

Acreage diversion programs

Federal government programs that divert land from crop production have been a common feature of U.S. agricultural policy over the past thirty years. Although the emphasis has shifted from time to time, these programs have usually carried the dual objectives of holding down production during periods of surpluses and guarding against undue soil erosion. With the re-accumulation of huge grain and soybean surpluses and the inauguration of the new long-term Conservation Reserve Program, the amount of farmland diverted from crop production is expanding rapidly. Preliminary USDA estimates suggest that some 45 million acres were diverted from production in 1986. Projections for next year suggest that the total could rise to a range of 65 to 70 million acres. Such a level would surpass the acreage typically diverted during the heavy surplus years of the 1960s and rank second only to the 78 million acres diverted from production in 1983.

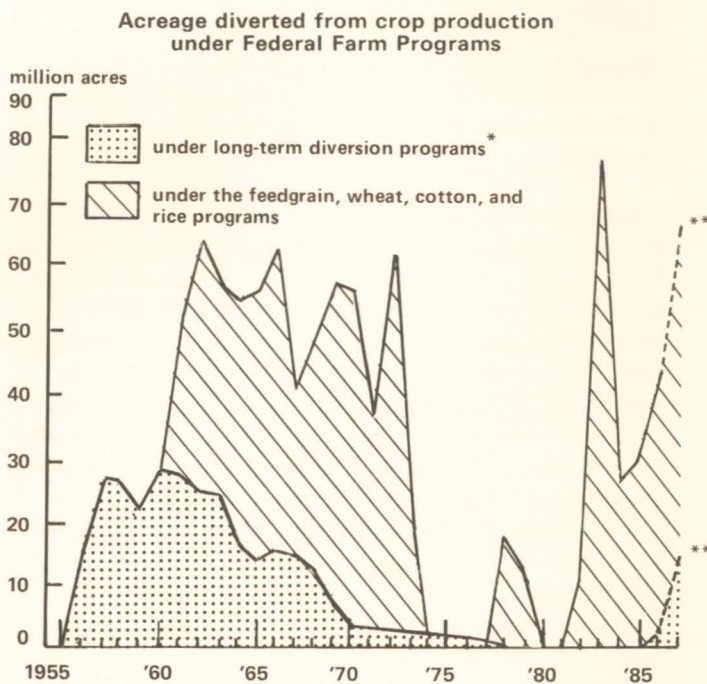
Federal government programs to remove acreage from crop production started in 1956. By 1957, some 27 million acres were diverted, a level that held fairly stable through 1960. During this period, the Soil Bank Program and a short-lived Acreage Reserve Program accounted for all the acreage diverted from production. Under the Soil Bank Program, farmers were compensated for entering into long-term (5 or 10 year) contracts to divert land from crop production to soil conserving uses. Acreage enrolled in the Soil Bank Program peaked in 1960, at nearly 29 million acres, and then trended downward until the last of the contracts expired in 1977.

Since 1961, most of the acreage diverted from crop production has come from acreage restrictions imposed on farmers who enroll in commodity price support programs for wheat, feed grains, cotton, and rice. Those restrictions, when applicable, represent a one year commitment requiring participants to divert a percentage of their program crop acreage from production. During the 12 years ending with 1972, the acreage removed from crop production annually under price support programs ranged from 25 to 59 million acres and averaged 40 million acres. Those levels, when combined with the declining enrollment in the Soil Bank Program, boosted total diversion under all programs to an average of nearly 55 million acres

during the era of heavy surpluses in the 1960s and early 1970s.

Because of a surge in exports that ultimately eliminated the surpluses, the amount of acreage diverted from crop production dropped sharply in 1973 and fell to only nominal levels from 1974 through 1977. In the late 1970s, modest restrictions were temporarily reimposed but then dropped again in 1980 and 1981.

The removal of all acreage restrictions in 1980 and 1981, and only modest restrictions in 1982, were unfortunate developments when judged with the advantage of hindsight. At that time, changing market conditions were triggering what would prove to be a pronounced slide in exports. That slide, plus continuing gains in productivity, set the stage for the burdensome surpluses of the 1980s. Following a record harvest in 1982 that belatedly signalled the re-emergence of surpluses, the 1983 commodity price support programs were redesigned to include Payment-In-Kind options. Heavy participation in the 1983 price support programs led to the all-time high



of 78 million acres being diverted from crop production, an area equivalent to more than a fifth of all cropland harvested the previous year. The 1983 PIK Program, and the extensive drought damage that year, provided only temporary success in reining-in excess production. Diverted acreage dropped to 27 million acres in 1984 but has risen since then. Yet surpluses have continued to mount, prompting calls for still more diversion. In all likelihood, the amount of acreage diverted from crop production will surpass the 1983 record before the end of this decade.

The bulk of the roughly 45 million acres diverted from crop production in 1986, and the 65 to 70 million acres projected for 1987, is the result of commodity price support programs. These programs accounted for 43 million acres of diversion in 1986, including 18.5 million acres under the feed grain program and 19.5 million under the wheat program. For 1987, participants in commodity price support programs are expected to divert 50 to 55 million acres from production, with virtually all of the increase coming through the feed grain program.

The Conservation Reserve Program (CRP) is a new program that will capture a growing share of the farmland to be diverted from production in the future. The CRP is similar in concept to the Soil Bank Program in that it imposes long-term (10-year) commitments on participants. Some 70 million acres of "highly erodible" farmland are eligible to enter the program. In 1986, some 8 to 9 million acres were enrolled but only 2 million of that acreage was enrolled early enough to affect 1986 crop production. Total enrollment is scheduled to reach 15 million acres in 1987 and continue to grow to a minimum of 40 million acres by 1990.

The success of past diversion programs in cutting production during periods of large surpluses has been, at best, limited. Because of the way participant benefits are structured, the productivity of land diverted from production under commodity price support programs tends to be considerably lower than that of the land remaining in production. Moreover, the effectiveness of past diversion programs has been compromised by farmer efforts to clear and drain new land for crop production (often with the encouragement of substantial federal subsidies) and by the fact that participation in price support programs is voluntary and not mandatory. These problems have led to a substantial acreage slippage in past diversion programs. Reflecting this slippage, changes in harvested acreage of program crops from one year to the next is often equivalent to only 50 to 80 percent of the change in the amount of acreage enrolled in diversion programs. And because of lower per acre yields on land diverted

from production, the slippage is even greater in terms of changes in total bushels of production.

Problems of slippage in future land diversion programs are likely to be less evident. The so-called "sodbuster" and "swampbuster" provisions in the Food Security Act of 1985 will discourage some farmers from converting new land into cropland. Also, the introduction of uniform acreage bases for individual farms and the limited cross-compliance features of price support programs will tend to reduce slippage in land diversion programs. Nevertheless, using programs that divert acreage from production will still likely prove to be an inefficient way to address problems of surpluses.

Gary L. Benjamin

Agricultural price trends in 1986

Prices received by farmers have hovered below year-ago levels through most of 1986. Only during the summer months, when a sharp rise in livestock prices boosted the overall index, did prices for all farm products hold near or above 1985. Despite the summer uptrend, the index of prices received by farmers during the first eleven months of this year averaged more than 4 percent lower than during the comparable period in 1985.

Prices of livestock and livestock products, after holding well below a year earlier through the first half of the year, have risen above 1985 levels since July. Although down from the August peak, the index of livestock and livestock product prices stood at 145 percent of the 1977 average in November, compared to 138 a year ago. Moreover, the year-to-year increases of the last several months have boosted the eleven-month average almost 2 percent above 1985. Most of the recent gains are due to the summer surge in hog prices and strengthening cattle prices. These factors have pushed the average of the index of meat animal prices almost 13 percent above a year earlier in the five months ending in November. However, sharp declines in the early months of the year have limited the average year-to-year gain in the index through November to about 1.9 percent. Partially offsetting the gains in meat animal prices, dairy prices through November averaged 2.6 percent lower than in 1985.

With livestock sector prices showing gains, the factor holding the index of prices for all farm products in check has been sharply lower crop prices. The index of prices received for all crops trended lower during the summer and early fall before rebounding somewhat in November. For the eleven-month period the index of crop prices averaged more than 11 percent below the 1985 level.

The sharpest drops have been registered in food grain and feed grain prices, although oilseed crop prices have also been below a year ago. Even though they had been below a year earlier through May, both food grain and feed grain prices dropped sharply in June. The declines resulted from the sharply lower support prices for wheat in the 1986/87 marketing that began June 1, which also triggered a response on feed grain markets to overcome the relative price change. In addition, lower support levels for corn went into effect at the start of the new marketing year in September. For the first eleven months of 1986, the index of food grain prices has averaged more than 17 percent below a year earlier, while feed grain prices have dropped about a fifth. Moreover, both the food grain and feed grain indexes have averaged about 30 percent below the previous year's level for the three months ending in November.

Prices for oil-bearing crops have also been below 1985 levels throughout the year. However, the index of oil-bearing crop prices weakened considerably in September when the soybean support price was lowered. Through November the index averaged almost 9 percent lower than the same months in 1985. The decline has occurred despite reductions in soybean, peanut, and cotton output, the principal oil-bearing crops in the United States, as large inventories maintain pressure on prices. The index of prices for these crops has held near the year-earlier level through the first three months of the current marketing year, but prices will likely come under pressure as the Southern Hemisphere harvest approaches.

Although the reductions in loan rates, the mechanism through which government programs support crop prices, were expected to lower prices, several commodities have seen prices decline well below support levels. This situation has been brought about by the introduction of generic PIK certificates. These certificates are issued in lieu of cash for a portion of the income support, or deficiency payments, and the diversion payments that participants in government programs receive. They have a stated dollar value and can be exchanged for commodities owned by the Commodity Credit Corporation or used to redeem commodities pledged to the CCC as collateral for price support loans.

One result of the issuance of the certificates is that they allowed producers to avoid the storage crunch that was expected to follow this year's large harvest. It allowed producers with inadequate storage space to

secure price support loans, then pay off the loan with certificates, and either sell the commodity or feed it to livestock. This "PIK and roll" strategy provided operators with an opportunity to receive the full loan rate on their grain, irrespective of storage cost and availability. Moreover, it channelled additional grain, mostly corn, into commercial markets rather than into storage, increasing free supplies. The increased supplies of commodities, in turn, pressured market prices lower, circumventing the loan rate support mechanism.

In addition to producers using the certificates issued to them, a market in which they could be sold developed rapidly. Moreover, certificates have traded at a premium in this secondary market. The premium, which at one point this fall exceeded 30 percent of face value, resulted from a relatively short supply of certificates when they were first introduced and strong demand generated by opportunities to use them profitably to redeem CCC loans.

The profitable opportunities result from differences between the local loan rate and the posted county price (PCP) for a commodity. The certificates can be used to redeem CCC loans or to acquire CCC-owned commodities at the PCP. The PCP is set daily at roughly the equivalent of the local cash market price. With the PCP below the local loan rate, sometimes by a substantial margin, a producer can redeem the bushels pledged as collateral for a CCC loan at less than the value of the loan. There have been a number of recent developments that have reduced certificate premiums. These developments along with an increasing supply of certificates as more are issued will likely temper future premiums.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
Receipts from farm marketings (\$ millions)	August	9,861	5.5	-9	-12
Crops*	August	3,615	2.5	-29	-31
Livestock	August	6,067	2.4	10	6
Government payments	August	179	N.A.	-39	3
Real estate farm debt outstanding (\$ billions)					
Commercial banks	June 30	12.1	3.8 [†]	15	22
Federal Land Banks	June 30	41.4	-4.6 [†]	-14	-16
Life insurance companies	September 30	11.4	-1.2 [†]	-5	-10
Farmers Home Administration	June 30	10.9	1.0 [†]	2	8
Nonreal estate farm debt outstanding (\$ billions)					
Commercial banks	June 30	34.2	0.9 [†]	-14	-17
Production Credit Associations	June 30	12.7	-1.1 [†]	-24	-35
Farmers Home Administration	June 30	18.8	5.3 [†]	1	12
Commodity Credit Corporation	June 30	17.9	-9.5 [†]	103	174
Farm loans made (\$ millions)					
Life insurance companies	September	52	-85.1	-31	76
Interest rates on farm loans (percent)					
7th District agricultural banks					
Operating loans	October 1	11.33	-4.1 [†]	-12	-22
Real estate loans	October 1	10.76	-4.4 [†]	-14	-23
Commodity Credit Corporation	December	5.73	0.0	-27	-43
Agricultural exports (\$ millions)					
Corn (mil. bu.)	October	2,435	27.1	4	-15
Soybeans (mil. bu.)	October	125	53.6	-1	-20
Wheat (mil. bu.)	October	90	196.7	62	119
	October	92	-11.4	4	-35
Farm machinery sales^p (units)					
Tractors, over 40 HP	November	3,032	-40.2	-19	-42
40 to 139 HP	November	2,243	-40.0	-15	-36
140 HP or more	November	789	-40.9	-29	-54
Combines	November	610	-57.1	-46	-66

N.A. Not applicable.

*Includes net CCC loans.

[†]Prior period is three months earlier.

^pPreliminary



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