quotas limit the quantity of an individual commodity imported. Limits are generally allocated among potential exporting countries. Specific limits are frequently negotiated to avoid more restrictive voluntary or mandatory limits. The specific size of quotas may be either legislated, negotiated, or determined by executive action. Those determined by executive action under Section 22, as interfering with the operation of a price support program, are recommended by the International Trade Commission and imposed by the President.

Objective: To establish a maximum quantity of specific commodities which can be imported and, thereby, protect U.S. producers and/or price support programs from foreign competition.

When Used: Beef import quotas have been mandated by the Congress. Cheese import quotas, imposed to protect the price support program, have been the subject of negotiation and agreement under GATT. Import quotas are also imposed on sugar and related products. Import quotas exist on textile imports as a means of avoiding harm to the domestic textile industry.

Experience: The imposition of import quotas is highly political. Even though the International Trade Commission recommendations to the President are based on objective criteria, the ultimate Presidential decision is highly political. The existence of U.S. import quotas has made it difficult to get other countries to reduce trade barriers. Japan argues that its beef import quotas are no different from the beef import quotas of the United States.

Consequences:

- Import quotas restrict available supplies and raise domestic prices.
- Textile import restrictions reduce export demand for U.S. cotton lint but may increase sales to domestic mills. Less overall demand is likely because of higher ultimate consumer product prices.
- Without import quotas on price supported commodities, the CCC would acquire a larger quantity of commodities under the price support program.
- Import quotas result in windfall profits to licensed importers.
- Supply control aspects of import quotas result in greater price fluctuations than would occur in a free market.
- Efficiency of production plays no role in determining competitiveness under a system of quotas.
- Retaliation for non-agricultural commodity quotas can lead to reduction in agricultural exports from the United States.
- Import quotas established by large importing countries (European Community, United States, Japan) tend to depress world prices.

Policy Tool: **Import Tariffs, Countervailing Duties**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: Import tariffs are a tax or duty on commodities entering the United States. A countervailing duty is a tariff that offsets an export subsidy of another country. A tariff may be either a fixed charge per unit of product imported (specific tariff) or a percentage of the value of the product imported (ad valorem tariff). The specific size of the tariff may be legislated, negotiated, or determined by executive action. The size of the countervailing duty is designed to exactly offset the size of the export subsidy of a competing country.

Objective: To restrict imports of certain commodities and, in the past, to generate tax revenues.

When Used: Because of the emphasis of GATT on reducing tariff trade barriers, their importance has gradually decreased. Substantial tariffs, however, exist on a number of specialty commodities. The authority exists for the imposition of countervailing duties equal to the amount of export subsidies provided by other countries. Such countervailing duties are generally limited to those instances where there is a reasonable indication that an industry in the United States is being materially injured or threatened with injury because of subsidized imports. Antidumping duties may also be imposed if a commodity is sold in the United States at less than fair value in the event of a finding of material injury. Countervailing duty and antidumping duty actions involve determinations by both the International Trade Commission and the Department of Commerce.

Experience: The visibility of tariffs and GATT emphasis on reducing tariff trade barriers have fostered the use of nontariff barriers to trade. Tariff barriers are less effective in reducing trade because they do not constitute an absolute limit on quantities that can be imported. That is, while efficiency plays no role in import quotas, tariffs potentially continue to reward efficiency. Tariffs were used to raise the price of imports and thus prevent their interfering with domestic price support programs and depressing U.S. prices. There has been a hesitancy to utilize countervailing duties because of the potential for precipitating trade wars.

Consequences:

- Tariffs raise the effective price of goods entering the United States and thereby reduce the comparative advantage of foreign produced goods.
- Tariffs reduce the volume of commodities imported at all price levels.
- Economists regard tariffs as a lesser evil than quotas or other nontariff barriers because with a tariff efficient producers may still be able to obtain access to the market.
- Countervailing or antidumping duties offset export subsidy practices of other countries and, thereby, protect U.S. producers.
- The U.S. Treasury receives the revenue from a tariff.
- The absolute quantity of price fluctuation is the same or nearly the same with a tariff as in the free market. Price changes are reflected to consumers.
- Import tariffs may result in retaliation by trading partners.
- On tariff regulated commodities, consumers in the importing country pay higher prices than in the absence of tariffs.
- Import tariffs established by large importing countries (European Community, United States, Japan) tend to depress world prices.

Policy Tool: **Nontariff Trade Barrier**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: Nontariff trade barriers, strictly speaking, cover all restrictions on imports other than tariffs. Thus, quotas are nontariff trade barriers. Likewise, the variable levy (tariff) employed by the ECC in CAP is a nontariff trade barrier. For a discussion of these policy tools, see import quotas and variable levy. The nontariff barriers discussed here include a wide array of devices such as health and sanitation, packing, packaging, and labeling regulations, as well as foreign exchange restrictions.

Objective: To restrict imports of certain commodities.

When Used: The use of nontariff trade barriers has increased, in part because of the GATT emphasis on reducing tariff trade barriers. The most common U.S. nontariff restrictions relate to health and sanitation restrictions such as the prohibition of meat imports from countries having foot and mouth disease. Sometimes such restrictions are justified, while at other times they are purely protectionist.

Experience: Nontariff trade barriers are generally more restrictive than tariff barriers since they may constitute absolute barriers to trade. Nontariff barriers have had a tendency to proliferate in recent years. Nontariff barriers have been used to reduce the competitiveness of foreign producers who are able to use pesticides and other products that are banned in the United States.

Consequences:

- Nontariff trade barriers restrict available supplies and raise domestic prices.
- Nontariff trade barriers may be an absolute barrier to trade with efficiency playing no role in determining competitiveness.
- The imposition of a nontariff barrier may increase the degree of price variability.
- Nontariff trade barriers increase the risk faced by importing firms.
- Nontariff trade barriers may result in retaliation by trading partners.
- Nontariff trade barriers may assure standardization and product quality of imported goods.
- Nontariff trade barriers tend to depress world prices when used by large importing countries.

Policy Tool: **Voluntary Export Restraint**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: An agreement whereby foreign governments are asked to limit exports of specific commodities to a given quantity. Often the agreements are negotiated under duress because of the potential inactment of formal import restrictions.

Objective: To control the importation of certain commodities thereby protecting domestic producers.

When Used: In the United States, voluntary export restraints are used in conjunction with the Meat Import Act of 1979. Whenever USDA estimates of meat imports appear likely to exceed 110 percent of the adjusted base quantity, the U.S. government has negotiated voluntary restraints rather than impose and administer formal import quotas.

Experience: The voluntary export restraint mechanism has served as a useful adjunct to formal import quotas authorized by the Meat Import Act.

Consequences:

- Voluntary export restraints restrict available supplies and raise domestic prices.
- Greater price fluctuations in world markets result from voluntary export restraints than would occur in a free market environment.
- Voluntary export restraints erode the importance of efficiency of production in determining competitiveness.
- Income derived from holding import license or quota is transferred to exporting country.
- Some countries may be left out of the market because they refuse to limit their imports.

Policy Tool: **Variable Levy**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: A minimum price is set at which a commodity can be imported. If the import price falls below that minimum price, a levy or import tax is imposed equal to the difference between the world price and the import price. A variable levy is classified as a nontariff trade barrier because the size of the levy (or tariff) is not fixed in either absolute or percentage terms.

Objective: To control importation of specific commodities.

When Used: The variable levy is the principal protectionist tool used by the ECC. Under CAP the EEC farmers are guaranteed a feedgrain price greater than the world price. An import levy equal to the difference between the EEC producer price and the price of grain landed in Rotterdam must be paid on imported grain.

Experience: The variable levy is an effective barrier to trade because it eliminates the economic (price) advantage of the imported commodity. Efforts to negotiate a less restrictive EEC agricultural policy have failed because the variable levy is the very basis of CAP. Getting rid of the variable levy would mean that the EEC would have to develop a whole new agricultural policy approach.

Consequences:

- A variable levy effectively reduces imports and thus raises domestic prices to a predetermined level.
- Efficiency plays no role in determining competitiveness under a variable levy policy.
- The variable levy constitutes a source of revenue to the importing country, when the world price is below the predetermined minimum price.
- The variable levy ensures a stable internal price while increasing instability in world markets.

Policy Tool: **Cargo Preference**

Policy Area: **International Trade Programs, Domestic Industry Protection**

What It Is: Cargo preference refers to the provision of the Merchant Marine Act of 1936 which requires that a portion of cargoes procured, furnished, or financed by the United States be transported in U.S. ships. Under the requirements at least 50 percent of P.L. 480 shipments must be transported in U.S. vessels. The 1985 farm bill provides for an increase in the tonnage requirements by 10 percent in 1986, 20 percent in 1987, and 25 percent each year thereafter, contingent on funding from the Department of Transportation.

Objective: To provide a minimum volume of business to the the U.S. maritime industry.

When Used: Cargo preference requirements have been an important factor in U.S. agricultural exports since the enactment of P.L. 480 in 1954.

Experience: Cargo preference has had a major impact on agricultural food aid programs of P.L. 480. Transporting commodities aboard U.S. vessels costs between 1.5 to 2.5 times more than for foreign vessels. This increased cost is paid for out of USDA funding for P.L. 480, some $150 million in 1985. In 1985, a federal court ruling that cargo preference also applied to USDA blended credit programs resulted in suspension of the program because the increased transport cost made the program no longer cost effective.

Consequences:

- U.S. food aid assistance programs are able to deliver less commodities than would otherwise be possible with the same funding levels.
- U.S. agricultural exports are less competitive due to curtailment of certain credit programs as a result of increased transport costs.
- U.S. maritime industry receives subsidies in excess of $100 million per year.

Policy Tool: **Export Embargoes**

Policy Area: **International Trade Programs, Embargoes**

What It Is: Export embargoes set absolute limits on quantities that can be exported. Partial embargoes may allow only a certain quantity to be exported after which permission must be obtained from the exporting country.

Objective: To hold down U.S. commodity prices, to prevent shortages of commodities, to achieve a foreign policy objective, or any combination of the above.

When Used: Since 1970 export embargoes have been imposed three times:

(1) In 1973 an embargo was placed on the export of soybeans to provide assurance that poultry and hog producers would have a sufficient lower cost supply of soybean meal.

(2) In 1975 an embargo was placed on exports of grain sales to the Soviet Union after concern about increasing food prices.

(3) In January 1980 an embargo was placed on all exports to the Soviet Union after the Soviet invasion of Afghanistan and the subsequent tensions in Poland. This embargo was not lifted until April 1981.

Provisions of the 1985 farm bill continue protection for producers against the imposition of export embargoes by assuring direct payments for compensation to producers of affected commodities.

Experience: Embargoes or the threat of embargoes have been a major factor in reduced confidence in the United States as a dependable supplier. Therefore, embargoes have contributed to the decline in the U.S. share of world agricultural trade. Serious questions also exist concerning the effectiveness of embargoes as a policy tool.

Consequences:

- Embargoes reduce U.S. export sales and lower prices.
- Embargoes reduce confidence in the United States as a dependable supplier, thus, encouraging foreign buyers to cultivate other sources of supply.
- Embargoes encourage other countries to increase production as a means of achieving self-sufficiency.
- Embargoes encourage exporting countries to increase production.
- It is difficult to prevent the intended embargoed country from importing the commodity from another source.
- The mere potential for embargoes is reflected in the market place as exporters and importers adjust for this uncertainty.

Policy Tool: **Sanctity of Contracts**

Policy Area: **International Trade Programs, Embargoes**

What It Is: Sanctity of contracts provides that exporters will be able to fulfill their contract obligations for a period of 270 days after the imposition of any embargo. Sanctity of contract provisions were included as an amendment to the commodity futures trading commission bill in 1983.

Objective: To assure importing countries the United States is a dependable supplier and to reduce the impact of export embargoes on exporting firms and producers.

When Used: After lifting the Soviet grain embargo in April 1981, producer organizations and exporting firms applied increasing pressure on the Reagan administration for sanctity of contracts. In 1982 President Reagan provided assurance that he would allow increased purchases by the Soviets with sanctity of contracts. This principle was written into law in early 1983 and applies to all agricultural export sales. This assurance is continued in the 1985 farm bill.

Experience: The abrupt imposition of the Russian grain embargo in January 1980 left U.S. producers and exporters with delivery commitments that were disallowed. While the U.S. government provided compensation to exporters for losses incurred, long-term injury ensued to the reputation of the United States as a reliable agricultural exporter. This was one of several factors leading to a decline in the U.S. share of total world trade in the early 1980s.

Consequences:

- The United States is viewed as a more reliable supplier of agricultural exports.
- Importers know that when they sign a contract for delivery of U.S. agricultural products, there will not be governmental interference with performance on it.
- Exporters are assured their sales will be allowed.
- Producers are shielded from the immediate effects of embargoes.
- Producers should receive higher prices, since exporters do not have to discount for the uncertainty posed by a potential embargo.

Policy Tool: **Long-Term Bilateral Trade Agreements**

Policy Area: **International Trade Programs, Trade Agreements**

What It Is: A long-term bilateral trade agreement is a contract between two countries specifying the quantity of a commodity to be traded over a certain time period. Bilateral trade agreements normally run for a period of 3 to 5 years, although they may be simple 1-year agreements that are renewed annually. The agreements normally specify the minimum quantity to be purchased and the maximum quantity to be supplied. Generally no provisions exist with regard to the price to be paid.

Objective: To assure the importing country a minimum supply and the exporting country a market for its production, and to normalize trade, develop markets, and retain markets for farm products.

When Used: Trade agreements have become increasingly common since a world food shortage was experienced in the early 1970s. The most publicized agreement was the 5-year contract negotiated with the Soviets in 1975 which contained an agreement to purchase a minimum of 6 million metric tons of grain with the United States agreeing to supply at least 8 million metric tons. In the early 1980s the United States became cool to the trade agreement concept while Australia and Canada signed agreements with several countries including the Soviet Union and China. In 1983, the Reagan administration changed policy and renegotiated a new long-term trade agreement with the Soviets requiring annual purchases of between 9 and 12 million metric tons of grain.

Experience: Trade agreements are a means of opening a new market on a long-term basis. The quantities specified in the agreement have generally been less than the normal trading levels. Due in part to increased domestic production, abundant world supplies, and various extra-agricultural policy disputes, both China and the Soviet Union have recently failed to live up to their contracts.

Consequences:

- The total volume of trade tends to be increased and stabilized between the parties to the agreement.
- Importing countries outside of the agreement may be denied a source of the commodity if supplies become short.
- Exporting countries outside of the agreement may be denied market outlets when supplies are plentiful.
- Trade agreements are, in essence, barriers to trade in that they tie up markets over long time periods.
- Trade agreements cause greater fluctuations in world prices since they effectively reduce the world supply which can be competitively traded.
- Trade agreements are difficult, if not impossible, to enforce and may lead to false market expectations.

Policy Tool: **International Commodity Agreements**

Policy Area: **International Trade Programs, Trade Agreements**

What It Is: An international commodity agreement is a multilateral agreement among countries to affect the terms of trade. The terms of trade affected by an international commodity agreement may include the price level, quantity sold, quantity produced, or quantity held in reserve. Legally, commodity agreements are treaties among the participating nations.

Objective: To raise the world price above equilibrium levels, to stabilize price, and to provide increased supply assurance.

When Used: Commodity agreements have been used most extensively on wheat, being first established in 1949. Currently they are used extensively among developing countries on commodities ranging from tin to sugar and coffee. OPEC might also be looked upon as an international commodity agreement.

Experience: Commodity agreements have had a reasonably good history of stabilizing prices as long as burdensome surpluses or shortages do not exist. Commodity agreements designed to raise prices have a tendency to fall apart because of a lack of control over production. To be effective, commodity agreements require close coordination of domestic farm programs with the activities of international commodity agreements.

Consequences:

- Commodity agreements provide increased price stability.
- Domestic prices are raised by commodity agreements.
- Exchange of information among countries on market conditions is increased.
- When prices are raised, excess supplies frequently accumulate unless effective supply control mechanisms are included.
- Unless commodity agreements are well coordinated with the domestic farm programs of the participating countries, they tend to break down.
- As with any international trade agreement, enforcement is virtually impossible.

Policy Tool: **Barter/Counter Trade**

Policy Area: **International Trade Programs, Trade Agreements**

What It Is: Barter is trade among two or more countries or firms involving the exchange of goods and/or services of equal value instead of currency or credit transactions as payment for a commodity.

Objective: To facilitate trade with developing countries experiencing short-run financial difficulties and to obtain sources to strategic raw materials that might not otherwise be available.

When Used: The exchange of powdered milk to Jamaica for bauxite in 1982 was the first barter negotiation in 15 years. The 1985 farm bill requires the Secretary of Agriculture to establish and carry out at least two pilot barter programs by 1987. Agricultural commodities are to be bartered for designated strategic materials.

Experience: Barter has a limited ability to expand exports. Rather, it is more of a temporary measure to maintain an existing market during periods of adverse economic conditions. Its greatest potential appears to be as a market development tool for developing countries with mineral or strategic metals of importance to the U.S. defense and industrial sectors. The biggest problem in barter is matching needs with products.

Consequences:

- Barter helps maintain export levels.
- Barter provides increased potential for developing commercial markets for agricultural products.
- Barter has limited applicability because of the required coincidence of need.
- Barter may displace commercial sales.
- Barter value generally approximates relative world market value of the commodities bartered.

MARKETING PROGRAMS

Policy Tool: **Commodity Distribution**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: Commodity distribution programs provide primarily staple food products direct from the government to needy households. Commodities provided are generally in surplus, although nonsurplus food products have been provided in times of high unemployment. Commodities are distributed to those households who qualify according to specific eligibility standards—normally participation in some welfare program or unemployed.

Objective: To expand the demand for farm products, utilize surplus commodities, and improve nutrition of needy consumers.

When Used: Commodity distribution was a forerunner of the food stamp program. Such direct distribution programs date back to the Great Depression era. However, even after widespread adoption of the food stamp program in the 1960s, commodity distribution has from time to time resurfaced either to dispose of surplus government stocks or to deal with problems of unemployment and poverty. The special cheese and butter distribution programs operating in the early to mid-1980s provide examples of such surplus disposal efforts.

Experience: Commodity distribution programs are costly because of the necessary network of qualification, processing, storage transportation, and distribution systems. With the advent of food stamps in the 1960s, the direct distribution system was dismantled. In the 1980s when surpluses and unemployment reappeared, pressure grew to once again distribute commodities—beginning with cheese. Rather than establishing a distribution system, the Reagan administration provided the commodities to volunteer welfare groups such as churches. It was found, however, that under this system many unqualified recipients received the products. Subsequently, government appropriations were provided to pay for at least a portion of the costs of distribution.

Consequences:

- Product movement is expanded to the extent that the quantities given away exceed normal recipient consumption levels. Reduced expenditures for distributed products results in purchases of other foods and/or nonfood items.
- The commodities given away displace retail sales of the commodities and their substitutes. If people are given commodities, they certainly will not buy them or the substitutes for them. Food processors and retailers thus tend to be opposed to direct distribution programs.
- For commodities in surplus that are acquired under price support programs, such as dairy products, the government will end up actually purchasing more products to the extent that those receiving the products buy less of them through grocery stores.
- Nutrition levels of recipients are improved to the extent of the nutritional value of the additional quantities or items consumed.

Policy Tool: **School Lunch**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: The school lunch program provides assistance to schools through direct commodity distribution, cash subsidies, and, at times, subsidies for the purchase of equipment. Over time this program has been expanded to encompass both breakfast and lunch. Free or subsidized meals are given to children from low-income households.

Objective: To improve the nutritional levels of school-age children and assure that they have at least one nutritionally balanced meal on school days.

When Used: The school lunch program has been in existence since the 1930s. Over time it has gradually put increasing emphasis on cash as opposed to commodity distribution. Schools have had increasing impact on the specific commodities obtained under the program. In the 1980s, the program fed nearly 30 million students at a federal cost of about $5 billion.

Experience: The school lunch program began as a depression measure to support prices and to improve nutritional levels for all school children. From its inception through much of the 1960s, emphasis was placed on distributing surplus commodities in a nutritionally balanced relationship. Schools, however, gradually wanted more to say about what was received. In addition, increasing costs of in-school preparation, relative to institutional and fast-food preparation, led to increased pressure to provide a larger proportion of cash subsidies relative to commodities. The increasing cost of meals led to school lunch and breakfast subsidies being restricted to children from low-income households. One of the main problems with the program has been complaints about the quality of meals served. Pressure always exists to provide a larger proportion of cash assistance.

Consequences:

- The demand for food used in the school lunch program is increased.
- Nutritional levels of school-age children are increased—particularly of low-income households.
- While commodities distributed are a less important proportion of the total food used, the school lunch program continues to provide an important outlet for surplus dairy products, meat, fruits, and vegetables.
- The development of a large institutional food service sector designed to serve this very large program has been fostered.

Policy Tool: **Women, Infants, and Children (WIC) Program**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: The WIC program combines direct commodity distribution with nutrition education. Most WIC recipients probably are also on food stamps or aid to families with dependent children. Nutrition education programs teach the recipients how to combine commodities with food expenditure dollars most effectively to improve nutrition and family living standards.

Objective: To provide low-income mothers with a complete assistance program designed to improve nutrition levels for the family as a whole.

When Used: The WIC program began on an experimental basis in the early 1960s and has experienced almost continual expansion since. Participation in the program has a tendency to increase in times of recession and increased unemployment.

Experience: Many of the recipients are single mothers with very low incomes and pre-school children. Although WIC has been criticized for its predominantly unwed mothers constituency, studies demonstrate it to be one of the most effective programs in improving nutrition levels. This results largely from the combination of monetary, commodity, and nutrition education assistance. Attempts to discontinue the WIC program (as a cost reducing measure) have consistently failed under the weight of studies showing the positive impact on nutrition and resulting broad based "hunger lobby" support.

Consequences:

- Nutrition education programs result in increased consumption of foods normally considered to be part of a nutritionally balanced diet—particularly poultry, milk, cereals, fruits, and vegetables.
- Commodities distributed tend to be in surplus and/or have particular nutritional value.
- Commodities distributed partially displace commercial retail sales of these products and their substitutes.
- Overall recipient nutritional level is demonstrably improved.

Policy Tool: **Food Stamps**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: The food stamp program provides eligible recipients with stamps having an equivalent cash value. Eligibility is determined on the basis of income levels in relation to established poverty guidelines. Level of assistance is based on a USDA "thrifty food budget" covering the cost of commodities needed to achieve a balanced diet. Higher levels of assistance are provided for lower incomes and larger family sizes.

Objective: To provide income assistance for the purchase of food by low-income households and thereby expand the demand for food as well as improve nutritional levels of recipients.

When Used: The food stamp program, while first used in the 1930s, began in earnest as a long-term food assistance program in the early 1960s and has since mushroomed to a social program with more than 20 million recipients and costing about $12 billion in the early 1980s. Food manufacturers and retailers actively supported the conversion from direct commodity distribution to food stamps because food stamps do not displace commercial sales (see Commodity Distribution).

Experience: The merits of the food stamp program have been extensively debated. Major concerns regarding the program involve who should be eligible, the level of assistance, the commodities allowed to be purchased with stamps, and the potential for program abuse. Among the advocates of change are some who would prefer going back to commodity distribution and others who would prefer giving recipients cash (referred to as cashing out). Some advocate moving food stamps out of USDA.

Consequences:

- Consumption of food is increased. The largest increases occur in the demand for meat, milk, and poultry.
- Some farm-state congressmen argue that the food stamp program helps them to get farm legislation through the Congress because major farm bills with food program components invariably attract urban interest.
- Nutritional levels of recipients are improved, although not as much as under such programs as WIC.
- Food retailers realize direct benefits—particularly those in low-income neighborhoods.

Policy Tool: **Cashing Out, Welfare Reform**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: Cashing out would provide food assistance in cash rather than commodities or food stamps. All food and income assistance programs would be consolidated into a single cash payment.

Objective: To provide income assistance to low-income households.

When Used: While cash has not yet been substituted for food stamps, over time there has been gradual but persistent movement in the direction of providing a larger proportion of cash, as opposed to commodity or food stamp, assistance: Food stamps were substituted for direct commodity distribution, and cash subsidies to schools have become increasingly important relative to commodities.

Experience: Cash has provided schools greater flexibility in the ultimate use of the assistance. Thus it is argued to result in a greater increase in satisfaction. The cost of running several individual programs each having different eligibility standards has become increasingly high. There are those who believe that such consumer-oriented policy changes have come to so dominate USDA that producer-oriented programs have taken a back seat.

Consequences:

- The total welfare bill would be reduced as program duplications are eliminated.
- Food consumption would fall if the current equivalent level of cash assistance was provided.
- Prices of surplus commodities would fluctuate more as government outlets for surplus commodities are reduced.
- Food assistance programs would be moved out of USDA and would not be part of the farm bill deliberations, thus reducing the potential for obtaining urban support for farm programs.

Policy Tool: **Foreign Market Development, Cooperative Programs**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: Foreign market development activities of the U.S. government involve assisting firms or producer organizations in selling products abroad. These programs, managed by the Foreign Agriculture Service (FAS) in the USDA, are planned, implemented, evaluated, and financed jointly by the FAS and the cooperator organizations. They emphasize market information and technical assistance in servicing the needs of importing countries to utilize products effectively, enhance buyer awareness, and educate consumers. Producer program costs are generally financed through a checkoff program on commodities sold (see also checkoff programs).

Objective: To expand export demand for farm products.

When Used: Foreign market development activities depend heavily on producer, processor, and handler initiative to develop and finance a joint FAS-industry cooperator program. While FAS through its agricultural counselors has a general responsibility to promote exports, the greatest effort is devoted to those products where cooperator programs exist.

Experience: Cooperator programs that are well conceived and financed are effective at expanding the demand as long as the commodity is available at competitive prices. It is difficult, if not impossible, to expand export markets for U.S. farm products when our prices are higher than the world price.

Consequences:

- The quantity of products exported is increased.
- Increased producer understanding of international markets is developed.
- Cost of operating the market development program is shared by a large number of producers, making it more cost effective (see also checkoff programs).

Policy Tool:	**Domestic Market Development**
Policy Area:	**Marketing Programs, Demand Expansion and Food Assistance**
What It Is:	Domestic market development programs assist producers in raising funds required to carry out generic promotion and advertising programs. In addition, provision is made for refunds to producers desiring not to participate and audits of the use of funds (see also checkoff programs). Such programs are authorized on an individual commodity basis under either Congressional or state legislative authority.
Objective:	To expand the domestic demand for farm products.
When Used:	Domestic market development programs get started only on producer initiative. Producers have to be organized to obtain the checkoff legislation or marketing order programs needed to implement a market development program. Market development programs have been most extensive in milk, cotton, and oranges, although programs have existed also in wheat and potatoes. Several of the marketing orders contain provisions for the collection of funds needed for market development activities.
Experience:	Most producer domestic market development programs are generic—promoting the product in general as opposed to a particular brand of the product. In a limited number of instances (e.g., cotton), significant resources are devoted to joint advertising—subsidizing the advertising of innovative new uses of the product even though it is branded. Research indicates brand promotion and joint advertising programs are more effective than generic advertising.
Consequences:	• A well-conceived and well-researched producer-oriented advertising program has the potential for raising producer returns through demand expansion. • Promotion and advertising programs are high in cost and difficult to evaluate. • Promotion and advertising programs must be geared to the product available and the size of the market.

Policy Tool: **Checkoff Programs**

Policy Area: **Marketing Programs, Demand Expansion and Food Assistance**

What It Is: Checkoff programs deduct a given amount per unit of product marketed by the producer to finance market development or research programs. Such programs exist under either special individual commodity legislation or general authorizing legislation, such as marketing orders. Such legislation may allow for refunds.

Objective: To finance foreign and domestic market development programs and research for basic commodities.

When Used: Checkoff programs are used when the necessary legislation exists and the required majority of the producers approve it in a referendum. In special commodity legislation at the federal level, refund provisions have generally been required. Numerous states have enacted local checkoff programs to fund research and market development, e.g., cottonseed checkoff to fund research on cotton varieties and rice checkoff based on acres planted to fund rice research.

Experience: Voluntary checkoff programs have proved difficult to maintain. Mandatory checkoff programs with refund provisions have sometimes encountered problems with relatively high redemption experience. Congress has generally been unwilling to allow a mandatory program without refund provisions.

Consequences:

- Well run programs increase the demand for particular products. Yet overall demand for food is probably not changed. Thus one commodity is expanding its demand at the expense of another.
- If products such as milk and cotton are not promoted, they are not in a position to compete against soft drinks or synthetic fibers.
- Without refund provisions, checkoff programs provide an equitable means of financing costly market development programs.
- With refund provisions, checkoff programs offer the potential for inequities and a reduction in effectiveness.
- Checkoff programs provide a continuous flow of funds to related commodity organizations and thus increase the effectiveness and/or political power of these organizations.

Policy Tool: **Cooperatives, Capper-Volstead**

Policy Area: **Marketing Programs, Market Organization and Control**

What It Is: The Capper-Volstead Act gives producers the right to act together in marketing their products, therefore providing cooperatives limited exemption from the antitrust laws. It prohibits cooperatives from unduly enhancing price, however. The Secretary of Agriculture is responsible for enforcing the provisions regarding undue price enhancement.

Objective: To assist producers in jointly marketing their products by providing a means for increasing prices, lowering costs, stabilizing market flows, expanding markets, or improving communication.

When Used: The Capper-Volstead exemption is limited to farmers and to marketing functions. Farmers are those involved in actual growing functions; therefore, agribusiness corporate integrators are not farmers. Likewise, joint, otherwise illegal, activities between cooperatives and noncooperatives are not covered by the Capper-Volstead exemption. Marketing functions are interpreted broadly to include bargaining, information, pricing, processing, and so forth. Cooperatives appear to have virtually unlimited rights to merge with one another. They cannot, however, engage in predatory or coercive practices with regard to either members or nonmembers.

Experience: Cooperatives have effectively organized to market their products in a number of ways. The cooperative market share is about 33 percent overall, but as high as 65 percent of the market in milk, fruits for processing, and vegetables for processing. Cooperatives are most effective when they are integrated and there is a firm producer commitment to market through them. Marketing orders are frequently used to augment cooperative market power and influence. Proposals have been made to eliminate the Capper-Volstead exemption or to transfer it to the Federal Trade Commission for enforcement.

Consequences:

- Suspending provisions of the Capper-Volstead Act would render pricing activities among farmers a violation of the Sherman Act and the Federal Trade Commission Act.
- Cooperatives have potential for raising producer returns if well organized, well managed, and producers have a commitment to market through the cooperative.
- Cooperatives' influence is frequently eroded by "free riders" who obtain the benefits of the cooperative but pay none of the costs.
- Substantial producer investment is generally required for successful cooperative activity.
- Cooperatives have been important to the functioning of marketing orders because cooperative members have been allowed to vote as a bloc. Orders augment cooperative market power.

Policy Tool: **Marketing Orders**

Policy Area: **Marketing Programs, Market Organization and Control**
Domestic Farm Programs, Price Support

What It Is: Marketing orders are joint industry - government programs regulating the quantity and/or quality of specified products entering the market channel. Marketing orders are authorized for specific commodities under the Agricultural Marketing Agreements Act of 1937.

Objective: To create more orderly marketing conditions for farm products and thereby stabilize supplies, prices, and producer incomes.

When Used: Marketing orders are available only for commodities designated in the Agricultural Marketing Agreements Act. These include specific fruits, vegetables, nuts, and milk. Orders for fruits, vegetables, and nuts emphasize the establishment of minimum quality, grade, size, or maturity standards for products entering the market. Reserve pools exist for some commodities in which stocks are held over the marketing season or into the next marketing season. Milk prices are set by the marketing order in terms of the milk's end use. Higher prices are charged for milk used for fluid purposes. Orders are put into effect after a request is received from producers (generally a cooperative), a hearing is held, the Secretary of Agriculture concurs, and two-thirds of the affected producers approve in a referendum. The 1985 farm bill deviated from these procedures by virtually mandating changes in milk marketing order provisions.

Experience: Marketing orders have been highly effective in stabilizing markets where they have been used. Over time, however, the Secretary of Agriculture has been less inclined to utilize orders as strict supply management tools. Emphasis has thus been placed on orderly marketing and price stabilization. Strict marketing quotas have been limited to minor commodities such as hops and peppermint. All marketing orders with market flow provisions are under attack by the Office of Management and Budget as well as consumer advocate groups.

Consequences:
- The balance of market power is shifted from processors to producer cooperatives. Increased price stability is provided throughout the marketing season by strict marketing controls.
- Commodities available for sale are of more uniform quality.
- Commodities are more readily available throughout the year.
- Producer prices are increased.

Policy Tool: **Marketing Boards**

Policy Area: **Marketing Programs, Market Organization and Control**
International Trade Programs, Trade Agreements
Domestic Farm Programs, Price Support

What It Is: A marketing board is a central government authority which directs the marketing of a commodity. Export management is the most frequently performed function of a marketing board. With all exports centralized in a single government agency, producers give up the right to their commodities at harvest; all storage and marketing functions are managed by the government. Producers receive an advance on commodities delivered or stored on farm, with subsequent payments being made as marketing is completed. All producers receive the same price (pool price) adjusted for location and quality. Additional farm program provisions, such as minimum return to producers, may also be provided through the marketing board.

Objective: To raise and stabilize producer prices as well as offset the superior market power of commodity buyers.

When Used: Marketing boards have never been used in the United States. They are used extensively in Canada, Australia, and South Africa.

Experience: Evidence of the impact of marketing boards on producer prices and incomes is mixed, with some showing higher returns and others not. Boards do, however, provide increased price and income stability to the producer, since the producer is shielded from the effects of within-year price fluctuation. While boards are frequently credited with providing strict control over production, their record is considerably less impressive.

Consequences:
- Within-year producer price and income risk would be reduced.
- The marketing and pricing function would be removed from the producer.
- Much of the profit opportunities from handling and storing grain would be eliminated.
- The influence of major exporting and marketing firms on commodity prices would be reduced.
- The role of government in marketing would be substantially increased.
- The United States would be better able to compete against state traders for export sales.
- If adopted by the United States, the continued existence of viable futures and options markets would be questionable.

Policy Tools: **Market News Price Reporting**

Policy Area: **Marketing Programs, Market Facilitators**

What It Is: Market news provides daily information on prices in spot or cash markets for farm products.

Objective: To improve the quality and quantity of information on market activity available to farmers and agribusiness firms and thereby make market conditions more competitive.

When Used: Authority for market news extends back to World War I.

Experience: Market news has been in a continuous state of modernization and improvement since it was established. Market news increasingly finds itself competing with private information sources such as Urner-Barry and the Yellow Sheet. These private reports are used extensively in formula pricing. Private reports have been the subject of much debate over accuracy and reliability, while USDA reports have been subject to questions of timeliness, accuracy, and statistical reliability. Proposals have been made to transfer all market news functions to the private sector. Considerable controversy surrounds USDA's unwillingness to report contract terms for products such as broilers.

Consequences:

- Market news provides increased equality of price information among producers and agribusiness firms.
- Market news is of greatest benefit to small and middle size farm firms because they cannot afford private sources of information.
- Market news acts as a public check on private sources of market information.
- Market news is even more useful with increasing numbers of vertical integration and forward contracts which reduce price information in the market.
- Government cost cutting measures raise the question of what market news users should pay for price information.

Policy Tools: **Crop and Livestock Production Reports**

Policy Area: **Marketing Programs, Market Facilitators**

What It Is: Crop and livestock production reports provide detailed estimates (predictions) of crop production from before planting (intentions) through harvest.

Objective: To improve the quality and quantity of available information on production prospects and thereby make markets more competitive.

When Used: Crop and livestock production reports have their origin in a series of laws enacted between World War I and the late 1940s. They are used by the private sector as an aid to production and marketing decisions, by economists to forecast, and by government officials to develop policy and aid in program decisions.

Experience: The USDA's goal is estimates within 1 or 2 percent of actual production. Its record in achieving this degree of accuracy has been outstanding. USDA crop reports are frequently charged with having the effect of lowering farm prices. A bias one way or the other is impossible to confirm. Extensive steps are taken to protect the integrity of the reports. Government cost cutting measures have reduced the quantity (and maybe the quality) of available information. Efforts to charge for access to crop and production reports have come under considerable fire.

Consequences:

- Crop and livestock reports make markets more competitive.
- Without crop and livestock reports, this information would be available only to those firms that can afford this service from private information sources. This would be mainly agribusiness firms and large-scale farmers.
- Crop and livestock reports increase the accuracy of both public and private sector economic outlook and situation analysis.
- Crop and livestock reports are needed for informed policy decisions. They provide the data base on which economic analyses are conducted.

Policy Tool: **Export Sales Reporting**

Policy Area: **Marketing Programs, Market Facilitators**

What It Is: The USDA presently requires that export sales involving more than 100,000 MT of major grains and oilseeds be reported to the USDA within 24 hours of sale. For other commodities, weekly reports are required.

Objective: To provide information for the government to use in developing export policies and programs, to provide producers with information to help in their marketing decisions, and to improve performance of U.S. commodity markets by making timely information on export sales transactions available to the public.

When Used: Following the impacts of the unanticipated large grain sales to the USSR in 1972, the government instituted the export sales reporting system in September 1973 under Section 812 of the Agriculture and Consumer Protection Act of 1973. It has been in operation since that time. Modifications to the system were made in 1980 to shorten the public reporting lags of 11 to 18 days to approximately 7 to 14 days.

Experience: The export sales reporting system has had moderate success in achieving its goal of increased access to timely information. The system still suffers from substantial lag time in reporting information and limited detail on contract specifics. A number of alternatives, including specific contract terms and prenotification, have been considered.

Consequences:

- Overall quality and quantity of information concerning export transactions is increased.
- USDA is provided with prior warning of sales that could jeopardize supplies available in the United States.
- More information on supplies reduces the probability of an embargo resulting from commodity shortages.
- Prices are more responsive to export market conditions.

Policy Tools: **Grades and Standards**

Policy Area: **Marketing Programs, Market Facilitators**

What It Is: Grades and standards classify units of a commodity according to quality so the variation or range in quality is smaller within groups than it is over the whole range of the commodity.

Objective: To develop homogenous groups by quality to facilitate orderly marketing of a commodity.

When Used: Grain grades are established under the U.S. Grain Standards Act while other grades are established under several different pieces of legislation, including the Agricultural Marketing Act of 1946. Grades and standards exist for virtually all agricultural commodities. Most grades are primarily designed to facilitate trading at the wholesale market level although grades such as those on beef have a definite consumer orientation.

Experience: Once grades are established, they are very difficult to change. In addition, there is resistance to the establishment of consumer oriented grades because opportunities for product differentiation (advertising) are reduced. Questions exist regarding the extent to which grades should reflect the end use of the product. Frequently, private grades and USDA grades reflect a different set of factors. Over time, grades and standards tend to become unresponsive to consumer preferences, probably because of resistance to changing the grades.

Consequences:

- Grades increase the quantity of information available to buyers and sellers.
- Grades increase the accuracy of pricing within different quality classes of the commodity.
- Grades reduce the opportunity for abuse and misunderstanding between buyers and sellers of commodities that are sold without buyer inspection.
- Grades force the quality marketed to the lowest acceptable level of each grade.
- Grades reduce the opportunity for product differentiation.

CREDIT PROGRAMS

Policy Tool: **Principal and Interest Deferrals**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: Principal deferrals—borrowers are not required to make principal payments on part or all of the debt for a designated time period, but are required to pay interest. Interest deferrals—borrowers are not required to make interest payments on part or all of the debt for a designated time period, but interest would accrue and be added to the debt.

Objective: To allow a borrower with cash flow problems time to restructure debt or recover from adverse economic pressure.

When Used: Used when adverse economic conditions are expected to be temporary or time is needed to restructure the operation to alleviate cash flow problems. Most private lenders do not defer interest, but roll it into the principal of the loan. This policy results from legal limitations on the collection of interest which is past due for longer than a specified period. Farmers Home Administration (FmHA) uses a combination of a principal deferral and interest waiver in their debt adjustment program. A borrower may defer a portion of the principal up to 5 years and accrue no interest on the deferred portion if it is necessary for the operation to meet cash flow requirements.

Experience: Principal deferrals have tended to be used by private lenders in conjunction with disaster clauses tied to low production levels or commodity prices. Have provided a temporary solution to temporary financial problems. Where problems are of a long-term nature, deferrals may simply be delaying the inevitable.

Consequences:

- Deferrals can temporarily reduce cash flow requirements of debt servicing.
- If the financial stress is due to long-term economic pressures, deferrals of interest payments make matters worse and further weaken the borrower's financial position.
- At the end of the deferral period, either the debt will have to be reamortized over a longer period, or it will be necessary to increase payments because of the larger outstanding balance.
- If financial stress persists and asset markets continue to soften, lenders will experience even greater losses and loan risks.
- High (low) interest rates can make the carrying cost of a principal deferral program very (moderately) expensive.
- If recovery does not occur, public cost could be high due to losses on direct government loans.
- Principal and interest deferrals can create a great deal of ill will on the part of producers who are paying their debts.
- May aid in keeping assets (land and machinery) off of an already glutted market.

Policy Tool: **Interest Buy-Down**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: An interest rate buy-down involves an interest rate reduction on existing loans with the government paying a portion of the cost.

Objective: To improve a producer's financial position by reducing interest cost.

When Used: The interest rate buy-down provided for in the 1985 farm bill allows FmHA to pay 50 percent of the total cost of reducing the interest rate to the borrower, up to a maximum of 4 percentage points. The buy-down, however, will only be approved if there is no alternative way to project a positive cash flow. The duration of the buy-down may not exceed 3 years. A number of states have also implemented interest buy-down programs.

Experience: Interest rate buy-downs can be used to restructure debt held by private lenders when there is a reasonable chance the borrower can recover. The program has also been used to reduce the workload for an overburdened FmHA by leaving debt servicing in the hands of private lenders. Lender participation has been less than might have been anticipated because of the requirement to accept a lower rate of return. State programs have encountered considerably higher costs than had been explicitly recognized or anticipated.

Consequences:

- Private lender participation depends on whether they stand to lose less by no longer financing the borrower or by accepting a lower return in anticipation that the borrower's situation will improve.
- Interest rate buy-downs can result in large public outlays.
- Rural communities benefit directly if the buy-down reduces borrowers' cash flow burden and/or the number of farm liquidations.
- Since interest buy-downs are temporary, they benefit financially stressed borrowers only in the short-run.
- Interest buy-downs can create a great deal of ill will on the part of producers who are paying their debts.

Policy Tool: **Principal Buy-Down**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: A principal buy-down is a reduction or forgiveness of part of a borrower's debt in return for some form of compensation.

Objective: To reduce loan levels in line with lower asset values and to reduce farmers' debt servicing requirements.

When Used: Used when economic conditions are such that a reduction in total debt is the only way a farm can remain solvent and the farm's failure would have a politically unacceptable impact on asset markets. Since September 1984 FmHA is allowed to issue guarantees of up to 90 percent on loans classified as substandard by the lender's supervising agency. To be eligible for the program, the lender is required to write-down at least 10 percent of the loan principal or a present value equivalent interest rate write-down. The borrower also has to be able to project the ability to cash flow the restructured loan.

Experience: In cases where the potential losses are reduced, private lenders have been willing, in some instances, to write-down part of the outstanding principal and restructure a borrower's payments in exchange for a FmHA guarantee on the remaining debt. Because the principal must be reduced to the point where the loan will cash flow and the guarantee can be for no more than 90 percent of the reduced principal, the program has not been widely used.

Consequences:

- Principal buy-downs may make it possible for borrowers to service their remaining debt obligations.
- Although a government guarantee on the remaining debt can protect against further losses, private lenders still suffer an equity loss equal to the write-down.
- Principal buy-downs can support asset values by reducing the number of farm liquidations.
- Principal buy-downs can result in large public costs if economic conditions fail to recover and the government must pay banks for losses on guaranteed loans.
- Principal buy-downs can create a great deal of ill will on the part of producers who are paying their debts.

Policy Tool: **Principal and Interest Waivers**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: Principal and interest waivers are a forgiveness of some portion of a borrower's debt obligation.

Objective: To minimize losses and/or stabilize asset markets.

When Used: FmHA's debt adjustment program combines a deferral of principal with a waiver of the interest on the deferred principal for up to 5 years. Private lenders have written down principal and accrued interest to minimize losses when they feel the borrower can adequately service the remaining debt.

Experience: Interest waivers have been used as a means of minimizing long-run losses when adverse economic pressures reduce borrowers' ability to service debt and widespread foreclosures would disrupt asset markets principal. The borrower must have a reasonable chance of financial solvency with debt waivers. There has been a hesitancy to utilize this option on the hope that financial conditions would improve. Waivers have, therefore, been a last resort option.

Consequences:

- Waivers may make it possible for borrowers to service their remaining debt obligations.
- Waivers by public lenders result in substantial costs to taxpayers.
- Interest waivers create a more politically acceptable way to forgive debt than do principal waivers, although the actual cost is the same.
- Principal and interest waivers can create a great deal of ill will on the part of farmers who are paying their debts.
- Principal and interest waivers represent direct subsidies to the borrowers who receive them.

Policy Tool: **Two-Tier Debt Restructuring**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: The program would involve classifying a borrower's debt into two tiers. Tier-one debt—debt the borrower could reasonably repay over the next 5 years, under "normal" conditions, with payment made on principal and interest at the current market rate. Tier-two debt—all remaining debt would carry a minimum interest rate and no principal payments would be required on this debt. Each year the amount of tier-two debt equal to the principal payment on tier-one debt would shift to tier-one, until all of the restructured debt was repaid.

Objective: To restructure debt based on the repayment ability of the operation.

When Used: The program was first proposed by the American Farm Bureau in 1985 to deal with the existing financial crisis. Any new short-term operating debt would be scheduled for repayment within each production and/or marketing year or offset by a minimum inventory of 120 percent for crops and 130 percent for livestock. Approval for new debt would require demonstration of repayment capacity in addition to the repayment requirements of the two-tier program. If a financial analysis reveals that no reasonable solution exists for a farmer's financial problems and that profitability is not possible through the two-tier debt restructuring, then partial or total liquidation of the operation would occur.

Experience: This proposal has not been tried in agriculture. It is similar in philosophy to existing practices involving delinquent foreign debt.

Consequences:

- The program has the economic advantage of being tied to a repayment philosophy based on both projected cash flow and profitability.
- Because of the profitability requirements, structural adjustment would continue to take place in agriculture.
- The program could help avoid overreaction by agricultural lenders and asset markets.
- If the interest rate on tier-two debt is not subsidized, the potential cost to lenders is substantial.
- If the interest rate on tier-two debt is subsidized, the program would involve significant public costs.

Policy Tool: **Farm Credit Capital Corporation**

Policy Area: **Credit Programs, Debt or Payment Restructuring**

What It Is: The Farm Credit Capital Corporation is a separate entity of the Farm Credit System rechartered to: (1) direct the pooling and allocation of System risk capital, (2) purchase, restructure and/or dispose of distressed System assets, and (3) to manage the use and repayment of any eventual federal assistance.

Objective: The Capital Corporation is intended to serve as the mechanism for allocating risk funds and federal assistance as needed to maintain the System's integrity.

When Used: The Capital Corporation was originally chartered to facilitate the movement of the System's capital assistance to and management of distressed assets in the Spokane and Omaha Farm Credit Districts. With the passage of the 1985 Farm Credit Amendments Act, its role was expanded to assure the System's own capital is fully utilized before any federal assistance is provided.

Experience: In its implementation, the Capital Corporation experienced considerable delays and resistance in establishing guidelines for withdrawing capital from contributing districts and in developing uniform credit standards and control procedures. It is too early to know how any federal assistance will be handled. The precedence for assistance to the System was established at its inception when government funds were used to capitalize the System.

Consequences:

- The Capital Corporation and the Farm Credit Amendments Act have reduced but did not eliminate System borrowers' and investors' fear that their investment would be lost.
- The initial effect on investors was to lower the risk premium the System was paying for its funds.
- If properly administered, the Capital Corporation and the increased regulatory authority of the Farm Credit Administration should improve the quality and uniformity of credit administration throughout the System.
- The increased centralization of regulatory authority tends to reduce local autonomy and control over the System.
- One of the key, and as yet undetermined, issues is the cost of any government assistance. If the funds are free or subsidized, the System could benefit tremendously in terms of rebuilding capital, but the cost would be passed on to the public.
- Centralization of administering the System's distressed assets may increase the visibility and political sensitivity to such a level that the System will be unable to manage these assets in a businesslike manner. This would defeat much of the benefits afforded by the Capital Corporation concept.
- The purchase of distressed assets creates a source of liquidity for institutions with large portfolios of nonperforming loans.
- If the distressed assets are conservatively valued and purchased at a discount, the Capital Corporation will have increased flexibility in restructuring distressed credit.
- Increased liquidity, lower cost of funds, and capital assistance can contribute to the stabilization of farm asset values by reducing pressure on System institutions to acquire and liquidate collateral.

Policy Tool: **Direct Government Loans**

Policy Area: **Credit Programs, Government Loans**

What It Is: Direct government loans involve a government agency lending money to specified categories of borrowers for specific purposes. Frequently such loans are subsidized and made at an interest rate which is less than either the cost to the government or the market rate of interest for comparable loans from private lenders.

Objective: To provide loan funds for purposes deemed to be in the public interest to borrowers who cannot obtain financing either in adequate amounts or at reasonable terms from private lenders.

When Used: FmHA has been the federal government's agricultural lending agency. Several states have also initiated agricultural loan programs. FmHA makes both farm operating and farm ownership loans. Interest rates on these loans are tied to the government's cost of borrowing and are thus lower than comparable conventional loans. A special limited resource loan program exists for farmers whose financial condition is such that they cannot afford to pay the normal interest rate. The minimum interest rate on these loans is usually about half the normal rate. Direct government agricultural loans are made primarily to farmers and ranchers who cannot qualify for adequate financing from other lenders. These loans are not intended to supplant or compete with credit available from conventional lending sources. They are intended to bear the financial and market risk conventional lenders are unwilling or unable to bear.

Experience: The government's share of total producer loans have tended to increase causing concern that government credit may become the major source of agricultural credit. Concerns also exist that loans made by government agencies are subject to political influence. Yet Congress favors the government credit option because the loan is an asset as opposed to a direct government outlay. Foreclosure on government loans has been difficult and subject to strong political resistance.

Consequences:

- Subsidized interest rates and more liberal credit terms can encourage new entrants and provide continued financing for segments of agriculture that suffer from surplus resources and production.
- As a policy tool, direct loan programs can be used to guide resources into or out of agriculture.
- Direct loan programs can be used to manage the rate at which asset markets adjust to changing economic conditions.
- Interest subsidies and the cost of administering direct loan programs can be very costly to taxpayers.
- Direct loans can be used to encourage the adoption of new technology.

Policy Tool: **Guaranteed Loans**

Policy Area: **Credit Programs, Government Loans**

What It Is: Guaranteed loans involve a government agency agreeing to protect a private lender against some or all potential losses resulting from borrower default.

Objective: To encourage private lenders to make and service loans they would not make without a loan guarantee.

When Used: Guaranteed loans are used to encourage private lenders to make, service, or restructure loans to borrowers who exceed the lender's risk requirements. They have also been used to encourage lenders to make loans to young farmers and to minorities. FmHA can guarantee both operating loans and farm ownership loans made by private lenders. The loans are funded and serviced by the private lender subject to FmHA approval. Guarantees can be extended for up to 90 percent of the loan amount. Loan guarantees have political appeal because they are low cost in the short-run and because the funds flow through the private sector.

Experience: Guarantees have been moderately effective in encouraging lenders to make new loans. Many lenders feel the return from this type of loan is not worth the time and red tape involved in meeting the terms of the guarantee provisions. There is also some concern about how the terms of the guarantee would be interpreted in the event of borrower default. The greatest use of loan guarantees has been to restructure existing loans to avoid or reduce potential losses. Lenders have also used loan guarantees when financing ventures or enterprises with which they have limited experience, or where the size of the loan involved putting a significant portion of the institution's capital at risk. Some lenders use loan guarantees as a means of servicing borrowers who would otherwise exceed the institution's legal lending limit. Others use guaranteed loans to increase profits by discounting the guaranteed portion into secondary markets. Pressures are increasing to make FmHA largely a loan guarantee agency.

Consequences:

- Loan guarantees can help financially strapped farmers who could recover with continued financing and restructured loan terms.
- They can encourage private lenders to finance new enterprises and technologies.
- If the guaranteed loans are not financially sound, the program can result in large longer-run public outlays.
- Properly structured, a loan guarantee program may provide the time necessary to implement a more permanent solution, thus protecting farm asset markets from collapse.
- Loan guarantee programs essentially become lender bail outs when improperly structured or when no feasible long-term solution exists.
- Loan guarantee programs can result in new entrants and continued financing for those segments of the industry that already suffer from surplus resources and production.
- Rural communities may realize marginal benefits since losses that would otherwise be borne by firms in the local community would be borne by taxpayers.

Policy Tool: **Economic Emergency Loan Program**

Policy Area: **Credit Programs, Government Loans**

What It Is: Economic emergency loans are government loans intended for farmers who are suffering economic hardships due to national or regional economic stress, or from general tightening of credit, high costs of production, or low farm product prices.

Objective: To make credit available to farmers suffering financial hardship from economic forces beyond their control.

When Used: The program was created in 1978 and administered by the FmHA primarily to refinance debts and provide operating expenses to continue farming. Loans were made regardless of whether financing could be obtained elsewhere. New loans under this program have not been made since 1984.

Experience: The program made billions of dollars of subsidized credit available at a time when real interest rates were low to negative. In many respects, it exacerbated the problem by deferring normal market adjustments, holding excess resources in agriculture, and artificially supporting asset values. When farm income began to turn down in the mid-1970s, farmers who were only marginally successful even in good times, and farmers who had inadequate repayment capacity, found credit markets tightening up. At the same time, the land market was relatively tight, although there were successful operators who would have purchased assets if the market had been allowed to force unsuccessful operators out of farming. Instead, the economic emergency loan program was created on the basis that the problem was short-run. As a result, excess resources were held in agriculture instead of being moved out.

Consequences:

- Additional credit can not correct an income problem.
- While credit is a liquidity management tool which can be used to bridge short-term cash flow deficiencies and to structure capital debt in line with the repayment ability of the assets financed, it will not correct long-term profitability or liquidity problems.
- Interest rates serve to ration available credit. Subsidized rates and loans based on other than repayment ability tend to distort the allocation process.
- The program made subsidized loans available to borrowers who were much larger than the FmHA's traditional family-size farm requirements.
- The definition of economic emergency was so broad that the program led to many widely documented abuses.

Policy Tool: **Emergency Disaster Loan Program**

Policy Area: **Credit Programs, Government Loans**

What It Is: The emergency disaster loan program is a government loan program which makes credit available to farmers in areas devastated by natural disasters.

Objective: To help farmers recover from the effects of natural disasters.

When Used: FmHA makes disaster loans in locations designated as disaster areas by the President or by the Secretary of Agriculture. These loans can be made to compensate for (1) actual physical losses directly related to the disaster, (2) annual production expenses and other needs arising from natural disasters, providing the borrower has some "all-risk" crop insurance coverage, if available, and (3) major adjustments in the farming operation necessitated by a disaster.

Experience: Emergency disaster loans have been used to help farmers recover from losses experienced as the result of natural disasters. They have also encouraged expanded production of crops in high risk areas. Interest rates on disaster loans are based on the government's cost of borrowing for those able to qualify for credit elsewhere and subsidized to farmers unable to obtain credit elsewhere.

Consequences:

- Crop production is encouraged in high risk areas.
- Credit assistance is provided at times when it is needed most.
- Subsidized interest rates pass part of the recovery cost on to the taxpayers.
- Producers are discouraged from obtaining adequate insurance coverage from private vendors.

Policy Tool: **Farm Credit Administration (FCA)**

Policy Area: **Credit Programs, Government Regulation and Intervention**

What It Is: FCA is the regulatory agency for the Farm Credit System.

Objective: To establish regulatory standards for the performance of the system.

When Used: FCA has existed throughout the life of the Farm Credit System. Until the enactment of the 1985 Farm Credit Amendments Act, FCA performed dual regulatory, public relations, and advocacy functions. This Act materially strengthened FCA's regulatory role and eliminated its member controlled board of directors.

Experience: Despite changes in its function over time, FCA continued to serve important advocacy and public relations functions for the Farm Credit System and had limited regulatory powers compared to the regulatory agencies for other financial institutions. Establishing lending policies and standards was considerably more decentralized. When the farm credit crisis developed in the 1980s, FCA became the brunt of criticism for not having provided adequate regulatory guidance and control. Its regulatory function was, therefore, materially strengthened, with the producer control structure severed.

Consequences:

- The 1985 Farm Credit Act dramatically increased the regulatory role of FCA and reduced or eliminated its public relations and advocacy role.
- Independence of the System's banks in establishing policy is reduced.
- Responsiveness of the System to changing conditions is increased.
- The 1985 Farm Credit Act changed the function of FCA to more like the regulatory role of the regulators of other financial intermediaries.

Policy Tool: **Foreclosure Moratorium**

Policy Area: **Credit Programs, Government Regulation and Intervention**

What It Is: Foreclosure moratoria forces lenders to stop foreclosures on agricultural related loans.

Objective: To temporarily relieve financially pressed borrowers of financial obligations associated with excessive debt.

When Used: Moratoria were applied under the Frazier-Lemke Act in the 1930s to bankruptcy proceedings. The moratorium was applied to real estate mortgage loans. In recent years, various states have also instituted temporary moratoria on farm foreclosures. FmHA was prohibited from foreclosing on borrowers from May 1983 through November 1985 as a result of the *Coleman vs. Block* lawsuit.

Experience: During the 1930s' Frazier-Lemke Act moratorium, a farm was appraised and the courts granted a stay of proceedings for 3 years, during which time the farmer retained possession of the property and paid rent for its use. Within the 3 years the farmer could pay the appraised value and redeem the property. If the property was not redeemed, it was sold to satisfy the debt against it. The farmer was not held liable for loan amounts greater than the appraised value of the property or its sale price. The various moratoria imposed on or by the FmHA have simply been stays of foreclosure. The farmer was given time to restructure debt and service the loan obligations.

Consequences:

- Security interest in farm collateral is materially reduced.
- A moratorium tends to make credit less available and raise interest rates for those borrowers not subject to foreclosures in order to compensate lenders for the higher credit risks.
- A moratorium can help temporarily stabilize asset values because fewer assets are forced on the market.
- Costs to lenders resulting from the nonpayment of interest, collateral depreciation, and additional borrower operating losses during a moratorium can be substantial.
- A moratorium can be successful only if the financial conditions of the firm and/or the industry improves during the period so (1) the borrower can pay the debts, or (2) the asset markets can absorb the assets at more favorable prices.
- A moratorium serves to hold surplus resources in agriculture.
- Conditional or limited moratoria can be used to encourage reluctant lenders to use public sector assistance programs or accept forbearance and other restructuring approaches.

Policy Tool: **Warehousing Farm Assets, Agriculture Conservation Corporation**

Policy Area: **Credit Programs, Government Regulation and Intervention**

What It Is: A proposal to form a government corporation to purchase assets (land and equipment) from problem farm loans at a "fair" market value. Assets acquired under the program would either be retired or later resold or leased back to farmers.

Objective: To stabilize the value of agricultural assets and to prevent further erosion of farmers' equity and lenders' collateral values.

When Used: An Agricultural Conservation Corporation was proposed as a limited life program to be used when adverse economic conditions result in large numbers of foreclosures and voluntary liquidations. The program would support asset values by taking surplus assets off the market.

Experience: The program has not been implemented. The concept appeared to be rejected on the potential for extensive government ownership of farmland and equipment.

Consequences:
- To the extent assets, particularly land, are retired from production, the program would serve a double purpose in asset stabilization and supply control.
- Sale of assets would be very unpopular when they force down local land and equipment values.
- The release price for assets would serve to set a ceiling on asset values until all assets in the program are sold.
- By allowing lenders to sell acquired property and farmers to sell distressed assets, the program would reduce losses associated with foreclosures.
- The initial cost to the government of acquiring sufficient assets to stabilize farm asset markets would be substantial.
- Losses to lenders and farmers resulting from owning assets earning less than their carrying costs would be passed to taxpayers.
- Problems of establishing "fair" market value and targeting assistance would raise questions of equity and be difficult to administer.

Policy Tool: **Secondary Markets for Agricultural Loans**

Policy Area: **Credit Programs, Secondary Financial Markets**

What It Is: Secondary markets involve the originating lender selling loans or claims on agricultural loans to investors. In its most limited sense, the process involves a direct transaction between the original lender and an investor. A potential exists for greater liquidity when brokers act as middlemen to facilitate the sale of loans or loan participations to investors. An extension would be to establish an agricultural credit corporation to pool loans and sell negotiable pooled participations (or mortgage bonds) to investors.

Objective: To add liquidity, spread lending risks, and broaden the market for agricultural loans.

When Used: Existing secondary markets for agricultural loans include the sale of farm mortgage loans by originating lenders to life insurance companies. There is a highly developed secondary market for FmHA guaranteed loans through brokers. Commercial banks have long used the sale of loan participations to correspondent banks as a means of funding agricultural loans. The Federal Intermediate Credit Banks also discount short- and intermediate-term agricultural loans from commercial banks and agricultural credit corporations. These are funded by the sale of consolidated Farm Credit System bonds and notes. Major banks have also used bankers' acceptances as a means of marketing agricultural loans in established secondary markets.

Experience: The Federal Intermediate Credit Banks, correspondent banking relationships, and secondary markets for bankers acceptances and government guaranteed loans provide several alternatives for marketing short- and intermediate-term agricultural loans. Secondary markets for farm real estate loans are not nearly so well developed. Most farm mortgages sold by originating lenders to insurance companies are on a prearranged basis. The concept of an "Aggie Mae" program to buy farm loans has been frequently proposed but never implemented. This program would initially involve the creation of a government-backed agricultural credit corporation to pool farm mortgages and sell pooled participations or mortgage bonds in a manner similar to the Federal National Mortgage Corporation which buys residential mortgages. Such a program could be used to purchase both high quality and weak loans by discounting the purchases to reflect the risk involved.

Consequences:

- Secondary markets enable direct access to capital markets.
- Secondary markets could add liquidity to the farm real estate mortgage market.
- The "Aggie Mae" concept would likely require standardization of loan paper and utilization of public guarantees or commercial insurance as well as initial assistance from the federal or state governments to facilitate administrative arrangements.
- Limitations on active secondary markets for agricultural loans involve the relatively high risk of agricultural loans, the nonuniformity of loan documentation and credit arrangements, the relatively small size of the loans, and the lack of mortgage guarantee insurance.

[Blank Page in Original Bulletin]

[Blank Page in Original Bulletin]

Mention of a trademark or a proprietary product does not constitute a guarantee or a warranty of the product by The Texas Agricultural Experiment Station and does not imply its approval to the exclusion of other products that also may be suitable.

All programs and information of The Texas Agricultural Experiment Station are available to everyone without regard to race, color, religion, sex, age, handicap, or national origin.

6M—8-86