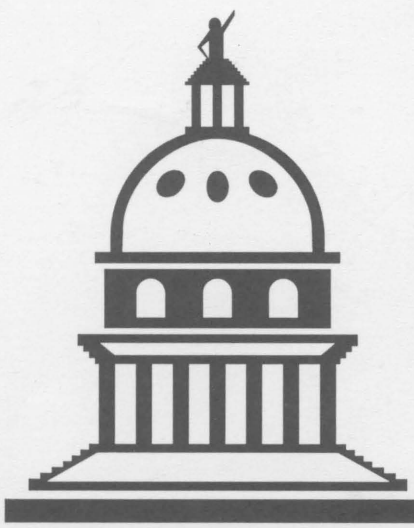
B-1548
Revised
January 1993

Policy Tools for U.S. Agriculture



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POLICY TOOLS FOR U.S. AGRICULTURE

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FOREWORD

This document summarizes what has been learned from more than 60 years of experience dealing with more than 100 agricultural and food policy tools. Contemporary federal policy regarding agriculture has its origin in the late 1920s. Since that time policy has evolved continuously as problems, conditions, goals and/or philosophies toward government involvement in agriculture have changed.

So many policies have been tried or evaluated that it is often said that few, if any, truly new policy options exist. It is also said that agricultural policies tend to cycle between various degrees of concern about the need for income support, conservation, food assistance, and export orientation. These realities make it possible to learn from our experience with policy tools that have been tried, as well as those that have been analyzed but for one reason or another not tried.

This is the third edition of agricultural and food policy tools. The first publication dated August 1984 had 41 tools. The second dated August 1986 had 69 tools. It was honored by the American Agricultural Economics Association with a Quality of Communication Award. This edition contains 101 tools. The increased number of tools reflects the broadened scope of agricultural and food policy as well as its increased complexity. While every Congress and administration since 1980 has vowed to reduce the complexity of farm bills, they have not succeeded. This edition, for example, adds a maze of conservation and environment tools authorized by the 1990 farm bill.

Perhaps most important, this publication has no axe to grind. There is no hidden agenda. Its purpose is to provide just enough objective and factual information on a tool to wet the appetite of a congressional staffer who is thirsty for knowledge, a farm organization director who needs to sharpen his/her policymaking tools, or a student who is involved in policy education. Because time is valuable, each tool is allotted a single page.

Keywords: Domestic farm policy, commodity programs, conservation, environment, international trade policy, marketing policy, demand expansion programs, food assistance, nutrition, food safety, credit policy.

ACKNOWLEDGEMENTS

This publication has benefitted from the comments, suggestions, and work of many individuals. Primary among these are the staff of the Agricultural and Food Policy Center, particularly Dawne Hicks, our staff assistant, and Sue Jones, our editor. Faculty reviewers of the manuscript included John Nichols, Dan Padberg, John Penson, David Leatham, Larry Lippke, and Gary Williams. Our friends at the Texas office of the Agriculture Stabilization and Conservation Service, particularly Lester Byrd, Darrell Davis, and Kermit Decker, reviewed the sections of the manuscript related to the farm program.

Since the original publication of *Tools,* we have received many suggestions, corrections, and additions from our friends in the Economic Research Service/USDA, from farm organization leaders, and from congressional staff for whom this publication was designed.

The authors accept full responsibility for any errors that appear in this publication.

INTRODUCTION

Agricultural policy is a broad term used to encompass government programs that directly affect the prices and incomes received by farmers. Producers and agribusiness leaders, agriculture related organizations, and government policymakers must sort through a myriad of potential policy tools in developing this nation's agricultural policy.

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 in controlling production than acreage reduction programs. Policy tools often 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 five general categories:

- **Domestic Farm Programs** - Designed to raise or stabilize farm prices and incomes.
- **Conservation and Environmental Programs** - Designed to conserve natural agricultural resources and protect the environment.
- **International Trade Policies** - Designed to create a more favorable trading environment for U.S. farm products.
- **Marketing and Demand Expansion Programs** - Designed to improve farmers' position in domestic and foreign markets.
- **Food Assistance, Nutrition, and Safety** - Designed to improve the level of living for everyone who consumes food and natural fibers.
- **Credit Programs** - Designed to ensure 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 in this publication.

- Halberg, M. C. *Policy for American Agriculture.* Ames: Iowa State University Press, 1992.
- Hillman, J.S. *Technical Barriers to Agricultural Trade.* Boulder, Colo.: Westview Press, 1991.
- Houck, J. P. *Elements of Agricultural Trade Policies.* Prospect Heights, Ill.: Waveland Press Inc., 1992.
- Knutson, R. D., J. B. Penn, and W. T. Boehm. *Agricultural and Food Policy.* Englewood Cliffs, N.J.: Prentice-Hall, Inc. 1990.
- Tweeten, L. *Foundations of Farm Policy.* Lincoln: University of Nebraska Press, 1979.
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DOMESTIC FARM PROGRAMS

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

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

What It Is: A cost-sharing 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 per unit assessment 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 farm 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. The 1990 farm bill established an assessment for nonfat dry milk, cheese, and butter purchases by the CCC in excess of 7 billion pounds, milk equivalent.

Experience: Producer resistance has been substantial to the "assessment" under each program. Tobacco cost sharing was eliminated in the 1985 farm bill. Dairymen chose an even higher assessment to avoid support price cuts that would have been imposed by Gramm-Rudman. Assessments have become quite unpopular with producers. When it was suggested that milk producers ought to pay the extra WIC costs associated with an increase in the price support level, milk producer support for a 1991 dairy bill fell apart.

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 places the burden of program costs directly on producers, whereas price support reduction places the burden on cooperatives, processors and exporters who traditionally hold inventories.

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 producers' yield and planting risks by providing them a relatively free (program compliance may be 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 harvested less than 65 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 (MPCI). Whenever widespread disasters strike, however, Congress has been inclined to provide disaster payments such as in 1986, 1988, 1989, 1990, 1991, and 1992.

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. Ad hoc disaster programs discourage producer participation in crop insurance. The effect is to undermine the crop insurance program.

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.
- Disaster programs can encourage 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.
- Special disaster payments undermine the crop insurance program.

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

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

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

Objective: To provide federally subsidized crop insurance to producers unable to obtain adequate crop insurance elsewhere. 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: MPCI for wheat was first authorized under the 1938 Federal Crop Insurance Act. Federal crop insurance was available only for wheat from 1939 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 MPCI has a high cost of administration relative to commercial insurance. The propensity of the Congress to enact ad hoc disaster payments in times of weather adversity undermines the effectiveness of the crop insurance program.

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: **Findley Payment, Findley Loan**

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

What It Is: Deficiency payment to make up the difference between the formula loan rate and the effective loan rate or the market price for wheat and feed grains.

Objective: To compensate U.S. farmers for adjustments to the formula loan rate made by the Secretary.

When Used: The 1985 farm bill established a formula for calculating the loan rate based on historical prices. The Secretary was authorized to reduce the formula loan rate (also referred to as the basic loan rate or basic price support) up to 20 percent to ensure the competitiveness of U.S. exports. When the Secretary reduced the formula loan rate, USDA was required to make producer payments to compensate fully for the loan rate reduction when average market prices fell below the formula loan rate. The payment rate is the formula loan rate less the greater of the market price or the effective loan rate. The payment was subject to the $200,000 limit in the 1985 farm bill. The 1990 farm bill continued the 20 percent loan adjustment subject to supply/demand conditions. The Findley payment was made subject to a $75,000 annual limit, however.

Experience: Loan deficiency payments were made each year of the 1985 farm bill for wheat and feed grains because the Secretary opted for the maximum reduction in the formula loan rates of these crops in 1986-1990. The budget exposure created by payment under the 1985 farm bill resulted in a $75,000 limit in the 1990 farm bill.

Consequences:

- Adjusted loan deficiency payments can lead to large government payments overall and to individual farmers.
- Adjusted loan deficiency payments reduce the adverse effect on farm income of the Secretary's actions to make U.S. exports more competitive in the world market.
- Adjusted loan deficiency payments reduce income risk for producers.
- Lower effective loan rates make U.S. exports more competitive in the world market.

Policy Tool: **Flexibility (Flex)**

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

What It Is: Flexibility allows producers to participate in the farm commodity program while planting up to 25 percent of their crop acreage base to permitted alternative crops. Participating producers retain their crop acreage base. No deficiency payment is received on flexed acreage although applicable loans apply. Producers do not receive deficiency payments on 15 percent of their acreage base, regardless of whether they flex it to an alternative crop.

Objective: To reduce government costs and provide farmers an opportunity to adjust cropping patterns in response to price changes.

When Used: Mandated in the 1990 budget act, a companion piece of legislation to the 1990 farm bill. The first opportunity to utilize the flexibility provisions was with the 1991 crop.

Experience: Relatively high prices for cotton encouraged farmers to flex considerably to cotton. Oilseed production likewise was increased. Producers' net incomes declined because of the 15 percent cut in deficiency payments. Flexing to soil-conserving crops did not appear to be overwhelming nor did moves to diversification.

Consequences:

- Lowered producer returns, particularly for those who had limited flex options.
- Provided opportunities to switch cropping patterns in light of technological changes, particularly variety improvements.
- Provided opportunities to implement conservation practices.
- Reduced incentives for increased production by reducing payment acreage.
- Increased farmers' ability to respond to price signals in areas where viable alternative crops existed.

Policy Tool: **Income Insurance**

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

What It Is: Income insurance would involve an expansion of the MPCI 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 MPCI, such a program would be difficult to develop.
- Producers' premiums would likely be unacceptably high, and because 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 and from one region 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 because losses caused by either low yields or low prices would be widespread and catastrophic for the treasury.

Policy Tool: **Marketing Loan**

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

What It Is: Marketing loan is a nonrecourse loan with a repayment rate at the world market price, as determined by ASCS/USDA. The difference between the loan rate and the repayment rate (the loan deficiency payment rate) is not subject to the basic $50,000 payment limit. It is, however, subject to a separate $75,000 payment limit.

Objective: To remove the loan rate price floor and thereby expand exports.

When Used: Marketing loans were first authorized by the 1985 farm bill. While authorized for all price supported commodities, marketing loans were only initially implemented in rice and cotton. The 1990 farm bill extended the marketing loan to oilseeds. The 1990 bill also included a GATT trigger that mandated implementation of a marketing loan for wheat and feed grains in the absence of a GATT agreement by June 30, 1992. The GATT agreement was not reached so the marketing loan will extend to wheat and feed grains in 1993.

Experience: With the release of government stocks in 1986, largely through generic certificates, market prices fell to the repayment level. Foreign country competitors objected strongly to increased price competition from U.S. commodities in the world market. The marketing loan is most effective in expanding exports when the CCC is releasing stocks. If there are no CCC stocks to release, the market price plus loan deficiency rates plus producer equities or premiums will exceed announced loan rates.

Consequences:

- Marketing loan repayment rates become the market floor price when not used in conjunction with generic certificates that release CCC stocks.
- Prices become more unstable.
- Commodities become available for export at competitive world prices, thus increasing exports when the CCC is releasing stocks.
- With an expanded payment limit on the difference between the loan rate and the repayment rate (loan deficiency payment rate), large farms have a greater incentive to participate in the program.
- Government program costs increase sharply in the presence of large surplus stocks.
- Farm program costs for competing exporting countries increase and/or their producer returns decline.
- Domestic processor/consumers gain access to U.S. commodities at world competitive prices.
- Producers' returns increase because of the potential for marketing loan payments combined with premiums (equities) that might be offered to secure release from the non-recourse loan.

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, marketing or Findley loan 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 minimize 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, particularly rice, wheat, and cotton farms. 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, escalated to $40,000 in 1977 and subsequently raised to $50,000. The 1990 farm bill payment limit remains at $50,000 with the emergency disaster program limited to $100,000. Benefits from the marketing and Findley Loan are subject to a separate $75,000 payment limit.

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. As a result, the payment limit may not be very effective in accomplishing its objective.

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 rates, 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.
- Payment limits encourage larger farms to divide their operations and/or convert to cash rental arrangements that reduce the effectiveness of the limit, create extra costs, and thereby make payment limits inefficient.

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

Policy Area: **Domestic Farm Programs, 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 participating farm's payment acres and farm program yield. Payment acres equals base acres less idled (set aside) and Flex (normal and optional) acres (see Flex). The farm program yield is based on each farm's yield history. Since 1985, however, they have been frozen. Although target prices were set initially to reflect an average cost of production, they are now legislatively determined.

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. The 1985 farm bill specified about a 10 percent sequential reduction in target prices by 1990. The 1990 farm bill froze target prices at 1990 levels through 1995. Deficiency payments are paid on eligible crops if the average cash price is less than the target price.

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 and which costs should be included. 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 regarding inflation, crop yields, or production costs. Excess production and high government program costs resulted. Target price reductions in the 1985 farm bill and frozen target prices in the 1990 farm bill, along with Flex and the CRP, substantially reduced production incentives, stocks, and government program costs.

Consequences:

- Target prices set above market clearing levels stimulate production and reduce market prices, thereby reducing 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, i.e., an implicit export subsidy. This is a significant advantage over using 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 of up to $50,000 to large-scale producers. Because deficiency payment are paid on eligible farm program yield, smaller scale producers receive less absolute support.
- Deficiency payments reduce income risk for producers and increase their ability to obtain financing.

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 for wheat, feed grains, rice, 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, depending on program participation and loan eligibility.

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. 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 feed grains. During World War II, the loan rates for basic commodities were set at 100 percent of parity to encourage production of crops. 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 result, (a) the loan rates acted as a supply incentive for producers, (b) the CCC acquired large stocks of grain and cotton, and (c) the volume of exports declined as commodities were priced out of the world market. These events resulted in the marketing loan (see Marketing Loan) being authorized in the Food and Agriculture Act of 1985. In addition, loan rates were established based on a moving average formula of the previous five years' prices. The loan rate formula in the 1985 farm bill was retained by the 1990 bill to keep loan rates competitive with world prices. Further reductions in the loan rate for wheat and feed grains were allowed (see Findley Loan) to make them competitive in the world market.

Consequences:

- Loan rates with reasonable release levels act as a price stabilizing force in the market and thus reduce price risk for producers and lead to greater production.
- The CCC loan reduces price risk for farmers and consequently encourages excess resources to remain agriculture.
- The CCC loan program extends the marketing period for producers from 9 to 12 months and even longer with extensions.
- High loan rates can effectively price U.S. commodities out of the world market and necessitate 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 can become a production incentive as a result.

Policy Tool: **Commodity Purchase Program**

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

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 whenever they are offered to CCC at the support price under the operation of the price support programs for 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 (e.g., to remove excess surplus of meat from market during the dairy baaed program).

Experience: Commodities purchased under special programs (other than price support program purchases) are generally those grown by producers who have the greatest political influence. 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 distribution programs to the needy have largely been replaced by food stamps; however, some of these programs still exist (see Commodity Distribution).

Consequences:

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

Policy Tool: Farmer-Owned Reserve (FOR)

Policy Area: Domestic Farm Programs, Price Support

What It Is: FOR is a three-year CCC loan for wheat and feed grains. The 1977 farm bill established the FOR as a three-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 until the extension expires.

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

When Used: FOR has been in use since 1978 for wheat and feed grains. 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. The 1985 farm bill established upper limits on wheat and feed grain stocks in the FOR as a percent of estimated total domestic and export use. The maximum wheat stocks was 30 percent of estimated use, and for feed grains, the maximum was 15 percent of estimated use. The Reagan-Bush administration deemphasized the role of FOR. The 1990 farm bill gives the Secretary authority to allow FOR entry within certain limits and subject to the stocks to use ratio and price conditions.

Experience: FOR attracts large quantities of stocks when the entry price is set above the equilibrium market price. Research has shown that 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. Within that range, prices may be more volatile because of the program pulling prices to either the entry or the release price. Under the 1990 farm bill, producers are allowed to redeem FOR commodities at their discretion, thus bypassing entry/release trigger induced volatility.

Consequences:

- FOR often results in the accumulation of stocks which, in turn, result in substantial storage and interest costs.
- FOR provides farmers three years to market their grain out of the reserve.
- Setting the FOR entry price above equilibrium market price creates, in effect, an income support program.
- In the face of declining export demand, there are no provisions to reduce the FOR entry 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.
- Upper limits on stocks in the FOR limit government storage costs and prevent an uncontrolled buildup of stocks.

Policy Tool: **Acreage Allotment**

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

What It Is: Acreage allotment is a mandatory mechanism to reduce the production of targeted commodities. Acreage allotments require that producers plant within a specified number of acres. The number of acres allotted to each farm is based on the farm's production history. The allocated acres may be adjusted annually to meet the supply objectives.

Objective: To reduce the quantity produced and consequently 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 were used as a means of allocating target price benefits (e.g., with rice from 1976-81). This practice has since been abandoned.

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 control production more effectively.

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, if allowed to be traded.
- High cash outlays to purchase allotments act as a barrier to entry for many farmers, especially those just beginning.
- 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: **Acreage Reduction, Set-Aside, and Diversion**

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

What It Is: Acreage reduction consists of an annual acreage set-aside and/or acreage diversion that is generally voluntary. Acreage set-aside programs require that participating farmers idle and devote to a conserving use a percentage of their crop base acres in order 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 farm'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 have been used continuously since 1977. These programs are generally used when prices are depressed due to a stock buildup. During the early 1980s when supplies were in substantial excess, set-aside levels rose to the 20-35 percent range. The 1990 farm bill explicitly tied the Secretary's annual acreage reduction decision to the relationship between a commodity's ending stocks and its total use.

Experience: Acreage reduction programs have been only modestly effective in reducing supply over the long run. These programs have generally been used when loan rates, target prices, or market prices were high enough to 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. By the early 1990s, commodity supplies had been reduced sufficiently by low loan rates, lower real target prices, expanded export subsidies, and increased CRP enrollment that annual acreage reduction requirements were reduced to relatively low levels.

Consequences:

- To the extent that acreage reduction programs decrease production, they reduce supply and stocks and raise prices.
- 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 that does not result in correspondingly lower production, e.g., due to removing the poorest land.)
- Diversion programs can result in significant treasury outlays.
- Payment limitations and offsetting compliance (when used) discourage participation by large-scale operators who farm large acreages for multiple landlords.
- 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, costs of production for livestock, and prices for food and fiber.

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

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

What It Is: Cross-compliance 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 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 on the farm, but the producer cannot plant in excess of the established crop acreage base for the other crops.

Objective: Cross-compliance has multiple objectives including those of 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 authorized in the 1985 farm bill. Cross-compliance requirements were eliminated in the 1990 farm bill and new flexibility provisions were incorporated to allow limited planting of alternative crops.

Experience: While cross-compliance theoretically 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 program 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: **Dairy Buyout, Termination 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 five years. Farmers submit competitive bids in a buyout program.

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

When Used: The buyout program was initiated in 1986 after the dairy diversion program proved unsuccessful at reducing production.

Experience: The maximum bid accepted in the Dairy Buyout Program ($22.50/cwt annually 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 ensure that 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 that have the lowest returns over variable costs.
- Farmers who were contemplating going out of business anyway were most likely to participate.
- Buyouts create strong incentives for nonparticipants to increase production. As a result, production declines tend to be temporary.
- No long-term incentives exist to reduce production.
- Increased dairy slaughter raises beef supply and depresses meat prices.
- Animal rights activists become very concerned about branding requirements and conditions surrounding the resulting animal slaughter.
- After the buyout program, beef producer interests became actively involved in dairy policy debates, expressing strong opposition to any program that would mandate reduced milk production.

Policy Tool: **Dairy Diversion Program**

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

What It Is: The Dairy Diversion Program paid farmers $10/cwt of reduced production, from an historical base, for an 18-month period. Reduced production was accomplished by early culling of cows, reduced feeding, and modified breeding schedules. The origin of the name "diversion" is unclear since there is no diversion, just reduced production.

Objective: To reduce milk production; government purchases; government stocks of butter, nonfat dry milk and cheese; and government dairy program costs.

When Used: The dairy diversion program was authorized in 1983 and implemented in 1984. Dairy program purchase costs had exceeded $2 billion annually and the government was purchasing more than 10 percent of the milk supply.

Experience: Highest participation was in states that were already reducing production. Participating farmers reduced production by the subscribed percentage but many nonparticipating farmers increased production. Therefore, total production decreased by only 50 percent of what was anticipated. Participating farmers who stayed in production had their cows and heifers bred to go into a full-production mode at the end of the program. Therefore, production increased sharply to record levels the subsequent year.

Consequences:

- Slippage in dairy proved to be at least as large as in crops because of nonparticipant increases in production and the temporary nature of the program.
- Participation was highest in regions that have the lowest returns over variable costs.
- Farmers who were reducing production and/or contemplating going out of business were the most likely to participate.
- Strong incentives for nonparticipants were created to increase production.
- No long-term incentives exist to reduce production.

Policy Tool: **Generic PIK**

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

What It Is: A negotiable commodity certificate that can be redeemed by the holder for his/her farmer-owned reserve loan, any uncommitted commodities in CCC inventories, or cash. The certificates were 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 that 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 that were applied to individual commodities available only in designated locations.

When Used: Can be used only when stocks are held in the CCC, Farmer-Owned Reserve (FOR) or under price support loan. First implemented in the 1986 farm program 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 commodity specific 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 farm program provisions. Multiple expiration dates, however, 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 and/or programs.
- 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, (e.g., cotton) may have an adverse impact on the market prices for another commodity (e.g., 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: **Long-Term Land Retirement, Soil Bank, Conservation Reserve Program (CRP)**

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 requiring 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. (See the Conservation Reserve Program in Conservation and Environment Section).

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. The Soil Bank was unpopular because it paid landowners the same per acre rental rate to retire lands with different productivity and because of the adverse effects on rural communities. 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 under the Conservation Reserve Program (CRP). Land retirement is politically acceptable to consumers and producers when surplus stocks and low prices are chronic problems. If needed, the land can 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. To reduce the adverse effect on rural communities, the 1985 farm bill established the maximum acreage that could be enrolled in the CRP within a single county at 25 percent of the total cropland acreage unless the Secretary of Agriculture determines that higher participation would not adversely affect the local economy.

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 and food prices over time.
- Land retirement can be used to encourage conservation of cropland, promote 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. However, paying for land retirement based on productivity (bid basis) increases the efficiency of the program. Slippage may be reduced somewhat if whole farms are removed from production.

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 less than normal production levels. The national quota is allocated to each producer, based on past production. Marketing certificates may be issued to producers holding quotas that grant them the right to market a specified quantity of the commodity. The certificate, if allowed to be sold, will develop a value determined through market exchange.

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

When Used: Because 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 if proclaimed by the Secretary and approved in referendum by 60 percent of the eligible producers. These quotas would have been put into effect for the 1987-90 crop years, but they were never used.

Experience: Marketing quotas are the most effective means of controlling supply. They were initially imposed after acreage allotments proved to be ineffective in controlling supply. Marketing quotas have effectively reduced production and stock levels but only when the national quota was set at levels consistent with demand.

Consequences:

- Once a quota is in place, there is pressure to increase the national quota, thus defeating 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 little, if any, slippage.
- Marketing quotas are associated with low treasury costs unless the quota is so large 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 quota commodities increase the costs of production for livestock and food prices over time.

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 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 allowed the Secretary, at least implicitly, the authority to require offsetting compliance for wheat and feed grains. The bill explicitly prohibited offsetting compliance provisions from being used for cotton and rice. The 1990 farm bill eliminated the Secretary's authority to require off-setting compliance.

Experience: While offsetting compliance is essential theoretically to implementing effective acreage reduction programs, it is not attractive politically or pragmatically. 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 program 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 the existence of multiple landlord-tenant relationships.

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

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

What It Is: PIK is an acreage diversion program with the diversion payment in the form of a commodity rather than cash.

Objective: To reduce production, stocks, and/or direct treasury outlays (government program costs).

When Used: PIK was used in the early 1960s for one year. In 1983 it was used for wheat, cotton, corn, sorghum, and rice; in 1984 it was used again for wheat. The program has been active whenever government-owned stocks have reached unacceptably high levels.

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 logistical 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 were 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 supplies available to the market by releasing CCC stocks while curtailing production.
- 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 sign-up is high.
- Instead of adjusting excess resources out of crop production in any given year, PIK's artificially high prices may actually encourage them to stay.

Policy Tool: Two-Tier Milk Pricing

Policy Area: Domestic Farm Programs, Supply Control

What It Is: Two-tier milk pricing plans establish a producer base or quota with a lower price for excess production. How much lower the excess price is determines the effectiveness of the plan in controlling production. For effective control, production in excess of the base (second tier production) must be priced below variable cost to control production.

Objective: To control milk production, raise producer returns, and lower government dairy program costs.

When Used: Two-tier pricing plans for milk were proposed and debated throughout most of the 1980s as a means of bringing milk production in line with consumption but were never authorized or implemented.

Experience: Not authorized or implemented largely because of disagreement within the industry over the desirability of mandatory controls. The Reagan-Bush administrations were strongly opposed to mandatory production controls. Beef producer interests realized that cutbacks in production meant more cow slaughter and lower beef prices. Thus, they were also opposed.

Consequences:

- Milk price could increase if the excess price is high enough.
- The pricing plan would require strong import controls to be effective.
- The pricing plan would require close monitoring and control of production.
- The enhanced returns, as a result of the program, would be capitalized into the price of the quota or the value of the dairy.
- Barriers to entry for new producers would be created by the presence and cost of the quota.

Policy Tool: **0/92 and 50/92**

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

What It Is: Participating wheat, feed grain, cotton, and rice producers are allowed to plant less than their program payment acreage while continuing to receive deficiency payments on 92 percent of their maximum program payment acreage. If wheat and feed grain producers plant between 0 and 92 percent of their maximum payment acreage to the crop and devote the remaining payment acreage to a conserving use, they are eligible to receive deficiency payments on 92 percent of their maximum payment acreage. To be eligible for the 92 percent deficiency payment provision, upland cotton and rice producers must plant between 50 and 92 percent of their maximum payment acreage to the crop and devote the remainder to a conserving use. Minimum deficiency payment guarantees are announced for all eligible crops.

Objective: To reduce the quantity produced and thus the supply of a given commodity while protecting farm income. In addition, environmental objectives can be achieved through the conserving use requirements on land entered into this program.

When Used: The 0/92 and 50/92 programs were established for wheat, feed grains, cotton, and rice in the 1985 farm bill. Initially, all eligible crops were subject to the 50/92 provisions. Beginning with the 1988 crop, however, wheat and feed grain producers were allowed to reduce their planted acreage to zero (0/92). The program was originally designed to reduce the substantial stocks that had built up in the mid-1980s.

Experience: There has been considerable debate on the effectiveness of the 0/92 and 50/92 programs. As annual acreage reduction requirements declined in the late 1980s and early 1990s, producers utilized the 0/92 and 50/92 programs more than they had previously. This suggests to some that land in the 0/92 and 50/92 programs would not be farmed even without the programs. Others see these programs from a lender's perspective as a risk reduction tool forced on producers who cannot achieve credit levels to farm full production. To the extent that payment limits pose a problem, these programs may offer some relief. In any event, the 0/92 and 50/92 programs have idled approximately 6.4 percent of the effective base over the 1989-1991 period.

Consequences:

- Removes land from production and thus reduces supply and raises prices.
- Removes land from production that, without government support, would otherwise be unprofitable.
- Stabilizes farm income, especially with the guaranteed minimum deficiency payment.
- Reduces lender risk as operating credit needs decline relative to expected revenue.
- Allows producers to save resources through implementation of conserving use practices on idled land.

CONSERVATION AND ENVIRONMENTAL PROGRAMS

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Policy Tool: Conservation Reserve Program (CRP)

Policy Area: Conservation and Environment

What It Is: Long-term land retirement program specifically targeted to remove highly erodible cropland from production. The government pays farmers an annual rental rate and shares a portion of the cost of establishing a cover, including trees. (See Long-Term Land Retirement, Soil Bank in Domestic Farm Programs section.)

Objective: To reduce erosion, improve water quality, and reduce surplus production.

Experience: The 1985 farm bill authorized the retirement of 40-45 million acres of highly erodible cropland. Highly erodible lands are defined as having three times the level of erosion that is considered necessary to sustain production (3T) or a minimum of about 15 tons per acre annually. By 1992, 35.4 million acres had been enrolled in the program at an average annual rental rate of about $49 per acre. The 1990 farm bill extended the CRP program to place greater emphasis on retiring land having direct impacts on water quality. The CRP is included in the Environmental Conservation Acreage Reserve Program (ECARP), which is under the Agricultural Resources Conservation Program (ARCP) in the 1990 farm bill. The 1990 farm bill provided protection to CRP payments from sequestration by the Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman-Hollings). The CRP is jointly supported by environmentalists and farmers.

Consequences:

- Reduces soil erosion.
- Improves water quality.
- Increases wildlife habitat.
- Reduces crop production.
- Increases commodity prices.
- Lowers commodity stocks.
- Increases commodity price variability.
- Increases tree acreage.
- Reduces economic activity in rural communities.

Policy Tool: **Agriculture Conservation Program (ACP), Conservation Technical Assistance (CTA), Great Plains Conservation Program (GPCP)**

Policy Area: **Conservation and Environment**

What It Is: ACP payments up to 3500/year are made to farmers to offset a portion of the costs associated with specific farming practices designed, for example, to conserve the soil or improve water quality. Related to the ACP program is the Conservation Technical Assistance program (CTA), which provides technical assistance to farmers in designing conservation and environmental practices such as terracing or contour farming. The Great Plains Conservation Program (GPCP) has similar objectives and provisions to ACP and CTA.

Objective: To reduce soil erosion and enhance water quality.

When Used: ACP and CTA have their origin in the Dust Bowl days of the early 1930s, specifically 1936. While originally enacted to support and expand conservation practices, the ACP program was subsequently broadened to encompass output enhancing practices such as the application of lime, construction of water tanks, and subsidization of pothole drainage programs. This expansion came under fire in the 1970s as unneeded subsidies and in the 1990s as being contrary to environmental interests such as maintaining wetlands and even reducing erosion. These factors, combined with budget cuts, resulted in a reorientation of the ACP program back to its original soil conservation objectives.

Consequences:

- Reduces soil erosion.
- Enhances farmland productivity and acreage in crops.
- Reduces waterfowl and wildlife habitats under the old program.
- Enhances farm income.
- Perserves water supplies.

Policy Tool: **Best Management Practices (BMP)**

Policy Area: **Conservation and Environment**

What It Is: Farming method, measure or practice that a producer could be required to implement as a matter of regulation or as a condition for receiving farm program benefits. (See Conservation Compliance.)

Objective: To improve the environment by improving water and air quality and reducing soil erosion, pesticide use, and animal waste runoff.

When Used: First authorized by implication in the 1985 farm bill when farmers were required to implement conservation compliance plans with a goal of reducing the level of erosion to T (the level at which the productivity of the soil is indefinitely maintained). More recently, best management practices are proposed to be required under the Clean Water Act and the Coastal Zone Management Act (see Conservation Compliance).

Experience: While BMPs may serve to achieve their desired objectives, farmers and ranchers feel that they represent an infringement on their right to farm. Considerable difficulty is encountered in specifying best management practices that apply to individual farming conditions.

Consequences:

- Reduces soil erosion.
- Improves water quality.
- Reduces farmer/rancher freedom of choice in production.
- Increases cost of production.
- Increases food prices.
- Reduces conflict with environmental interests once they are accepted and practiced.
- Reduces incentive to participate in farm programs if required as a condition for eligibility.

Policy Tool: **Conservation Compliance and Sodbuster (See Best Management Practices)**

Policy Area: **Conservation and Environment**

What It Is: Conservation compliance requires that farmers had to develop and file with ASCS/USDA a conservation plan for farming on all highly erodible land by January 1, 1990, and must fully implement that plan by January 1, 1995. Farmers who did not file and do not implement satisfactory conservation plans will be ineligible for farm program benefits, including deficiency payments, price support loan provisions, and disaster payments. In addition, they may not be eligible for new loans from Farmers Home Administration or for participation in federal crop insurance, and they may lose their CRP payments. Sodbuster discourages bringing highly erosive land into production. If this land is brought into production, it must be covered by an approved conservation plan or be subject to penalty.

Objective: To farm highly erodible cropland and reduce the level of soil erosion to T through appropriate conservation measures approved by the Soil Conservation Service. T is a soil loss tolerance value indicating the maximum level of soil erosion that will permit a crop productivity to be sustained indefinitely. The T requirement can be relaxed whenever local SCS/ASCS officials judge that it would cause severe economic hardship or be pragmatically impossible to achieve.

When Used: Enacted as a provision of the 1985 farm bill with the support of environmentalists and as a condition for enactment of the bill.

Experience: Conservation plans were developed in considerable haste after the enactment of the 1985 farm bill and delayed announcement of complex regulatory procedures. Conflict arose in some areas over the farming practices under which T could reasonably be achieved, with some resulting relaxation of conservation plan provisions. Since the conservation plans were often developed with considerable haste, questions exist over whether their provisions can be met realistically. SCS/ASCS will face a major decision on the conditions under which conservation plans can be modified and/or enforced by January 1, 1995. The 1990 farm bill provides for graduated losses in farm program benefits up to $5,000 for producers who violated the conservation compliance and sodbuster provisions but acted in good faith and had no prior violations.

Consequences:

- Reduces soil erosion.
- Reduces water runoff.
- Improves water quality.
- Increases costs of production.
- Lowers producer returns.
- Encourages producers to consider long-term land retirement in the CRP.
- *Reduces participation in farm programs. If price and income supports are eliminated,* conservation compliance provisions could be implemented only with the assistance of ACP payments or overt regulation.
- Eliminates economic incentives for new highly erosive land being brought into production.

Policy Tool: **Agricultural Water Quality Protection Program (AWQPP)**

Policy Area: **Conservation and Environment**

What It Is: Three- to five-year voluntary incentive agreement with landowners to implement plans to protect water quality. Lands eligible for the program are those associated with public water sources, shallow groundwater, and cropland with the potential for nonpoint source pollution affecting endangered species habitats and other sensitive areas. Participants are paid up to $3,500 per person, per year to implement water quality protection plans. Participants may continue to farm the enrolled land, but they must report nutrient and pesticide use to the SCS. The 1990 farm bill, which created the AWQPP under the Agricultural Resources Conservation Program (ARCP), calls for enrolling one million acres in the AWQPP by 1995.

Objective: To enhance water quality in agricultural areas.

When Used: First authorized in the 1990 farm bill.

Experience: Program was not funded in 1991. It was pilot tested in selected counties in the U.S. during 1992.

Consequences:

- Preserves/improves water quality.
- Provides incentives to farmers for nutrient record keeping.
- Does not reduce crop production.

Policy Tool: **Environmental Easement Program (EEP)**

Policy Area: **Conservation and Environment**

What It Is: Long-term program to retire cropland presently enrolled in the CRP or WRP, cropland containing riparian corridors important for wildlife habitat, or cropland that is environmentally sensitive. Participants agree to create and record deed restrictions on enrolled land that will permanently restrict land use to conform to a natural resource conservation management plan on the easement. Payments equal to the loss in value of land due to the presence of the easement, up to $250,000 per person, may be made. These payments can be made over time but may not exceed $50,000 per person per year. Cropland base is permanently retired.

Objective: To permanently remove environmentally sensitive cropland from production.

When Used: First authorized in the 1990 farm bill.

Experience: Too early to tell.

Consequences:

- Preserves wetlands.
- Preserves grasslands created by the CRP.
- Protects water quality in agricultural areas.
- Protects habitats for endangered species.
- Reduces crop production.
- Increases price and price variability for commodities if widely adopted.
- Reduces value of land enrolled in the program.
- Reduces producer flexibility for land enrolled.

Policy Tool: No Net Loss

Policy Area: Conservation and Environment

What It Is: No net loss specifies that if an individual decides to convert wetlands to farming or development, the same acreage must be replaced as wetlands elsewhere. (See Swampbuster.)

Objective: To discourage the reduction of wetland areas and acreages.

When Used: First established as a national goal by President Bush in 1990 budget message to the Congress. Implemented in the swampbuster provisions of the 1990 farm bill.

Experience: Reduced wetland conversion. Questions have arisen from environmental interests whether the quality of restored wetlands is the same as originally existed.

Consequences:

- Discourages wetlands from being brought into production.
- Conserves land and water resources.
- Retards increases in production.
- Restricts increases in the supply of cropland, thus supporting prices of land in production.
- Reduces current values of affected land that could be brought into crop production.
- Improves water quality and habitat for fish, shellfish, and wildlife.
- Allows farmers some opportunity to adjust operation by draining one area and restoring another.

Policy Tool: **Swampbuster**

Policy Area: **Conservation and Environment**

What It Is: Swampbuster denies farm program benefits for wetlands brought into production. Converting a wetland to make production possible invokes loss of farm program benefits that cannot be restored until the converted wetland is restored. Conversion of a wetland can occur by draining, tilling, or simply planting an agricultural crop in a designated wetland. A minimal effect clause exempts conversions when minimal effects are determined on the hydrological or biological properties of the wetland. This clause also allows wetland restoration to mitigate a wetland loss -- applying the no net loss concept. Graduated penalties in the form of lost program benefits of up to $10,000 exist for violations, with a good faith restoration allowed on the first violation. (See No Net Loss.)

Objective: To discourage the conversion of wetlands and implement a no net loss policy.

When Used: Enacted originally as a provision of the 1985 farm bill with the support of both environmentalists and farm organizations. The 1985 farm bill contained a so-called "drop dead" provision which meant a loss of all farm program benefits on the whole farm for a small wetland conversion. The 1990 farm bill instead implemented the graduated penalty structure with the good faith restoration clause.

Experience: Appears to have brought a halt to clearing and draining of fragile lands by producers who currently participate in the farm program.

Consequences:

- Discourages wetlands from being brought into production.
- Conserves land and water resources.
- Retards increases in production.
- Restricts increases in the supply of cropland, thus supporting prices of land in production.
- Reduces current values of affected land that could be brought into crop production through drainage.
- Improves water quality and habitat for fish, shellfish, and wildlife.
- Allows farmers some opportunity to adjust operation by draining one area and restoring another.

Policy Tool: **Wetland Reserve Program (WRP)**

Policy Area: **Conservation and Environment**

What It Is: Permanent or 30-year easement for lands restored by farmers and ranchers to wetland status or to prevent the conversion of existing wetlands. Like CRP, participants are paid an annual rental rate per acre over a period of 5 to 20 years. The goal of the program is to enroll one million acres by 1995. The WRP is a title under the Environmental Conservation Acreage Reserve Program (ECARP), which is part of the Agricultural Resources Conservation Program (ARCP) in the 1990 farm bill. Land enrolled in the WRP must forfeit its existing cropland base and allotment history.

Objective: To expand and preserve wetland acreage.

When Used: First authorized in the 1990 farm bill.

Experience: Too early to tell.

Consequences:

- Preserves wetlands.
- Improves water quality.
- Retains farmer's freedom to enter the program.
- Increases habitat for fish, wildlife, and waterfowl.
- Reduces production to the extent that existing cropland is enrolled in the program.

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INTERNATIONAL TRADE PROGRAMS

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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 previous law, 75 percent of government-sponsored exports had to be shipped on U.S. flag vessels. The 1990 farm bill requires that 50 percent of P.L.-480 commodities be shipped on a lowest-landed cost basis, regardless of country of registry of the vessels. Other provisions allow shipments on specifically designated American Great Lakes Vessels to be counted toward cargo preference requirements. Further, Great Lakes ports may be allocated a maximum of P.L.-480 shipments made in 1984. If shipments to Great Lakes ports must be shifted to non-Great Lakes ports to comply with cargo preference, the CCC must compensate the Great Lakes ports for the loss of business.

Objective: To assure a minimum volume of business to 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. 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 programs will likely increase volumes delivered due to the lowest-landed cost provisions of the 1990 farm bill.
- U.S. agricultural exports have been less competitive in some markets due to curtailment of certain credit programs as a result of increased transport costs.
- U.S. maritime industry and selected U.S. ports receive subsidies and compensation, thereby increasing the costs of administering food aid programs.

Policy Tool: **Import License**

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

What It Is: A government-issued right to import a specified quantity of a product or commodity.

Objective: Since import quotas limit the amount of a good imported, licenses may be used to allocate the limited supply of imports among domestic importers, as well as to limit the total quantity that can be imported.

When Used: Even though tariffs have been lowered through GATT, quantitative restrictions such as quotas have become more prevalent methods of limiting agricultural trade. Import licenses are used by some countries to allocate the rights to import certain goods and to limit the quantity imported.

Experience: The United States has issued import licenses for a stipulated quantity of imports to domestic importers of dairy products, sugar, and beef based on their historical share of the market. Mexico, for example, has implemented licensing systems for corn, barley, milk powder, and cheese. Import licenses were utilized for approximately 25 percent of all U.S. agricultural exports to Mexico in 1991. If a North American Free Trade Agreement is implemented, import licenses would be converted to tariff-rate quotas (see Tariff-Rate Quotas).

Consequences:

- Can limit the quantity available within the import market, raising consumer and producer prices.
- Creates additional market instability because of the often arbitrary nature of issuing licenses.
- Discriminates at times against new importers since no historical basis for importing exists, making access to markets difficult or virtually impossible.
- Eliminates imported supplies if the importing government fails to allocate licenses.
- Invites possible retaliation by foreign trading partners wishing to export larger volumes to the protected import market.

Policy Tool: **Import Quotas**

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

What It Is: Import quotas limit the quantity of a specific commodity that has been 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, which imposes quotas or fees on imports that interfere with operation of a price support program, are recommended by the International Trade Commission and imposed by the President. (See Section 22.)

Objective: To protect U.S. producers and/or price support programs from foreign competition by establishing a maximum quantity of specific commodities that can be imported.

When Used: Beef import quotas have been mandated by the Congress. Cheese import quotas, which were 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. 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 rice import quotas are no different from the import quotas imposed by 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 might 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 offset exactly the size of the export subsidy of a competing country.

Objective: To restrict imports of certain commodities.

When Used: Because of the emphasis of GATT on reducing tariff trade barriers, the importance of tariffs has gradually decreased. Substantial tariffs still exist, however, 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 in which 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. While tariffs were often used in the past to generate revenue, this is no longer the case.

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. 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 efficient producers may still be able to obtain access to the market with a tariff.
- 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 level 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 EC 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, packaging, and labeling regulations, as well as foreign exchange restrictions.

Objective: To restrict imports of individual commodities.

When Used: The use of nontariff trade barriers has increased, in part, because of the GATT emphasis on reducing tariff trade barriers. Common U.S. nontariff restrictions relate to health and sanitation restrictions on animal and plant products 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 because 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.
- Nontariff trade barriers like health regulators restrict trade as a side effect of the major objective of protecting public health (e.g., ban on imports of beef from countries with hoof and mouth disease). However, such health regulations can be used to explicitly restrict trade (e.g., EC ban on beef with hormones.)

Policy Tool: **Section 22**

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

What It Is: Section 22 of the Agricultural Adjustment Act of 1933 authorizes the President of the United States to impose import quotas or fees if it is determined that imports will interfere with federal price support programs or substantially reduce U.S. production of products processed from farm commodities (see Import Quotas).

Objective: To protect the integrity of domestic price support programs and domestic markets for farm commodities.

When Used: Section 22 requires the International Trade Commission, on direction by the President, to investigate the potential for imports to render ineffective or interfere with the operation of U.S. farm support programs. The President may impose import fees not to exceed 5 percent *ad valorem* or implement an import quota to reduce imports of a particular commodity to no less than 50 percent that of a representative time period. Special emergency authority allows the President to take immediate action to restrict imports of perishable commodities without waiting for a ruling by the International Trade Commission.

Experience: Action under Section 22 is initiated by the Foreign Agricultural Service-USDA. Since 1951, 51 investigations have been conducted by the International Trade Commission. Most of these were related to cotton and wheat, ice cream and cheese, and cotton-comber waste. The U.S. was granted a waiver of the GATT prohibition against import restrictions in 1955. Since first used in 1935, Section 22 has been imposed on 12 commodity groups: wheat and flour; rye, rye flour and meal; barley; oats; cotton; dairy products; almonds; filberts; peanuts and oil; tung nuts and oil; flaxseed and linseed oil; sugars and syrups. Section 22 is currently used to restrict imports of cotton, peanuts, dairy, and sugars and syrups. The first three commodities are restricted by import quota, while sugar imports are controlled by a combination of tariff and quota. In the current GATT round, the United States has offered to suspend and terminate Section 22 protection as part of its effort to eliminate trade distortions in agriculture.

Consequences:

- Import restrictions reduce available supplies on the market and raise domestic prices of protected commodities.
- Consumer prices for some food and fiber products are higher because of import controls imposed under Section 22. Recent estimates indicate that U.S. consumers pay $1 to $2 billion annually in higher sugar costs due to import quotas.
- Without Section 22 protection, CCC commodity acquisition costs would be much greater in some years.
- Import quotas invite GATT complaints and trade retaliation by other countries.
- World prices for protected commodities are lower than they would be without Section 22.
- Resource allocation and use are distorted due to import controls.
- Price instability is increased due to the imposition of import quotas and tariff restrictions.
- Large profits accrue to holders of import quotas.

Policy Tool: **Tariff-Rate Quota (TRQ)**

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

What It Is: Tariff-rate quotas apply a higher tariff rate to imported goods after a certain quantitative limit has been achieved during a specified period. A negotiated rate is applied to imports up to a quota limit. Subsequently, a much higher duty is applied. The TRQ is the "tariffication" method used in GATT and NAFTA to convert nontariff barriers, such as quotas or licenses, to tariffs.

Objective: To protect domestic producers and U.S. farm program integrity from import competition during transition periods from a protected market to more open market conditions. TRQs do not limit the quantity of goods that may be imported.

When Used: When converting a restrictive quota to a tariff for purposes of transition to freer trade.

Experience: The U.S. sugar quota system was replaced by a TRQ in 1990. The previous quota was found in violation of GATT rules after a complaint by Australia. The TRQ imposes a zero or nominal duty on raw sugar imports up to a given amount and a higher duty on imports above the quota, 1.4 million metric tons in Fiscal Year 1992. TRQs are the primary means of converting U.S. quotas imposed under Section 22 to tariffs as a transition mechanism in GATT and NAFTA negotiations.

Consequences:

- Raises domestic prices over free trade but does not restrict available supplies.
- Reduces export demand and lowers world prices if the importing country is large.
- Allows market forces to more efficiently allocate resources since TRQs are less restrictive than a quota.
- Requires lower CCC costs of acquisition and storage than under free market since imports are somewhat lower.
- Provides more market stability than arbitrarily imposed import quotas or licenses.

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 limit importation of specific commodities.

When Used: The variable levy is the principal mechanism used by the EC to restrict agricultural imports. Under CAP, the EC farmers are guaranteed grain prices greater than the world price. An import levy equal to the difference between the EC producer price and the price of grain landed in Rotterdam must be paid on imported grain. The variable levy on grains changes daily.

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 EC agricultural policy have failed because the variable levy is the very basis of CAP. Getting rid of the variable levy would mean that the EC 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.
- When the world price is below the predetermined minimum price, the variable levy constitutes a source of revenue to the importing country.
- The variable levy ensures a stable internal price while increasing instability in world markets.
- The variable levy, along with high internal support prices, transformed the EC from a net grain importer into a net grain exporter.

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. The agreements are often negotiated under duress because of the potential enactment of formal import restrictions.

Objective: To control the importation of certain commodities and thereby protect 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.
- As a result of voluntary export restraints, price fluctuations are greater in world markets than they would be 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 the exporting country.
- Some countries may be left out of the market because they refuse to limit their imports.

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 of 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 U.S. barter negotiation in 15 years. The 1985 farm bill required the Secretary of Agriculture to establish and carry out at least two pilot barter programs by 1987. Agricultural commodities were bartered for designated strategic materials. The 1990 farm bill specifies certain CCC commodities eligible for barter transactions.

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 needs.
- Barter may displace commercial sales.
- Barter value generally approximates relative world market value of the commodities being traded.

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, which were first established in 1949, have been used most extensively on wheat, cocoa, coffee, tea, and sugar. Currently, they are used extensively among developing countries. OPEC might also be looked upon as an international commodity agreement. The International Coffee Agreement expired in 1991 and has not been renewed.

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. Recent years have witnessed the demise of agreements in tin and coffee, due mainly to oversupply and low prices. To be effective, commodity agreements require close coordination of domestic farm programs to coordinate closely 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: **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 three to five years, although they may be simple one-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 five-year contract negotiated with the Soviets in 1975. It contained provisions that the Soviets would purchase a minimum of 6 million metric tons of grain, with the option for an additional 2 million 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 1991, the U.S. and the Soviet Union entered a new five-year agreement specifying that a minimum of 8 million metric tons and a maximum of 14 million metric tons would be purchased each year for five years. The U.S. also has had agreements with China, Egypt, and Taiwan.

Experience: Trade agreements are a means of opening a new market and maintaining a competitive position. The quantities specified in the agreement have generally been less than the normal trading levels. With recent developments in the former Soviet Union, it is doubtful that agreed-to minimums will be met in some years. Enforcement of minimum purchases also has been a problem under previous agreements due to increased production, high world supplies, and retaliation for non-agricultural trade related disputes.

Consequences:

- The total annual volume of trade tends to be increased and stabilized between the parties to the agreement.
- Importing countries outside the agreement may be denied a source of the commodity if supplies become short.
- Exporting countries outside 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 because they effectively reduce the world supply that can be traded competitively.
- Trade agreements are difficult, if not impossible, to enforce and may lead to false market expectations.

Policy Tool: **Contract Sanctity**

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 was 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 and 1990 farm bills.

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 because exporters do not have to discount for the uncertainty posed by a potential embargo.

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 commodity prices in the exporting country prevent domestic shortages of commodities, and achieve a foreign policy objective.

When Used: Export embargoes have been imposed three times since 1970:

(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 1990 farm bill continue protection for agricultural producers against the imposition of export embargoes by assuring the sanctity of export contracts negotiated prior to any embargo.

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 may 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 competing 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: Blended Credit

Policy Area: International Trade Programs, Export Subsidies

What It Is: Blended credit is a non-price form of export subsidy that 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 were 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 but has not been used since 1985 because of budget considerations and complaints in GATT.

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 markets in developing countries 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 that provides financing for U.S. agricultural exports with terms up to 36 months.

Objective: To provide financing to countries and/or foreign buyers who would otherwise be unable to secure the necessary credit to purchase U.S. agricultural commodities.

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, 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 billion 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 or 1990 farm bills. As a result, those sales that would have been made as a result of GSM-5 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.
- Direct credit programs are needed to compete with similar programs offered by other exporting countries.
- Direct credit programs provide a basis for expanding markets in developing countries.
- 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 that provide financing for foreign buyers to purchase U.S. agricultural products. The CCC insures up to 98 percent of the free on board (f.o.b.) value of an export sale in the event that a foreign bank or government fails, for any reason, to make payment 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 1990 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 offers credit terms of 3 to 10 years and includes financing for infrastructure development.

Experience: Both GSM-102 and GSM-103 credit guarantee programs are currently in operation. They have been successful in maintaining U.S. sales to countries with severe debt problems. This success has occurred only through continued increase in federal appropriations, from $671 million in 1980 to authorization for up to $5 billion annually through 1995. Defaults under either program have been minimal, with Iraq being the most recent example. Over $2 billion in export credit guaranteed loans have been made to former USSR republics.

Consequences:

- U.S. agricultural exports declined less than they would have in the absence of such programs.
- Export credit guarantees promote long-term development of markets.
- 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 that 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.
- Extensive use of export credit invites retaliation by other major exporters.

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 contained provisions for export PIK to support both targeted export assistance programs and export market enhancement programs. In general, the use of export PIK has been limited to surplus commodities held in CCC inventories.

Experience: Export PIK was used to 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. The 1990 farm bill created the Export Enhancement Program (EEP) that replaced BICEP. EEP continues to use export bonuses, in cash or in-kind, to regain and maintain U.S. markets lost to unfair export competition, primarily from the European Community (see Export Enhancement Program).

Consequences:

- Improved the United States competitive position in the world market, despite reduced demand and loan rates that were above world market clearing levels.
- In-kind export PIK was less overt than direct monetary export subsidies and thus not as likely to invite either retaliation or GATT sanction.
- Government stocks of commodities can be lowered.
- An export alternative is provided by export PIK as long as the CCC owns sufficient stocks.
- Export PIK may be a violation of at least the spirit of GATT.
- Widespread use of export PIK has invited public scrutiny of many export promotion programs and may threaten to undermine U.S. efforts for trade reform in 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: **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. EC subsidies do not violate GATT because 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 loan program authorized for cotton and rice in the 1990 farm bill is similar to an export subsidy (see Marketing Loan in Domestic Policy section). 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.
- Stocks are reduced as a result of increased exports and price variability increases.
- 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: **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 from 10-30 years repayment.
- Title II involves emergency food relief directed to nutritionally vulnerable nations.
- 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 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 regarding 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:

- Provides a government alternative to exports when the United States is not price competitive in the world market.
- Combines commodity aid with development assistance and thus becomes more politically acceptable.
- Reduces government stocks of commodities.
- Promotes long-term development of markets.
- Provides the State Department with a diplomatic tool that can be used in foreign policy negotiations.
- Provides assistance in alleviating hunger and starvation.
- Risks displacing commercial sales with P.L.-480 sales.
- Risks becoming a disincentive for production in developing countries by providing too much commodity aid and making the countries overly dependent on imports.

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 supporting a higher price for domestic sales than for foreign sales. Exports are, therefore, indirectly subsidized because domestic marketing is reduced with the residual sold for exports.

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: **Export Enhancement Program (EEP)**

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

What It Is: EEP is an export incentive program created by the 1985 farm bill and extended by the 1990 farm bill to permit USDA to use surplus commodities or cash as export bonuses to make U.S. products more competitive on the world market or to offset the effects of unfair trade practices and subsidies used by other countries. In the 1990 farm bill, EEP was authorized at $500 million each year through 1995.

Objective: To make U.S. farm products price competitive on the world market, reduce commodity surpluses and counter unfair trading practices.

When Used: EEP was first used in 1985 to regain North African wheat markets lost to unfair EC competition. Since then, EEP has been used to ship 139 million tons of agricultural products valued at $13.9 billion. Although wheat sales have represented over 70 percent of total EEP shipments in most years, EEP has been used to sell poultry, flour, barley, sorghum, rice, cattle, animal feeds, vegetable oil, and eggs.

Experience: The authority to implement EEP sales is granted to the Secretary of Agriculture. EEP was established to counter the high export subsidies used by the EC to capture wheat markets in Algeria and Egypt. Use of EEP has expanded to include countries in Eastern Europe, China, Norway, Venezuela, Israel, Poland, Philippines, Finland, and Dominican Republic. EEP as a share of all wheat exports has increased since 1989, reaching over 60 percent in 1992. Although EEP bonuses ($/bushel) have declined as U.S. prices have increased, U.S. action to force the EC to negotiate away such practices has resulted in higher bonuses in recent years.

Consequences:

- Restores competitiveness of United States in world markets despite unfair or subsidized competition.
- Invites complaints from trading partners and allies such as Australia and Canada.
- Reduces government stocks of commodities and increases price variability.
- Violates the spirit of the GATT.
- Invites public image problem and undermines U.S. efforts in GATT.
- Offsets commercial sales of U.S. products.
- Places upward price pressure on domestic consumers.

Policy Tool: **Free Trade Agreement (FTA)**

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

What It Is: An agreement among an association of member nations to overcome impediments to trade by reducing or eliminating both tariff and nontariff barriers to trade in goods and services. Free trade agreements do not provide for a common external tariff for other nonmember countries or the free movement of labor and capital among members (see Preferential Trading Arrangements).

Objective: To facilitate the free movement of goods and services among member nations of the agreement. A free trade agreement is the least complete form of economic integration, followed by a customs union, common market, and economic union.

When Used: Unsuccessful attempts to reduce or eliminate nontariff trade barriers in GATT have led to pursuit of mutual interests among nations by forming FTAs or more complete forms of economic or political integration, such as the EC. GATT rules apply to the negotiation of FTAs, and FTAs must operate within the provisions of GATT and other international treaties.

Experience: The United States has negotiated free trade agreements with Israel and Canada. The Canada-United States Free Trade Agreement became effective January 1, 1989, while the trade agreement with Israel was signed in 1985. The most recent undertaking is the negotiation of an FTA among the United States, Canada, and Mexico. Under the North American Free Trade Agreement (NAFTA), three separate agreements will exist. For most goods and services, a trilateral agreement will be used. For agriculture, however, two bilateral agreements -- one between the United States and Mexico and another between Canada and Mexico -- will be required. NAFTA must first be approved by the U.S. Congress and similar legislative bodies in Mexico and Canada. It appears likely Chile will accede to NAFTA and other Latin American countries will consider joining.

Consequences:

- Contributes to economic efficiency gained from specialization in production of goods for which a comparative advantage exists.
- Encourages free flow of goods and services among member countries.
- Results in gains in employment and income for member participants.
- May reduce trade with nonmember countries.
- Allows for greater commonality of purpose in trade policies, thereby providing political and economic leverage in trade negotiations with nonmember nations.
- Undermines the purpose and effectiveness of multilateral trade forums such as GATT.
- Secures gains to trade already achieved under recent economic reform in Mexico.
- May increase use of sanitary and phytosanitary standards to restrict trade in agriculture.

Policy Tool: **GATT Trigger**

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

What It Is: GATT triggers are trade policy mechanisms authorized by the Omnibus Budget Reconciliation Act of 1990 which requires commodity and export program adjustments to be used or considered by the Secretary of Agriculture if trade reform is not achieved in the Uruguay Round of GATT. Implementation of marketing loans for wheat and feed grains, export promotion, and waiver of acreage limitations are the major components. The triggers are linked to specific dates and actions taken to maintain the international competitiveness of U.S. program crops. GATT triggers were necessary because of concerns about the reluctance of the EC to agree to meaningful agricultural policy reform and insistence on schemes to place import duties on U.S. oilseed and corn gluten.

Objective: To strengthen the U.S. arm in trade negotiations.

When Used: If implementing legislation for a GATT agreement was not enacted on or before June 30, 1992, the first trigger required a $1 billion increase in export promotion programs and implementation of marketing loans for wheat and feed grains. It allowed the Secretary to consider waiving any minimum level of acreage limitation for the 1993-95 program crop years. If no GATT agreement becomes effective by June 30, 1993, the Secretary is required to consider: (a) waiving all or part of the reductions in program spending required by the Budget Reconciliation Act; (b) raising the level of funding available for export programs; and (c) instituting a marketing loan for wheat and feed grains. If this authority is used, action must be taken under (a) and either or both of (b) or (c). If Congressional "fast track" procedures are unavailable for consideration of a GATT agreement in agriculture, then (a) and (b) no longer apply.

Experience: In announcing the 1993 wheat and feed grain programs, the Secretary chose to implement the provision to void the acreage reduction limitation defined by the 1990 Omnibus Budget Reconciliation. In addition, it appears a marketing loan in wheat and feed grains will be implemented for the 1993 crop year. On September 1, 1992, the President announced a $1 billion funding initiative under export enhancement for 28 countries and covering over 13 million tons of grain. Major recipients of the initiative, which will remain in effect through June 30, 1993, are China, the former Soviet Union, Egypt, Algeria, Philippines, India, and Morocco.

Consequences:

- Creates additional budget costs of $1 billion for the additional export program funding required by the first trigger.
- Reduces U.S. supplies and higher domestic prices for producers and consumers of wheat products and grain-fed meats.
- Creates greater price instability for producers of wheat and feed grains.
- Lowers world grain prices because of greater availability on the international market.
- Invites possible retaliation by the EC, Australia, and Canada, all major wheat or feed grain exporters.
- Encourages the EC to consider agreeing to a reduction in domestic support to agriculture through reform of the Common Agricultural Policy.

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

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

What It Is: GATT is a multilateral United Nations treaty among 102 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 increase international trade among nations through negotiated reductions in tariffs and other 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. The Uruguay round of negotiations began in September 1986 with agriculture as the central focus of trade negotiations. The U.S. position in the Uruguay Round has been to call for the multilateral elimination of trade-distorting agricultural policies.

Experience: While experiencing success in the first seven rounds, difficult problems with reducing support to agriculture have emerged in the Uruguay Round. The reduction of agricultural trade barriers has proven difficult because the EC has been unwilling to agree to proposals offered by the U.S. and other nations for the phased reduction of border barriers to trade and domestic policy that distorts trade. Classic examples include the EC Common Agricultural Policy (CAP) and the aggressive export policies in both the 1985 and 1990 farm bills.

Consequences:

- GATT has increased world trade and expanded export opportunities.
- GATT provides a forum for settling disputes, although it is a lengthy process.
- GATT restricts the latitude of participating countries in subsidizing exports and engaging in other trade restricting practices.
- GATT contains no authority for enforcement of principles against the major country members, often leading to retaliatory tariffs.
- 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, a developing country that 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: **Market Promotion Program (MPP)**

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

What It Is: MPP provides assistance in cash or commodities to trade promotion organizations to partially fund foreign market development activities, especially in those countries where the U.S. encounters unfair trade practices by importers or exporters. MPP replaced TEA (Targeted Export Assistance) but is not limited to funding of activities only in markets where the United States faces unfair trade practices. Authorized by the 1990 farm bill, MPP was funded at $200 million in FY 91 and FY 92. Funding for FY 93-95 has been reduced to $148 million annually.

Objective: MPP was created to encourage the development, maintenance, and expansion of commercial export markets for U.S. agricultural products through cost-share assistance, with priority given to those markets facing unfair trade practices.

When Used: Priority funding assistance is provided to organizations whose commodity or product has experienced unfair trade practices, such as export subsidies or the use of health regulations to restrict trade. MPP is administered by the Foreign Agricultural Service, USDA. Under MPP, surplus stocks of funds are used to partially reimburse agricultural organizations conducting specific foreign market development activities in specified countries. Commodity and country coverage is much broader than under TEA. Funds are allocated to organizations on a matching basis.

Experience: MPP has been used in every country of the world to promote a wide variety of commodities and products, including apples, pears, canned peaches, poultry, wood products, almonds, red meat, ginseng, dates, processed tomato products, mink pelts, confectionery and other processed food products. Activities partially financed by MPP range from market research, consumer promotion, and trade promotion to construction of a model feed mill and a three-story wood demonstration building. In the early 1990s, these programs created substantial political heat because they were interpreted as being subsidies to agribusiness firms that were perceived as not really needing such subsidies.

Consequences:

- Maintains U.S. market share in the face of unfair foreign competition.
- Expands demand for agricultural products in markets where they otherwise would not be sold, resulting in higher domestic prices and greater returns to producers.
- Achieves trade policy goals of the U.S. and retaliates for unfair trade practices.

Policy Tool: **Most Favored Nation (MFN)**

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

What It Is: Preferential trade terms granted to a nation to have customs duties levied on its products at the lowest rate offered to any other nation and making the nation eligible for export credit. MFN is a foundation of the GATT.

Objective: To assure fair and equitable treatment for all GATT members.

When Used: MFN status has been used by the U.S. in recent years as an incentive to force political and economic reform in the former Soviet Union and China.

Experience: Access to the vast U.S. market has been used to entice other countries to comply with certain human rights beliefs, political goals, and economic principles acceptable to the government of the United States. The Jackson-Vanik amendment to the 1974 Trade Act requires that MFN status be granted only on the basis of compliance with basic human rights considerations.

Consequences:

- Assists in achieving foreign policy goals of the U.S.
- Fosters economic and political restructuring in other countries.
- Results in increased U.S. exports as other countries are able to export more to the United States because of lower duties and increased foreign exchange.

Policy Tool: **Preferential Trading Arrangements (PTA)**

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

What It Is: Formal arrangements between two or more nations to eliminate restrictions on international trade, payments, and factor mobility for the purposes of more complete economic integration. The major types of preferential trading arrangements include free trade area, customs union, common market, and economic union.

Objective: To stimulate economic growth by allowing the free movement of goods, services, labor, and capital and by providing for the coordination of member-nation monetary and fiscal policies.

When Used: PTAs often represent an acceptable alternative to the slow and ineffective efforts to achieve increased market access and trade liberalization in GATT. Although PTAs open markets within the member-nation group, they are often structured to discriminate against nonmembers, while in full compliance with GATT rules.

Experience: **Economic union** represents the most complete form of economic integration whereby nations agree to the unification of all national social, agricultural, taxation, fiscal, and monetary policies, along with the acceptance of a common currency. Belgium and Luxembourg completed an economic union in the 1920s under which social, taxation, and fiscal policies were coordinated by supranational authority. A **common market** is a group of trading nations that allow free movement of goods and services, common external trade restrictions against nonmembers, and the free movement of factors of production. The EC represents one of the most important attempts to form a common market, a process which began in 1957 and is to be completed by December 31, 1992, under the Single European Act. The Netherlands, Belgium, and Luxembourg formed a **customs union** in 1948 to remove all tariff and nontariff barriers to trade among members, but impose identical trade restrictions against nonmembers. The United States, Mexico, and Canada are negotiating to implement the least complete form of economic integration, a **free trade area** (see Free Trade Agreement).

Consequences:

- Provides for free trade among members, but may limit trade with nonmembers.
- Transfers a certain degree of economic sovereignty to a supranational authority.
- Allows specialization in production resulting in gains in trade from economies of scale, greater competition, and more investment.
- Results in the formation of a trading block that may be more effective in competing in international markets outside the block.

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MARKETING

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Policy Tool: **Checkoff Programs**

Policy Area: **Marketing, Demand Expansion**

What It Is: Checkoff programs deduct a given amount per unit of product marketed by the producer to finance education, market development, advertising, and/or research programs (see Domestic Market Development and Foreign Market Development). Such programs exist under either special individual commodity legislation or general authorizing legislation, such as marketing orders. Such legislation may allow for refunds. Milk is the only commodity authorized for a processor checkoff.

Objective: To finance foreign and domestic market development programs, advertising (mostly generic), education, and research on basic commodities.

When Used: Checkoff programs are used when the necessary legislation exists and the required majority of the producers approve the checkoff in a referendum. In the fluid milk processor program, a majority of the processors voting for implementation must represent 60 percent of the volume. In special commodity legislation at the federal level, refund provisions have generally been required. Numerous states have enacted local checkoff programs to fund education, 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 with refund provisions have sometimes encountered problems with relatively high redemption experience. As a result, the tendency has been to go to mandatory programs without a refund option. A high share of the funds generally have been spent on advertising and foreign market development.

Consequences:

- Well-managed programs increase the demand for particular products, yet overall demand for food probably does not change. Thus one commodity expands 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.
- Checkoff programs provide a continuous flow of funds to related commodity organizations and thus increase the effectiveness and/or political power of these organizations.
- 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.

Policy Tool: Domestic Market Development

Policy Area: Marketing, Demand Expansion

What It Is: Domestic market development programs assist producers in raising funds required to carry out generic promotion and advertising programs (see Checkoff Programs). Such programs are authorized on an individual commodity basis under either Congressional or state legislative authority. At the national level, they generally are administered by a Board of Directors appointed by the Secretary of Agriculture, with USDA having oversight responsibilities. The 1990 farm bill authorized a fluid milk promotion program for processors.

Objective: To expand the domestic demand for farm products.

When Used: Domestic market development programs get started only on the initiative of producers and/or processors who sponsor portions of the program. 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 exist in many other commodities. 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 and promote 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 that has the effect of subsidizing the advertising of innovative new uses of a branded product. The only authorized processor program is fluid milk. Research indicates brand promotion and joint advertising programs are more effective than generic advertising. Promotion and advertising programs must be geared to the availability of the product and the size of the market. In the early 1990s, the dairy checkoff program created intra-industry controversy when conflict developed between state programs and the federal dairy board. Low prices for milk fostered discontent over the merits of the program.

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 product availability and market size.
- Advertising programs often inspire feedback, giving producers a better reading on consumer attitudes.
- Advertising gives a commodity visibility and political strength.

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

Policy Area: **Marketing, Demand Expansion**

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 Checkoff Programs).

Objective: To expand export demand for agricultural 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 that have cooperator programs.

Experience: Cooperator programs that are well-conceived and well-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 U.S. prices are higher than world prices.

Consequences:

- Increases quantity of products exported.
- Increases producer understanding of international markets.
- Increases cost effectiveness as a result of large numbers of producers sharing the cost of operating the market development programs (see Checkoff Programs).
- Increases the potential for exporting more value added products rather than raw commodities.

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

Policy Area: **Marketing, 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 improving terms of trade, 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 activities between cooperatives and noncooperative 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 28 percent overall but as high as 80 percent of the market in milk. Cooperatives are most effective when 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 Antitrust Act and the Federal Trade Commission Act.
- Cooperatives have the potential for raising producer returns if the cooperative is well-organized, well-managed, and has a commitment from producers to market through the cooperative.
- A cooperative's 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 Boards**

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

What It Is: A marketing board is a central government authority that 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 the farm, with subsequent payments being made as marketing is completed. All producers receive the same price (price pool) 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. Some show higher returns than others. Boards do, however, provide increased price and income stability to the producer, who is shielded from the effects of within-year price fluctuation. While boards are frequently credited with providing strict control over production, their records are considerably less impressive. Conflicts arose in negotiations over the Canadian Free Trade Agreement with Canadian marketing boards that maintained producer prices above those in the United States.

Consequences:

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

Policy Tool: **Marketing Orders**

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

What It Is: Marketing orders are joint industry-government programs that may be authorized to manage the following industry-wide marketing activities: advertising, size or container, quality, and quantity or price (in some cases). 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 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 shifts from processors to producer cooperatives.
- Strict marketing controls increase price stability throughout the marketing season.
- Commodities available for sale have a more uniform quality.
- Commodities are more readily available throughout the year.
- Producer prices increase.
- A tendency for over-production is often seen under order provisions creating incentives to control production and/or marketings.

Policy Tool: **Crop and Livestock Production Report**

Policy Area: **Marketing, 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 to provide estimates within 1 or 2 percent of actual production or prices. 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, however, have reduced the quantity (and maybe the quality) of available information. USDA efforts to charge for access to crop and livestock production reports have come under considerable fire.

Consequences:

- Crop and livestock reports add information to the market and thus make markets more competitive.
- Without crop and livestock reports, this information would be available only to those firms that could 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 for conducting economic analyses.

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 have been considered, including specific contract terms and prenotification.

Consequences:

- The reporting system increases the overall quality and quantity of information concerning export transactions.
- Sales reporting provides the USDA prior warning of sales that could jeopardize available U.S. supplies.
- More information on large export sales reduces the probability of an embargo resulting from commodity shortages.
- Prices are more responsive to export sales when stock levels are low relative to use.

Policy Tool: **Grades and Standards**

Policy Area: **Marketing, 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 homogeneous quality groups 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. Private grades and USDA grades frequently 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. As a result, changing grades to become more consumer oriented has become a major goal of consumer advocates.

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 provide incentive for the quality marketed to be the lowest acceptable level for each grade.
- Grades reduce the opportunity for product differentiation and the incentive for product development.

Policy Tool: **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 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 can less 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 that reduce price information in the market.
- Government cost-cutting measures raise the question of what market news users should pay for price information.

FOOD ASSISTANCE, NUTRITION, AND SAFETY

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Policy Tool: School Lunch

Policy Area: Food Assistance, Nutrition and Safety

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 ensure 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 early 1990s, the program annually fed nearly 25 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 food 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. In 1992, the Secretary of Agriculture made a commitment to reduce the fat content of the meals to a level of 30 percent or less. This included a commitment to implement the Dietary Guidelines into the school lunch and breakfast program. Pressure always exists to provide a larger proportion of cash assistance.

Consequences:

- Increases the demand for food used in the school lunch program.
- Increases the nutritional levels of school-age children, particularly children from low-income households.
- Provides an important outlet for surplus dairy products, meats, fruits, and vegetables in spite of the fact that the distributed commodities are a less important proportion of the total food consumed.
- Fosters development of a large institutional food service sector to serve this large program.

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

Policy Area: **Food Assistance, Nutrition and Safety**

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.

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

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

Experience: Many of the recipients are single mothers with low incomes and pre-school children. Although WIC has been criticized for its constituency of predominantly unwed mothers, studies indicate that it is one of the nation's most effective programs in improving nutritional 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 the 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.
- Overall recipient nutritional level is demonstrably improved.
- Distributed commodities tend to be in surplus and/or have particular nutritional value.
- Distributed commodities partially displace commercial retail sales of these products and their substitutes.

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

Policy Area: **Food Assistance, Nutrition and Safety**

What Is It: 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, there has been a gradual but persistent movement in the direction of providing a larger proportion of cash assistance as opposed to commodity or food stamp assistance. Cash subsidies to schools and food stamps that have been substituted for direct commodity distribution have become increasingly important relative to commodities.

Experience: Cash has provided schools greater flexibility in the ultimate use of assistance. Also, some argue that cash donations result in a greater increase in satisfaction. The cost of running several 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 if program duplications were eliminated.
- Food consumption would fall if the current levels of food stamp and commodity distribution were provided in cash.
- Prices of surplus commodities would fluctuate more if government outlets for surplus commodities were reduced.
- Food assistance programs, if moved out of USDA, would not be part of the farm bill deliberations, thus reducing the potential for obtaining urban support for farm programs.

Policy Tool: **Commodity Distribution**

Policy Area: **Food Assistance, Nutrition, and Safety**

What It Is: Commodity distribution programs provide primarily staple food products direct from the government to needy households. These commodities are generally in surplus, although nonsurplus food has been provided in times of high unemployment. Commodities are distributed to school lunches, elderly feeding programs, and households that qualify according to specific eligibility standards (i.e., unemployment or participation in some welfare program).

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

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 resurfaced periodically to dispose of surplus government stocks or to deal with problems of unemployment and poverty. The special cheese and butter distribution programs that operated in the early to mid-1980s (Temporary Emergency Food Assistance Program, TEFAP) were an example of such surplus disposal efforts.

Experience: Commodity distribution programs are costly because of the necessary network of needs assessment, 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. When surpluses disappeared in the late 1980s, it was found to be politically difficult to discontinue the program.

Consequences:

- Product movement is expanded to the extent that the quantities given away exceed normal recipient consumption levels. Reduced expenditures on distributed products result in purchases of other foods and/or nonfood items.
- Nutrition levels of recipients are improved to the extent of the nutritional value of the additional quantities or items consumed.
- 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 oppose direct distribution programs.
- For surplus commodities (e.g., dairy products) that are acquired under price support programs, the government actually purchases more products to the extent that those people receiving the products buy less of them through grocery stores.
- Once started, these programs are politically difficult to discontinue.

Policy Tool: **Food Stamps**

Policy Area: **Food Assistance, Nutrition and Safety**

What It Is: The food stamp program provides eligible recipients with stamps that have 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 "thrift 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 mushroomed to a social program serving more than 23 million recipients and costing in the early 1990s about $15 billion annually. 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:

- Increased food consumption expenditures account for 26-50 percent of the value of food stamps. The remainder goes to purchase other goods and services from dollars that would have been spent on food if stamps had not been received. The program, therefore, releases income for spending on other goods and services. The largest increases occur in the demand for meat, milk, and poultry.
- Some farm-state congressmen argue that the food stamp program helps them get farm legislation through the Congress because major farm bills with food program components invariably attract urban interest.
- Nutritional levels of recipients improve, although not as much as under such programs as WIC.
- Food retailers, particularly those in low-income neighborhoods, realize direct benefits.

Policy Tool: **Delaney Clause, Zero Tolerance**

Policy Area: **Food Assistance, Nutrition and Safety**

What It Is: Delaney is a clause of the Food Additive Amendment to the Food, Drug and Cosmetic Act. The clause states that there shall be no cancer-causing substances added to the food supply. The standard is zero tolerance, meaning that food additives must be completely devoid of carcinogens.

Objective: To protect the general public from carcinogens entering the food supply. The Delaney clause specifically relates to the elimination of cancer-causing substances.

When Used: The Delaney clause was enacted in 1958. Zero tolerance has ostensively been applied as a standard for food additives ever since. However, zero can only be measured in terms of the sensitivity of the instrument used to detect specific chemicals or other harmful substances. As the scientific instruments have become increasingly sensitive, more potentially harmful substances (residues) have been discovered in the food supply. As a result, FDA has applied a de minimus tolerance. This means extremely small risks (levels) can be ignored. FDA established the de minimus tolerance at one in 1 million, meaning that an additive or residue cannot cause more than one additional cancer death per million people.

Experience: Delaney has worked as a standard only because FDA has followed the de minimus tolerance. Otherwise, FDA would have been continuously banning additional substances as the detection instruments became more sensitive. While realizing the inconsistence in interpretation with the law, Congress has been unable to muster enough votes to change the Delaney standard, which has substantial public appeal and support. Recent Federal Court decisions have held that zero tolerance means exactly that. FDA must either enforce it or Congress must change it.

Consequences:

- Many food additives become unusable.
- A lower level of tolerance means higher costs.
- Zero tolerance can reduce the number of products available on the market because there are no substitutes. Thus, there is less consumer/producer choice.
- A true zero tolerance cannot be objectively enforced because zero cannot be objectively measured.

Policy Tool: **Pesticides Regulation, Federal Insecticide, Fungicide and Rodenticide Act (FIFRA)**

Policy Area: **Food Assistance, Nutrition and Safety**

What It Is: FIFRA is legislation requiring registration of new pesticides before they can be sold. It requires the reregistration of existing chemicals by 1997.

Objective: To protect the public from hazardous chemical residue that might otherwise create health problems, primarily cancer.

When Used: Pesticide regulations were first adopted in 1910 regulating only the sale of adulterated or misbranded pesticides. FIFRA was enacted in 1947 to require the registration of pesticides. The requirements for registration include efficacy and safety. While the responsibility for proof rested initially on the government, it was shifted to the manufacturer in 1954. The standard for registration involves a balancing of risks and benefits. By 1997 all pesticides must be reregistered.

Experience: The registration process is lengthy, time consuming, and costly. Many chemicals, some for which there are no effective substitutes, have been banned. For some minor use chemicals, the manufacturers have decided that they cannot bear the cost of reregistration. The agriculture committees have maintained jurisdiction over FIFRA despite its move out of USDA in 1940 and to EPA in 1970.

Consequences:

- Regulations improve the safety of the food supply.
- Lengthy testing procedures and red tape for approval of new pesticides and reregistration of existing pesticides have two effects: increased cost to end users and reduced number of pesticides on the market.
- U.S. producers claim they are at a disadvantage relative to growers in other countries who use chemicals not available domestically.
- Fewer pesticides are available for agricultural producers as 1997 approaches.
- Regulations delay introduction of new pesticides.

Policy Tool: **Nutrition Labeling**

Policy Area: **Food Assistance, Nutrition and Safety**

What It Is: The National Labeling and Education Act of 1990 is designed to replace and update the nutritional labeling policy implemented in 1975. The former policy was mostly voluntary while the new act is mandatory, preempting all state regulations.

- Standard serving size in an amount normally consumed.
- Content of individual nutrients based on the standard serving size including calories, fat, saturated fat, cholesterol, carbohydrates, complex carbohydrates, sugar, fiber, protein, sodium, calcium, etc.
- Dictionary of product descriptions such as low calorie, reduced calorie, low fat, etc.
- Health chain relationships such as fat and cancer, fat and heart disease, calcium and osteoporosis, sodium and hypertension.

The new labeling requirement covers virtually all manufactured food products. Fresh meats and produce items are excluded. Small food manufacturers will also be exempt.

Objective: To provide consumers the information base for making improved nutrition decisions.

When Used: The labeling law must be implemented by May 1994.

Experience: The old law was voluntary except for fortified foods and instances in which a nutrition claim was made. It was used on an estimated 60 percent of manufactured products. Frequently, products with attractive nutritional properties were labeled. The new policy will cover some products with unattractive nutritional properties, especially products with high fat and sodium and low fiber.

Consequences:

- Improved basis for nutrition decisions.
- Potential for reduced consumption of fats, saturated fats, cholesterol, and refined sugar.
- Potential of substitution of labeling for other regulations such as standards of identity.
- New emphasis on fat, especially animal fat, may change American diet away from some traditional products.

CREDIT PROGRAMS

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Policy Tool: **Farm Credit System Capital Corporation**

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

What It Is: The Farm Credit Corporation was 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) manage the use and repayment of any eventual federal assistance.

Objective: The Capital Corporation was 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 chartered originally to facilitate 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 Amendment Act, its role was expanded to ensure that the System's own capital would be fully utilized before any federal assistance would be 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. The Agricultural Credit Act of 1987 replaced the Capital Corporation with the Farm Credit System Assistance Corporation. The precedent 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 1985 Farm Credit Amendment Act helped reduce System borrowers and investors feared that their investments would be lost.
- The initial effect on investors was to lower the risk premium the System was paying for its funds.
- The Capital Corporation creates a source of liquidity for institutions with large portfolios of nonperforming loans.
- If the distressed assets were conservatively valued and purchased at a discount, the Capital Corporation would 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.
- The increased centralization of regulatory authority tends to reduce local autonomy and control over the System.
- One of the key issues is the cost of any government assistance. If the funds are free or subsidized, the System can benefit tremendously in terms of rebuilding capital, but the cost is passed on to the public.
- Centralization of administering distressed assets can increase the visibility and political sensitivity to such a level that the System is unable to manage these assets in a businesslike manner. This would defeat many of the benefits afforded by the Capital Corporation concept.

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: An interest rate buy-down provided for in the 1985 farm bill allowed FmHA to pay 50 percent of the total cost of reducing the interest rate to the qualified borrower, up to a maximum of 4 percentage points. The 1990 farm bill maintained the 4 percent buy-down, but permitted FmHA to pay the total cost. The buy-down is to be used only if there is no alternative way to project a positive cash flow. The duration of the buy-down may not exceed three years. A number of states also have implemented interest buy-down programs to assist financially distressed farmers and ranchers.

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 also has 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 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.
- Rural communities benefit directly if the buy-down reduces borrowers' cash flow burdens and/or the number of farm liquidations.
- Because 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 and bearing the full cost of debt servicing.
- Interest rate buy-downs can result in large public outlays.

Policy Tool: **Loan Mediation**

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

What It Is: Loan mediation is a process that brings borrowers and creditors together with a neutral third-party mediator to resolve loan problems before they reach the point that the only options are foreclosure or legal action.

Objective: To resolve borrower/creditor disputes more quickly and with less cost than litigation. Because the mediation process is not adversarial, it is better suited to resolving disputes without destroying the relationship between the disputants.

When Used: The Agricultural Credit Act of 1987 provided funding to develop statewide mediation programs, subject to state approval, with the USDA and FmHA monitoring the programs. Several states already had established programs prior to the passage of the Agricultural Credit Act. Participation in non-binding mediation may be voluntary or mandatory depending upon individual state legislation. Eligibility for federal funding has been on a matching basis and requires that the programs be certified by FmHA.

Experience: Because the mediation process, unlike arbitration, is non-binding on participants, the programs have been generally well accepted by both lenders and borrowers. An analysis by FmHA indicated that mediation programs have saved the government from two to three times the amount spent to fund the programs.

Consequences:

- Rural communities can benefit if mediation results in a successful resolution that allows the farmer to continue in a successful business. Benefits accrue from reducing outmigration and avoiding increased demands for public welfare services.
- Voluntary resolutions to borrower/creditor disputes can be less costly and less time consuming than litigation.
- The resolution of disputes through mediation can help maintain a working relationship between the parties involved.
- Because the mediation process is non-binding and creditors maintain the right to pursue litigation if the dispute is not resolved to their satisfaction, mediation offers the opportunity to achieve a "least-loss" solution.
- Although participants may pay a nominal fee for mediation services, most program costs are born by the public.
- When a relatively large number of creditors are involved, it may not be possible to reach an effective solution without the agreement of all parties. Thus, the refusal of one party to participate in the mediation process can result in situations in which no agreement can be reached that provides the participating parties with a "win-win" solution.
- If lenders believe the mediation process is not impartial and that the mediator is acting as a borrower advocate, it can destroy the effectiveness of the program.

Policy Tool: **Mandatory Debt Restructuring**

Policy Area: **Credit Programs**

What It is: Prior to foreclosing on a distressed loan, some lenders are required to evaluate possible restructuring alternatives and to restructure those loans whenever restructuring would be a less costly alternative than foreclosure.

Objective: To minimize the amount of loan losses and the number of displaced farmers that would result from foreclosure.

When Used: The Agricultural Credit Act of 1987 requires FmHA and all Federal Land Bank Associations, Production Credit Associations, and other financing institutions that discount with the Farm Credit Banks to restructure distressed loans if restructuring would be less costly than foreclosure.

Experience: The debt restructuring requirement has resulted in significant loan write-offs by FmHA and the Cooperative Farm Credit System. However, these write-off losses also would have occurred in the event of a foreclosure, and the legal costs and borrower displacement that would have resulted from foreclosure have been reduced.

Consequences:

- Restructuring can reduce borrower displacement.
- Restructuring can result in fewer distressed assets being forced on the market, thereby reducing the downward pressure on all farm asset values.
- Restructuring can reduce the legal costs and number of bankruptcies that would otherwise occur.
- The loan write-offs represent losses that lenders would incur anyway if they foreclosed.
- Rural communities can benefit from a reduction in the number of farm liquidations and in the number of displaced farmers.
- Debt restructuring can create ill will on the part of producers in like circumstances who are financed by lenders not subject to the restructuring requirements.
- If borrowers with restructured debt continue to lose money, leaving them in control of the assets can increase the amount of lenders' future losses.
- There is nothing about restructuring that results in borrowers doing a better job of managing the business.
- Mandatory restructuring requirements may result in reduced credit being available to higher risk borrowers who are most likely to develop problems that would jeopardize the lender's security position.

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 that is past due for longer than a specific period. FmHA uses a combination of a principal deferral and interest waiver in its debt adjustment program. If it is necessary for the operation to meet cash flow requirements, a qualified FmHA borrower may defer a portion of the principal for up to five years and accrue no interest on the deferred portion.

Experience: Principal deferrals have tended to be used by private lenders in conjunction with disaster clauses tied to low production levels or commodity prices. They have provided a temporary solution to temporary financial problems. When 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.
- Deferrals may aid in keeping assets (land and machinery) off an already glutted market.
- 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 under their original loan terms.

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 five 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: Principal and 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. The borrower must have a reasonable chance of financial solvency with debt waivers. There has been a hesitancy to utilize this option in anticipation that financial conditions might improve. Waivers have, therefore, been a last resort option.

Consequences:

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

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 liquidation would have a politically unacceptable impact on asset markets. Since September 1984, FmHA has been allowed to issue guarantees of up to 90 percent of 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 a case in which 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 that 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.
- Principal buy-downs can support asset values by reducing the number of farm liquidations.
- 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 result in large public costs if economic conditions fail to recover and the government must pay private lenders 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 under their original loan terms.

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 is the debt the borrower could reasonably repay over the next five years, under "normal" conditions, with payment made on principal and interest at the current market rate. Tier-two debt would be all remaining debt and would carry a minimum interest rate requiring no principal payments. The amount of tier-two debt equal to the principal payment on tier-one debt would shift to tier-one, each year, 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 in agriculture. 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 of the loan for crops and 130 percent of the loan 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 were not subsidized, the potential cost to lenders would be substantial.
- If the interest rate on tier-two debt were subsidized, the program would involve significant public costs.

Policy Tool: **Beginning Farmer Programs**

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

What It Is: Direct government loans and/or government agency guarantees of loans made by private lenders to beginning farmers.

Objective: To help beginning farmers with limited resources get started in business by offering more favorable terms and loan amounts than would be available from private lenders in the case of direct loans or by encouraging private lenders to make loans they would not make without a loan guarantee.

When Used: Beginning farmer loan programs are offered by FmHA and by several states. Interest rates and equity requirements on direct loans are usually lower than would be required by private lenders. Repayment periods are also often longer than normal market terms to reduce debt servicing requirements. Government guarantees of loans made by private lenders have generally also involved interest subsidies. Direct loan and guaranteed loan program eligibility requirements have usually been subject to age and experience limits.

Experience: Such programs are politically popular because they are aimed at helping people with limited resources get started in business. They also address the entrance barrier created by increasing capital requirements, as well as the concern that the average age of the farm population continues to grow older.

Consequences:

- Subsidized interest rates and more liberal credit terms can encourage new entrants into segments of agriculture that already suffer from over-supply and low returns to resources.
- Although beginning farmer programs can help overcome entrance barriers, the size of units created may be smaller than what will be required to be economically viable.
- In some cases eligibility requirements have discriminated against young farmers with successful track records in favor of new entrants without demonstrated management ability.

Policy Tool: **Borrower Education Requirements**

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

What It Is: FmHA direct or guaranteed farm loan program borrowers would be required to participate in approved farm and financial management training until they reached a specified level of demonstrated knowledge of the subject matter.

Objective: To improve borrower's management skills and business performance and to reduce related credit problems.

When Used: FmHA was directed to start a borrower education program in the 1990 farm bill. The programs would be offered by existing organizations such as the agricultural extension service or community colleges with borrowers being loaned the funds for tuition. Programs would be required to cover specified subject matter and be approved by FmHA. Participation could be waived if the borrower was certified by FmHA to have demonstrated some minimum level of competence and knowledge regarding the required subject matter.

Experience: None. This program has not yet been implemented.

Consequences:

- The program could remove the excuse that borrowers do not know how to keep good records, complete financial statements, or develop business plans.
- By combining classroom education with actual experience, the transfer of knowledge could be much greater than with traditional education programs.
- The quality of borrower loan information provided as the basis for credit monitoring and decisions could be significantly improved, thus leading to better borrower counseling and credit decisions. This should help reduce FmHA's loan-loss experience.
- The improvement of borrower management skills should improve business performance and FmHA's graduation rate.
- This program would complement beginning farmer programs.

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 that 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. These loans are made primarily to farmers and ranchers who cannot qualify for adequate financing from other lenders and are not intended to supplant or compete with credit available from conventional lending sources. They are intended to bear the financial and market risk that conventional lenders are unwilling or unable to bear.

Experience: In the early 1980s, the government's share of total producer loans increased to the point that there was concern regarding government credit becoming the major source of agricultural credit. Concerns still exist concerning the effect of political influence on loans made by government agencies. 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 over-supply and low returns to resources.
- 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.
- Direct loans can be used to encourage the adoption of new technologies and new enterprises.
- Direct loans can be used to encourage adoption of alternative farming systems.
- Interest subsidies and the cost of administering direct loan programs can be very costly to 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 as a result of the negative impact of 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, and 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. The result was that asset values were artificially supported and the eventual market collapse was more severe and disruptive than it would have been otherwise.

Consequences:

- While credit is a liquidity management tool that 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 interest 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.
- Subsidizing interest rates and holding excess resources in agriculture can result in asset values being bid up to higher levels than would occur under normal market conditions.
- Additional credit cannot correct an income problem.

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 that 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 if the borrower has, when available, some "all-risk" crop insurance coverage, 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. 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 who are unable to obtain credit elsewhere.

Consequences:

- 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.
- Crop production is encouraged in high production risk areas.

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 also have been used to encourage lenders to make loans to start-up businesses and minorities. FmHA and RDA can guarantee both short-term and long-term loans made by private lenders. The loans are funded and serviced by the private lender subject to FmHA or RDA approval. Guarantees can generally 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 also have used loan guarantees when financing ventures or enterprises with which they have limited experience or when the size of the loan involved puts 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.

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.
- 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 can result in new entrants and continued financing for those segments of the industry that already suffer from over-supply and low returns to resources.
- They can positively influence job creation and retention by encouraging financing of business start-ups and expansion of existing businesses that would otherwise be perceived as too high risk for private lenders.
- They can make it possible for rural communities to finance infrastructure improvement and maintenance in order to enhance opportunities for economic growth and/or to stem economic decline.
- Rural communities may realize marginal benefits since losses that would otherwise be borne by firms in the local community would be borne by taxpayers.
- Loan guarantee programs essentially become lender bail outs when improperly structured or when no feasible long-term solution exists.
- If the guaranteed loans are not financially sound, the program can result in large, longer-run public outlays.

Policy Tool: **Rural Development Administration**

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

What It Is: The Rural Development Administration (RDA) involved the creation of a new federal lending agency by separating the activities of the FmHA into an agricultural agency *and a rural development agency. RDA assumes responsibility for FmHA's water and* sewer, community facility, and business and industrial loan programs.

Objective: To create a catalyst agency for directing federal assistance to rural areas from federal agencies and for fostering cooperation with the states on rural development programs.

When Used: The creation of RDA in 1992 was authorized by the 1990 farm bill. Its activities initially involve a transfer of existing programs and appropriations out of FmHA. To date, administrative and regional offices have been opened but no funds have been appropriated to hire field staff. Credit analysis, therefore, is being handled by FmHA personnel through a memorandum of understanding.

Experience: The creation of RDA has been embroiled in congressional debates over appropriations between those who favored its creation and those who wanted its activities to remain under FmHA. Another factor in the debate was opposition to RDA from those opposing the creation of a new agency at a time when the USDA is under pressure to streamline its operations and reduce its number of field offices.

Consequences:

- Provides a focal point for coordinating federal rural development efforts.
- Serves as a clearinghouse for information and assistance on rural development programs.
- Reduces many of the frustrations and inefficiencies rural communities and rural economic development organizations have experienced trying to work through the maze of federal programs.
- Creates the possibility of increasing and duplicating overhead and administrative costs.

Policy Tool: **Chapter 12 Bankruptcy**

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

What It Is: A business reorganization chapter of the federal bankruptcy code designed exclusively for family farmers.

Objective: To provide a streamlined procedure for farm business reorganization that would allow financially distressed family farms to remain in business if they can present a plan that would demonstrate how they could service their debts if the debts were written down to the value of the underlying collateral and if creditors were stayed from pursuing legal action to collect their loans.

When Used: The Family Farm Bankruptcy Act went into effect on November 27, 1986, and will sunset on October 1, 1993, unless extended by legislative action. Chapter 12 is available only to family-held agricultural operations, including family-held corporations, with the stipulation that at least 50 percent of the operation must be family held and stock or securities cannot be publicly traded. Protection under the Act is available to agricultural operations with up to $1.5 million in secured debt, provided the families who hold controlling interest in the operation receive at least 50 percent of their gross income from the operation and at least 80 percent of the family secured debt is involved in the operation, exclusive of debt related to family residences. A debtor seeking Chapter 12 protection has 90 days from filing to submit a reorganization plan to the bankruptcy court, and the judge is required to act on the plan within 45 days after receiving it. The judge may approve a reorganization plan, even if some creditors do not agree to it, provided the plan appears to be in the best interest of all concerned. If the plan is approved, the debtor will be under court supervision for three to five years. The debtor remains in charge of the agricultural operation, and a court-appointed trustee ensures that payments are made according to the plan and that no fraud or mismanagement occurs.

Experience: Chapter 12 has resulted in a significant amount of farm debt being discharged and has allowed many farmers to remain in business that would have otherwise been forced to liquidate as a result of lender collection action. It has also served as a bargaining lever for farm debtors by encouraging lenders to agree to debt restructuring rather than face the additional costs that would result from bankruptcy.

Consequences:

- Loan write-downs on secured debt and the discharge of unsecured debts may make it possible for borrowers to service their remaining debt obligations.
- Reorganization bankruptcy can support asset values by reducing the amount of assets on the market.
- Chapter 12 can result in lenders being more willing to negotiate debt restructuring alternatives.
- Chapter 12 can result in reduced credit being available to farmers who represent higher credit risks as lenders seek to avoid situations where they would be legally prohibited from collecting loans or be forced to write down loans if collateral values deteriorate.
- Property sold during the plan may generate an income tax obligation that could make restructuring plans unworkable for debtors.
- Secured creditors whose loans are written down to the value of their underlying collateral are precluded from benefiting from any improvement in collateral values that occurs after the plan is approved.

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 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 was criticized 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.
- The 1985 Farm Credit Act changed the function of FCA to be more like the regulatory role of the regulators for other financial intermediaries.
- Independence of the Systems's banks in establishing policy was reduced.
- Responsiveness of the System to changing conditions was increased.

Policy Tool: **Farm Credit System Insurance Corporation**

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

What It Is: The Farm Credit System Insurance Corporation is a separate entity of the Farm Credit System and was chartered to develop and administer a pool of risk capital to ensure the timely payment of principal and interest on notes, bonds, debentures, and other obligations of participating Farm Credit System institutions.

Objective: To ensure the financial integrity of financial instruments issued by the Farm Credit System Funding Corporation and to guard against the need for future federal financial assistance.

When Used: The Farm Credit System Insurance Corporation was mandated by the Agricultural Credit Act of 1987 in conjunction with a financial assistance package establishing federal aid to prevent the System from collapsing. The fund is to begin insuring obligations in January 1993.

Experience: The Insurance Corporation was established on January 6, 1988, and was initially capitalized by the FCA revolving fund. Beginning in 1989 each System bank was insured and subject to the law governing the Insurance Corporation and its powers. The initial premium payments began in 1990 with payments based on the accruing and nonaccruing loan volume of each bank for the previous year.

Consequences:

- The insurance fund should help ensure the safety of the investors in Farm Credit System financial instruments and help maintain the System's low cost of funding.
- Because the fund will be self-funded by the premiums assessed on the System's institutions, it can help avoid the need for public assistance in the event of future financial problems.
- As a policy tool, the level of premiums and size of the fund deemed necessary by the Insurance Corporation to ensure actuarial soundness can influence the credit policies and lending philosophy of the System's lending institutions.

Policy Tool: **Foreclosure Moratorium**

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

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

Objective: To temporarily relieve the financial obligations of financially pressed borrowers 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 Frazier-Lemke Act moratorium in the 1930s, a farm was appraised and the courts granted a stay of proceedings for three years, during which time the farmer retained possession of the property and paid rent for its use. Within three years, the farmer could pay the appraised value and redeem the property. If the property was not redeemed, it would be sold to satisfy the debt against it and the farmer would not be 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:

- Conditional or limited moratoria can be used to encourage reluctant lenders to use public sector assistance programs or accept forbearance and other restructuring approaches.
- A moratorium can be successful only if the financial conditions of the firm and/or the industry improve during the period so the borrower can pay the debts or if the asset markets can absorb the assets at more favorable prices.
- A moratorium can help temporarily stabilize asset values because fewer assets are forced on the market.
- 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.
- Costs to lenders resulting from the nonpayment of interest, collateral depreciation, and additional borrower operating losses during a moratorium can be substantial.
- A moratorium serves to hold surplus resources in agriculture.

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: None. The program has not been implemented. The concept appeared to be rejected based 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.
- By allowing lenders to sell acquired property and farmers to sell distressed assets, the program would reduce losses associated with foreclosures.
- 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.
- 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 Farm Credit Banks can 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 Farm 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 Federal Agricultural Mortgage Corporation was authorized by the Agricultural Credit Act of 1987. "Farmer Mac" provides a secondary market for farm real estate mortgages, rural housing loans, and the guaranteed portion of FmHA loans. Although loan pools have been created, Farmer Mac has been less active than anticipated. The program involves 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.

Consequences:

- Secondary markets expand agriculture's access to capital markets.
- Secondary markets could add liquidity to the farm real estate mortgage market.
- The sale of loans into the secondary market and the purchase of participations in loan pools could allow agricultural lenders to diversify their portfolios.
- Secondary markets may enable lenders to service borrowers who would otherwise exceed their legal lending limit.
- The ability to offer fixed rate loans may help reduce the restrictions on credit availability during periods of high loan demand.
- The underwriting standards for secondary markets can help in upgrading and standardizing financial reporting requirements for farm borrowers.
- Extended periods in which loanable funds exceed effective loan demand may create problems in maintaining the viability of secondary markets.

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Issued in furtherance of Cooperative Extension Work in Agriculture and Home Economics, Acts of Congress of May 8, 1914, as amended, and June 30, 1914, in cooperation with the United States Department of Agriculture.

3M--1-93, Revised