



Review

**FEDERAL RESERVE BANK
OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.**

	Page
Recovery Forces in the Economy	2
The Farm Problem . . . What Are the Choices?	6

Recovery Forces in the Economy

FORCES are coming into play to moderate and reverse the recent adverse trends in income, production, and employment. Some of these forces are automatic in nature, requiring no discretionary action. Other forces result from discretionary actions either by administrative agencies or by Congress. This article focuses upon the first of these general classes of forces tending to recovery, the automatic ones. In the first part of the article several features of the current economic decline are compared with the 1953-1954 and 1957-1958 recessions. In the second part, the recent behavior of automatic forces for recovery is compared with their behavior in earlier declines.

Patterns of the Current and Earlier Recessions

In February of this year the United States was well into its fourth postwar economic recession. Industrial production was down substantially from the level attained last spring. Unemployment was high by postwar standards. Although total output of goods and services is currently down only slightly from its high in the second quarter of 1960, it is substantially below the level which might reasonably have been projected on the basis of the growth trend of recent years.

Measured by the rate of economic contraction following the cyclical peak, this recession thus far appears to be less severe than the two previous ones. However, there is evidence that business activity was less vigorous as the recession began than at either the 1953 or 1957 peaks. Hence, the pace of economic activity may be as far below capacity as it was at a comparable time in either of the two previous recessions.

Industrial Production

The rate of decline in industrial production was somewhat smaller in the first eight months of the current recession (through January) than in the comparable periods of the previous two recessions.¹

¹ For the purpose of this article May 1960 has been taken as the beginning of the current recession. Other peak months used were July 1953 and August 1957, the upper turning points of the Reference Cycles identified by the National Bureau of Economic Research.

There has been a 7 per cent decline, as compared with 10 and 14 per cent declines in the 1953-1954 and 1957-1958 recessions. Each of the previous recessions involved an abrupt initial drop in production. The current recession, in contrast, seemed to ease into the decline (see Chart 1).

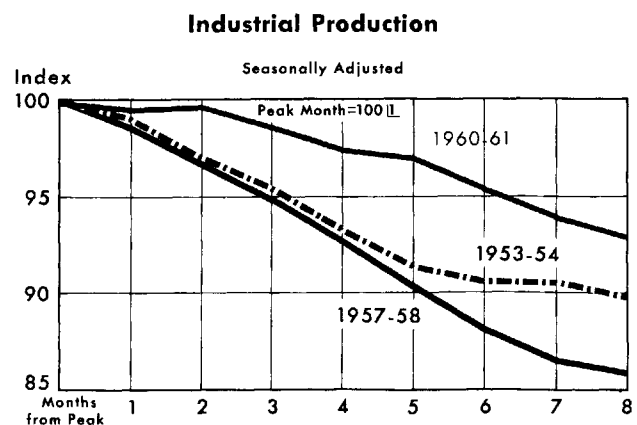
Unemployment

The proportion of the civilian labor force unemployed rose from less than 5 per cent last May to about 6½ per cent in January. Although the increase in unemployment, either in absolute numbers or as a proportion of the labor force, has not been as sharp during this recession as in previous declines, it should be observed that the change is being measured from a substantially larger base (compare Chart 2 with Chart 3). As against the roughly 5 per cent level of unemployment in May 1960, there was an unemployment rate of about 4 per cent at the start of the 1957-1958 economic contraction and one of less than 3 per cent at the beginning of the 1953-1954 recession.

Gross National Product

Total output of goods and services (Gross National Product) declined about \$1.6 billion in seasonally adjusted annual rates, or less than 1 per cent, from the second quarter of 1960 to the fourth quarter of the year. The decrease was more mild over the first

Chart 1



Source: Board of Governors of the Federal Reserve System

two quarters of the current recession than in the corresponding periods of the previous postwar recessions (see Table I). The shift from business inventory expansion to inventory contraction was about the same as in the two previous recessions, but the effects of the inventory contraction were largely offset by expansions in net exports, consumer expenditures, and government outlays. In addition, some other components of private domestic investment did not contract as much as they did in the 1957-1958 recession (see Table II). In this respect, current experience has been similar to the 1953-54 recession.

The Automatic Stabilizers

The United States economy is resilient. That is, there typically are forces at work in the economy to arrest downturns in business activity. Certain of these stabilizing forces are the result of the natural operation of our market system or are built into the economy by law. Other stabilizing forces may result from deliberate actions on the part of governmental authorities, particularly in the monetary and fiscal areas.

Automatic stabilizers are so called because they do not require explicit decisions in order to be brought into play. In addition to requiring no conscious actions before they begin to operate, the automatic stabilizers usually begin to take effect early in a recession, increase in force as a recession deepens, and moderate or reverse during a recovery. Under existing law, certain categories of government expenditures expand

when business activity declines and contract automatically when business activity increases. Some types

Table I
CHANGES IN THE GROSS NATIONAL PRODUCT
First Two Quarters from Peak

	In Billions of Dollars (Seasonally Adjusted Annual Rates)		
	1960-61	1957-58	1953-54
Personal Consumption Expenditures...	+ 1.8	- 1.0	-1.0
Gross Private Domestic Investment....	- 9.5	-15.2	-7.7
Government Purchases of Goods and Services	+ 3.5	+ 3.2	+ .2
Net Exports	+ 2.6	- 3.4	+ .7
Total Change in GNP.....	- 1.5	-16.3	-7.8

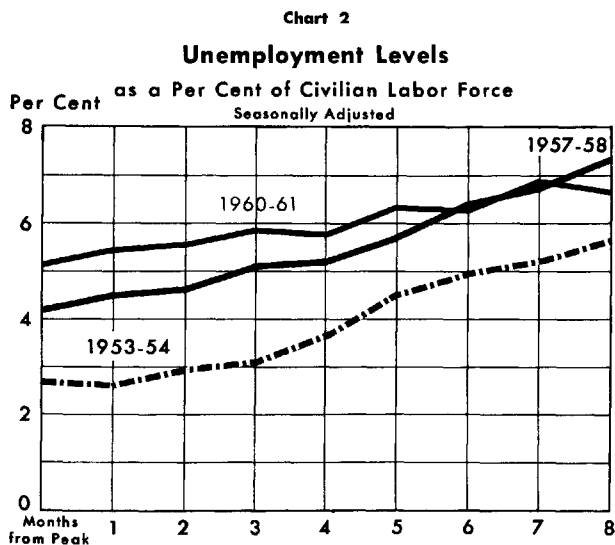
Figures may not add to totals because of rounding.

Source: U. S. Department of Commerce.

Table II
CHANGES IN GROSS PRIVATE DOMESTIC INVESTMENT
First Two Quarters from Peak

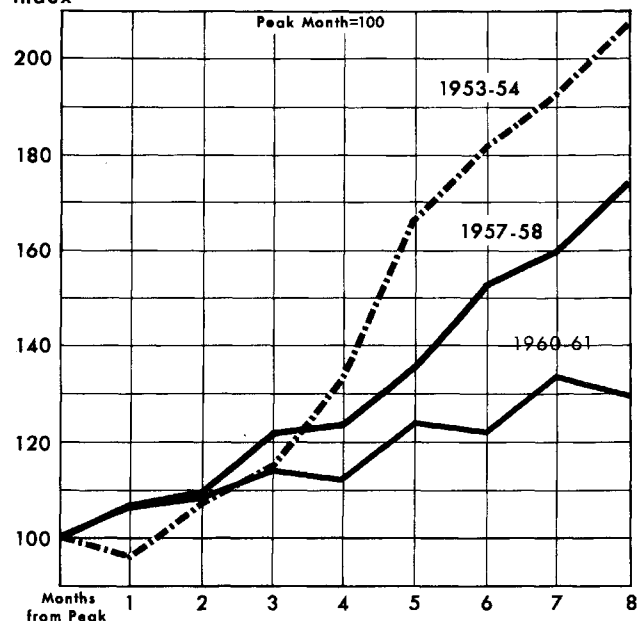
	In Billions of Dollars (Seasonally Adjusted Annual Rates)		
	1960-61	1957-58	1953-54
New Residential Nonfarm Construction..	- .8	+ .1	- .3
Other Construction	+ .4	- 1.2	+ .4
Producers Durable Equipment	- .8	- 4.8	- .1
Changes in Business Inventories	- 8.3	- 9.4	-7.7
Total Change	- 9.5	-15.2	-7.7

Source: U. S. Department of Commerce.



Source: United States Department of Labor

Chart 3
Index of Unemployment
as a Per Cent of Civilian Labor Force
Seasonally Adjusted



For each period, the pre-recession peak month is used as the base for the index.

Source: United States Department of Labor

of government receipts also vary automatically in a contracyclical manner. In addition to the stabilizers associated with government there are many business and consumer practices that tend to cushion economic declines.

Changes in Government Payments

Expansions in certain categories of government expenditures automatically accompany periods of decline in economic activity. Most changes in unemployment compensation payments, for example, result from the effect of changes in business activity on existing programs. During the period between last May and this January transfer payments, including unemployment compensation, Social Security benefits, and veterans' benefits increased \$2.6 billion in annual rates, after taking account of seasonal influences. This was an annual rate of increase of 14 per cent. Approximately \$1.4 billion of the increase may be accounted for by an increase in unemployment compensation payments alone. Table III compares the increases in transfer payments over the initial eight months of the present recession with increases in similar periods of the two previous recessions.

Table III

INCREASE IN GOVERNMENT TRANSFER PAYMENTS DURING FIRST EIGHT MONTHS OF RECENT RECESSIONS¹

(Seasonally Adjusted Annual Rates)

Recessions	Dollar Increase (billions)
1960-1961	\$2.6
1957-1958	4.7
1953-1954	1.7

¹ Transfer payments include unemployment compensation payments, Social Security benefits, and various veteran benefits.

Source: U. S. Department of Commerce.

Aside from the contracyclical changes in certain government receipts and expenditures, other built-in stabilizers are the sheer size and relative stability of most other government expenditures. Government outlays for goods and services have become an increasingly important demand factor in recent years, having increased as a percentage of GNP over the last decade from approximately 22 per cent in 1950 to slightly over 28 per cent by 1959. Most government programs are continued at about the planned rate despite changes in economic conditions that may cause temporary deficits or surpluses. Hence this large

component of GNP is relatively immune from the short-run contractive forces of most business cycles.

Changes in Government Receipts

Changes in business activity also automatically affect the volume of government receipts. Under existing programs, tax receipts tend to fall more rapidly in a recession than does economic activity and to rise more sharply than activity in a period of expansion. This characteristic of revenues results in part from the progressive structure of the personal income tax (i.e., additions to income are taxed at increasing rates). Also, tax receipts from corporate profits tend to fluctuate more widely than business conditions since taxable corporate profits are usually less stable than corporate sales. Because Government outlays in the short run are to a considerable extent independent of current receipts and because receipts rise and fall with the business cycle, the Government automatically tends to siphon off in receipts a smaller portion of the income stream during a recession than it contributes to the stream with its expenditures. Conversely, in a period of high activity, assuming no major changes in tax structure or expenditure programs, a cash surplus may be produced that tends to moderate inflationary pressures.

Business Behavior

Business firms also make some positive automatic contributions to keeping up consumer demand. Concerns usually do not change their work forces or their wage and salary payments as rapidly or to as great an extent as the demands for their products change. The practice of maintaining dividend payments in the early stages of declining profits helps to support incomes and buying power of shareholders. Over the first two quarters of the 1953-1954 and 1957-1958 recessions corporate profits after taxes, and after adjustments for seasonal influences, declined 29 per cent and 8 per cent, respectively. Over the same periods dividend payments remained approximately unchanged. Between the second and the fourth quarters of 1960 corporate profits declined again. Even so, dividend payments, at a \$14.1 billion annual rate in the fourth quarter, were up slightly from the rate prevailing in the second quarter.

Shifts from inventory accumulation to inventory contraction have accounted for a good deal of the decrease in economic activity during recent recessions.

Even here, tendencies automatically emerge which tend to work in the direction of checking the decline. Inventory liquidation implies that current sales to final users are exceeding current production. At some point, there should be a demand for current production to expand at least to the point at which current sales can be met. Purchasing for inventory purposes tends to be stimulative. As production and employment quicken in response to these orders, personal income and final demand tend to expand.

Structural Changes in the Economy

The structure of the economy has changed over the past several decades in such a way that cyclical fluctuations probably tend to be reduced. There has been a rapid growth in the service areas of the economy, including the professions, the civil service, finance, insurance, real estate, and personal services. In 1930, workers in services and government constituted 26 per cent of the labor force. In 1960 this proportion had grown to 33 per cent. In general, these areas of the economy have not been subject to so great cyclical fluctuations as have the production and retail areas.

The composition of the work force within manufacturing has also been changing in such a way as to soften the effects of economic declines. In 1940 the proportion of production workers in total manufacturing employment was approximately 82 per cent; by 1960 this proportion had declined to 75 per cent. When current production rates are reduced, insofar as companies tend to keep sales forces, research staffs, and administrative personnel, the impact of fluctuations in output on total personal income is diminished. It is true, of course, that the reduction in numbers of production workers resulting from technological development presents a long-run adjustment problem. Displacement of unskilled and semi-skilled factory workers has contributed to growth of unemployment in the past decade in good times as well as in bad. This problem, however, should be distinguished from the problem of cyclical unemployment.

Interest Rate Movements

Interest rate movements have equilibrating tendencies. A decline in interest rates during a recession reduces the cost of credit to new borrowers. Also, during recessions, when interest rates decline, the prices of marketable debt instruments increase. Hence, creditors experience an increase in the value of their assets. Increases in wealth tend to have a stimulative

effect on spending and lending. During the recovery phase of the cycle, interest rates tend to increase. This, in turn, means that the prices of debt instruments decrease. Hence, holders of these debt instruments experience a reduction in their liquidity positions, which tends to dampen their spending.

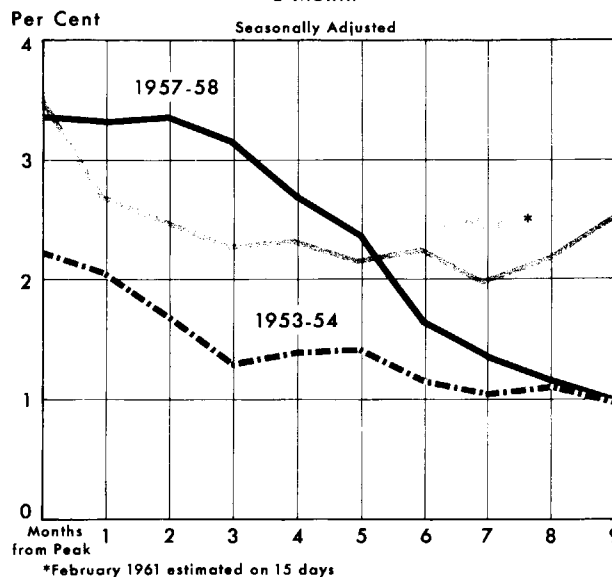
During the recessions of 1953-54 and 1957-58, three-month Treasury bill rates declined about 70 per cent and the period of decline lasted for approximately one year (see Chart 4). By contrast, yields on Treasury bills have declined only about 50 per cent from the December 1959 peak—the entire decline occurring in the months from December to June. Since May 1960, the beginning of the present recession, short-term yields have shown little net change.

Interest rates on long-term issues have declined substantially less during the current contraction than during the preceding two recessions. Yields on long-term governments declined from 4.16 per cent in May 1960 to 3.89 in January 1961. Since July of last year, yields on most long-term bonds have been virtually unchanged on balance. In absolute levels long-term rates in February were higher than at the peak reached before the 1957-58 recession.

There are several forces working simultaneously during a recession which tend to reduce interest rates. The demand for credit tends to fall as borrowers scale down their needs for funds. At the same time the

Continued on page 12

Chart 4
Treasury Bill Rates
3-Month



THE FARM PROBLEM

. . . What Are the Choices? ¹

The Farm Problem Identified

INCOMES in agriculture are low compared to incomes in nonfarm industries. In the last five years per capita farm income averaged only 53 per cent of that of nonfarmers.

The lower incomes in agriculture stem from the lag in adjustment of farm resources to technology changes. About 800 thousand people per year have left the farm in recent years. The number of farms has declined by about 100 thousand per year. Man-hours worked have declined 2.3 per cent per year since 1940. Cropland harvested is down from the 1950 level to about the same as in 1910. On the other hand, capital investment in agriculture measured in constant dollars has increased about 1.5 per cent per year since 1940. Despite the reduction in labor and cropland devoted to farming, output of farm commodities has been growing faster than population.

The nature of demand for most farm commodities is such that total farm income declines as production per capita increases. Consumption per person increases very little when prices decline and conversely consumption declines little when prices rise. Small gains in output cause large reductions in price and vice versa. A small increase in output sold at a greatly reduced price produces a smaller income. With farmers increasing production at a rate exceeding the rate of population growth total income from farming declined between 1950 and 1959. Despite the major decline in farm population, per capita income of farm people from all sources rose only about 15 per cent during the period while per capita income of nonfarmers rose 39 per cent.

The per capita income of farm people from all sources in the last five years averaged less than \$1,000, only about half the average for nonfarm people. However, there are wide variations in income among farmers. A relatively few farmers have kept pace with new production methods, widening the income gap between them and other farmers.

Small returns to a large per cent of the nation's farm families have led to numerous proposals for increasing the incomes of this group.

Possible Choices for Agriculture

Expansion of Domestic Demand?

Numerous proposals have been made for expanding domestic demand for farm products. Chief among them are (1) promotion and advertising, (2) food distribution pro-

¹ A summary of a study by the National Committee on Agricultural Policy (see box on page 7).

grams, (3) increasing consumption through raising incomes of low income people, and (4) reducing the price of farm commodities. However, the implementation of each of these proposals would probably be ineffective in view of the stable per capita consumption of food. Total consumption of food closely follows the rate of population growth. The nation's annual per capita consumption of food has been about 1,500 pounds throughout the past half century. Some substitution of high-value foods in terms of resources used is possible. For example, the production of livestock products requires five-to-seven times the basic farm resources per pound of product as does the production of cereal products. Nevertheless, the opportunities for greatly increasing domestic demand for farm commodities do not appear to be promising.

Promotion and advertising by one segment of the agricultural industry may increase the consumption of products advertised. But, such gains would tend to be at the expense of other farm products.

Food distribution programs with Federal assistance have merit primarily in improving diets. For example, the disposal of 2 per cent of total milk production through milk distribution programs might initially strengthen demand. But, any improvement in prices would probably motivate greater output, pushing prices back down to about their original levels.

The use of direct cash payments to low income individuals offers only a limited opportunity for expanding food consumption. Also, the cost would be high in relation to the consumption increase. It is estimated that if incomes of such individuals were supplemented by payments totaling \$3 billion per year, food consumption would increase only about 2.4 per cent from present levels.

Lower food prices would achieve some consumption gains. However, it is estimated that it would take a 20 per cent drop in retail prices to increase consumption by 4 per cent.

Expansion of Foreign Demand?

The possibilities of greatly expanding exports of farm commodities are also not too promising. Most people in the more highly developed countries already eat sufficient quantities of food and expansion of their total imports per capita can only be achieved by upgrading nutritional quality, or taste. Some hope exists for increased exports over the longer run as incomes rise in other countries and the quality of food is upgraded. However, the desire for self-sufficiency and the protectionist policies for agriculture in some countries are deterrents to expansion of American exports.

In general, the lower income areas have a shortage of funds to pay for the food imports they need. Prospects are relatively good for maintaining a high level of exports to Latin America. In the Middle East several major crops are competitive with those of the United States. Most of the countries in the Far East are attempting to expand production of food and clothing as rapidly as possible, but the more populous areas in India and Pakistan appear to be losing the battle of self-sufficiency. Here, however, incomes are so low that needed farm commodities cannot be purchased.

It may be possible to expand exports of some commodities in some countries. But it will not be easy to increase total exports significantly. Programs that have been in effect for a number of years have kept prices of some United States farm products higher to domestic consumers than to export customers. These programs have added to the taxpayers' burden. They have also tended to encourage domestic production, and to increase the stocks held by the Commodity Credit Corporation. Sales concessions to other countries may have increased consumption of some products but the resulting tendencies to stimulate production through domestic price supports involved in such programs should not be overlooked.

New Uses for Farm Products?

Expanding demand for farm products could be accomplished by (1) finding new uses for currently produced farm commodities and (2) finding uses for new farm commodities.

Both the Federal Government and private industries have been attempting to find new uses for farm products. Since 1938 four USDA laboratories have carried on farm commodity utilization research. The present budget for this purpose is about \$16 million per year. In addition, the government spends funds on farm commodity utilization in foreign countries. Private organizations have also been attempting to develop new uses for both farm and non-farm products.

It is doubtful whether either demand or supply will be greatly influenced by expanded farm commodity utilization research. Some people believe that if the Government supported farm product utilization research on a greatly expanded basis major new industrial markets for farm products could be found. The more optimistic scientists believe that an expanded research program after a period of 5 years or more could divert an additional \$1.5 billion, or 5 per cent, of annual production of farm commodities into industrial uses. However, the impact on farm incomes would probably be very small in the first few years. Even after five years or more the income gains might be small unless important findings are made which would require much more resources in farm production.

Although this program is unlikely to solve the low income problem in agriculture at least in the short run, it might be justified on the basis of general benefits accruing to society in the longer run.

Marketing Quotas?

The objective of a marketing quota program is to limit the marketing of farm products to quantities that will clear

THIS ARTICLE is a summary of thirteen separate studies under the general heading *The Farm Problem . . . What Are The Choices?* by the National Committee on Agricultural Policy, a committee of agricultural economists representing the cooperative extension services of the state land-grant colleges and universities and the United States Department of Agriculture.

Opinions expressed in the summary do not necessarily reflect the opinions of the Federal Reserve Bank of St. Louis or of the Board of Governors of the Federal Reserve System.

The series of studies covers various proposals for solving the income problem of farmers. They were designed to provide a background against which society can make sound decisions in arriving at public policy for agriculture.

The studies were sponsored by the Farm Foundation, a nonprofit farm research organization, located at 600 South Michigan Avenue, Chicago 5, Illinois, and The Center for Agricultural and Economic Adjustment, Iowa State University, Ames, Iowa.

The names of the participating agricultural economists and the titles of their studies are listed below in the order in which the summaries are presented.

- Wallace Barr, Ohio State University, *The Farm Problem Identified.*
- George S. Abshier, Oklahoma State University, *Expansion of Domestic Demand?*
- Luther Pickrel, University of Minnesota, *Expansion of Foreign Demand?*
- Mervin G. Smith, Ohio State University, *New Uses for Farm Products?*
- Arthur Mauch, Michigan State University, *Marketing Quotas?*
- W. L. Turner and Fred Mangum, North Carolina State College, *Compulsory Cropland Adjustment?*
- J. Carroll Bottum, Purdue University, *Voluntary Land Retirement?*
- Eber Eldridge, Iowa State University, *Restricting Capital and Technology?*
- Riley S. Dougan, Ohio State University, *Fewer Farmers?*
- Geoffrey Shepherd, Iowa State University, *Price Supports and Storage?*
- Kenneth R. Farrell, University of California, *Direct Payments?*
- Robert P. Story, Cornell University, *Multiple Pricing?*
- T. E. Atkinson, University of Arkansas, *Free Prices?*

the market at prices which will return an "equitable income" to farmers.

The following steps would be required to make the marketing quota program effective:

1. Determine fair prices for farm products.
2. Determine a national marketing quota that would attain the desired prices.
3. Allocate quotas to individual producers.
4. Provide machinery to restrict marketings to the quota assigned.
5. Provide a means to transfer quotas from one producer to another.
6. Provide programs to maintain adequate exports and avoid excessive imports.
7. Assure adequate storage programs to allow sufficient carryover of supplies.

It is assumed that Congress would set a "fair" price level and that the United States Department of Agriculture would set sales quotas which would bring the target prices. Farmers would receive quotas for each commodity initially on a basis of their historical record of production. Quotas would be represented by marketing certificates. Certificates would be transferable from one farmer to another so that individual farmers could expand or reduce farm business, and production could move to areas of greatest efficiency. Steps would be needed to prevent foreign producers from frustrating the aims of the program by taking advantage of the higher United States prices. Also, a Government storage program would be needed to protect consumers in years of small crops and producers in years of bumper crops.

The program would probably result in an increase in net income to farmers. Quotas could be set in such a way that farm commodity prices would rise enough to more than offset any decline in physical volume of sales.

The program would result in a reduction in real national income. A smaller farm output without a compensatory increase in output of nonfarm goods would result in a reduced total output.

Consumers would have to spend more of their incomes on farm products. The price effect of reduced output would be relatively less at retail than on the farm, as on the average, the farmer's share of the consumer's food dollar is only about 40 cents. Nevertheless, because a smaller quantity of farm products would be offered, retail prices would be higher.

Continued Government subsidization of exports of cotton and wheat would probably be necessary. Exports of these crops are vital since domestic consumption for each accounts for only about one-half the nation's output.

A quota program would probably further antagonize our friends and allies who also export farm commodities. Higher domestic prices would necessitate increased tariffs

and reduced import quotas. This would be a reversal of our declared policy of reducing trade barriers and might bring on international repercussions.

A marketing quota program would probably reduce the cost to the Government of production adjustments. However, costs of export subsidies, stabilization, and policing the program would partially offset some of the savings. Furthermore, the major part of the program costs would be borne directly by consumers through higher costs for farm products.

Once a marketing quota program was undertaken it probably would be necessary to continue it almost indefinitely in one form or another. Producers would receive a "windfall" when the certificates were granted. Termination of the program would, in turn, impose severe capital losses on certificate holders unless demand for farm products outran the ability to produce them.

Compulsory Cropland Adjustment?

The proposed cropland adjustment program was designed to limit the supply of farm products to effective market demand at a price "acceptable" to both producers and consumers. Such a program would limit the amount of land which could be used for farm production purposes. It is assumed that other inputs such as labor, fertilizer, and capital would be applied without restrictions as new technology becomes available and relative prices make such application profitable.

The program would involve the following provisions: (1) annual conversion of a national marketing quota into a national acreage allotment for each allotted crop, (2) allocation of national marketing quotas into individual farm acreage allotments, (3) establishment of a feed grain quota and feed grain acreage allotment, and (4) establishment of acreage allotments for all previously non-allotted crops.

As envisaged, complete cross compliance of all farm allotments would be necessary for the plan to work. High penalties for noncompliance would be required. Production rights would become transferable, permitting long-run interfarm and interregional shifts in production in line with comparative advantage.

Price supports, if needed at all, would be used only for minimum protection, as production would be geared to clear the market at some predetermined price level.

Farm income could be expected to rise above current levels and the total would be distributed among fewer producers as producers with small allotments or less productive land found more remunerative employment in non-farm occupations. Some of the added returns could be expected over a period of time to become a part of the value of land, resulting in a windfall gain to present land owners.

Government outlays for agriculture under this program would be less than under the current program of sliding scale price supports and acreage restrictions for some

crops. Administrative costs would rise, but storage cost would decline substantially after present stocks are depleted.

Cost of food to the consumer would increase. Prices of agricultural products at the farm level would be expected to increase as production is restricted. The increase would be passed on to the consumer. Consumer prices, however, would not rise in the same ratio as farm prices since marketing and processing costs would not be expected to change substantially.

The transferability of production rights should provide some needed flexibility in the organization and operation of individual farms. Such transferability would encourage underemployed labor to shift from farm to nonfarm occupations.

Voluntary Land Retirement²

The proposed voluntary land retirement program would involve voluntary agreements between landowners and the Government whereby approximately 60 million acres of plowland (13 per cent of all plowland) would be shifted out of production.² Any of the following three approaches could be used in attaining the objective: (1) a uniform proportion of cultivated land on each farm could be retired, (2) the less productive cultivated land in each state could be retired, or (3) the less productive cultivated land in the United States could be retired.

A program of retiring less productive land in each state offers some advantages. Under this plan, emphasis can be given to retiring whole farms. This would reduce the cost of the program compared to costs under plan one. A given amount of land can be retired for less on a whole farm basis than on a partial farm basis. Also, from the standpoint of the nation, this plan has an advantage in that it would mean the complete removal of a large number of farm families from agriculture. Compared to plan number three it would give funds to each state in the same proportion that the state's agricultural production is to that of the nation.

It is estimated that a program for voluntarily retiring 60 million acres of the less productive land under plan number two (land retirement funds apportioned to each state) would cost the United States Government about \$1.25 billion annually. This assumes payments averaging \$18 per acre would be required to induce farmers to release the 60 million acres. Funds for establishing cover crops constitute the remaining costs.

A voluntary land retirement program would eventually cost less than the present program. Storage cost would be reduced substantially after a period of years.

In addition to requiring tax dollars the program would cause an increase in food prices. The program is not

² Of the 1,904 million acres of land in the United States, about 450 million acres are in plowland, approximately 965 million acres are in permanent hay and pasture, and the remaining 489 million acres are in forest and other nonfarm uses.

designed to raise prices substantially because monetary gains beyond long-run equilibrium levels tend to be capitalized in land values or decrease the outflow of labor from agriculture. Either of these would tend to offset the objectives of the program.

This program would permit free prices in the market place and free transfer of resources. Individuals not participating could strive for maximum production on their farms.

Once the program is established it would appear to have a permanent impact on acres used for cropland. Land put into grass, timber, or recreational uses may stay in these uses even if payments are eventually withdrawn. In some areas such land may be purchased by the Government for public use.

Restricting Capital and Technology²

Capital restriction would probably contribute more toward reducing output of farm commodities than the restriction of either land or labor. The productivity of capital is relatively higher than either of the other two resources. Capital not only has a higher relative return currently, it is likely to continue to have a higher relative return in the future.

Several means of restricting capital might be used. Included among those are: (1) taxing physical inputs such as fertilizer, farm chemicals, and farm implements, (2) restricting credit to farmers, perhaps by increasing interest rates and abolishing all credit programs designed to give low equity, low interest rate loans to farmers, and (3) reducing public investment in farm technological research and education.

What is possible, however, is not always practicable, and the restriction of capital or the restriction of the use of capital through the failure to apply known technology has its drawbacks in terms of values held by our society. Such a program takes the form of restricting research and education as a means of controlling output. It involves slowing down future increases in output rather than just reducing present output. An increase in net farm income could be achieved, but at the cost of a decline in general economic efficiency and growth.

Fewer Farmers²

With the numerous new production techniques there are more commercial farmers in the nation than are needed to produce the amount of farm commodities that we are now producing. This larger-than-ample number of farmers is a result of a number of factors, including (1) high birth rate on farms, (2) increase in optimum size of individual farms, (3) lack of knowledge of nonfarm opportunities by many farmers, (4) nonmonetary benefits of country living, (5) strong community ties in rural areas, and (6) lack of training for available job openings.

A program designed to reduce the number of farmers might take one or more of the following approaches. (1)

Provide monetary assistance in grants or loans to farmers who are willing to change occupation. (2) Provide farmers with employment agency services and counsel. (3) Provide comprehensive training and rehabilitation services. (4) Provide training opportunities for farm youth to prepare them for nonfarm jobs.

The program would be directed at those farmers who are not approaching retirement age, yet can show evidence that they are established farm operators. Greatest emphasis should be given to the program during periods of nearly full employment.

This proposal might not raise prices and aggregate net income to agriculture. Actually, prices and net income to agriculture might decline further, but individual farmers would have opportunities for increasing their income through increases in farm size. An illustration of how the program would work assumes that the number of commercial farms would be reduced from the present 2.5 million to 1.5 million in the five-year period beginning in 1959. Should total net income to commercial farmers drop to \$8.8 billion it would mean an average of \$5,867 net income per commercial farmer in 1964, or substantially more than the average net income per commercial farmer in recent years.

The cost of a program designed to reduce the number of commercial farmers to 1.5 million over a five-year period is assumed to be approximately \$1.25 billion per year. It is assumed that 1.25 million commercial farmers must be moved out of agriculture in order to get a net reduction of one million. For purposes of the analysis an average cost of \$5,000 is estimated per family assisted. Included in costs per family are cash payments totaling \$3,000 over a 3-year period and services averaging \$2,000 per family. Some followup might be necessary to prevent excessive movement back to farming after the contract period had ended.

Consumer costs would probably not be changed greatly by the program. Prices of farm commodities might even decline with the more efficient use expected of productive resources.

Society could be expected to gain from increased earnings of those leaving agriculture. Increased taxes would accrue from their increased earnings. Their labor would be more fully employed producing nonfarm goods for society rather than farm commodities which are already in surplus.

Price Supports and Storage?

The price support and commodity loan and storage programs have become more and more expensive and less and less effective in supporting prices in recent years.

The program costs have risen to a high level in recent years. The 1958 realized cost of programs designed primarily for farm price stabilization was \$2.66 billion. Only part of the expenditure went directly to farmers, the rest went to other groups such as storage agencies and con-

struction companies. For example, the realized cost of the corn program in 1958 was \$271 million, of which \$110 million went to nonfarmer groups.

Price support and storage programs are inefficient as price-raising devices in agriculture. They give only temporary relief and in fact actually tend to impede rather than to promote adjustments needed in the industry.

Agriculture is beset with two major problems: (1) over-production, and (2) a continuous over-supply of farmers.

Over-production of farm products relative to demand has been caused by a rapid increase in output due to technological advance without the necessary adjustments in resources. Acreage of crops harvested has remained practically constant since 1920. Average yields for feed grains, for example, have risen more than 70 per cent since 1937-41. This condition has been made worse by the high price supports. They have induced still greater production while at the same time reducing consumption.

The over-supply of farmers results from the high birth rate on farms and the decline in number of farms as farms get larger. The farming area of the United States has remained almost constant at 350 million acres since 1910, and farming practices require less and less labor. Mechanization has substantially increased the optimum size of farms.

Storage and price support programs obviously cannot handle problems of over-production of farm products, and over-supply of farmers. They are workable for smoothing out price variations caused by short-run production variations. Price supports set at long-run market price levels would do the smoothing job. Support prices set above long-run market prices can be maintained only if effective methods of reducing production, increasing consumption, or some of both, can be supplied.

Direct Payments?

Growers would sell their products commercially at free market prices. If the average market price for a product in an area were less than the target price under the program, growers would receive a payment from the government equal to the difference between area market price and target price for each unit sold.

The entire volume of each supported commodity would be free to move to its highest priced use. Storage would be left to the private sectors of the economy.

Money costs of the program to the Treasury would depend upon the number of commodities included in the program, the level of the intended prices, the amount produced, and the market price. Estimates of such costs vary from \$2 billion to \$8 billion or more per year. Most estimates fall in the range of \$2 billion to \$3 billion.

Treasury payments to farmers under the direct payment program would probably exceed expenditures under the current storage and loan program assuming the same level of farm production and income. Costs of farm commodi-

ties to consumers, however, would be less. A larger volume of commodities would be offered at lower prices.

Under the direct payment program, total money costs to consumers, in their dual role as buyers of farm commodities and taxpayers, would be about equal to those of the storage and loan program. The larger proportion of grower receipts coming from the Government under the direct payment plan, however, would make a difference in how the costs were divided among the various income classes.

Direct payment programs, like most other plans to raise farm income, would impede the movement of land, labor, and capital resources to other activities where they can contribute the most to economic growth. Thus, they would not solve the problem of chronic over-supply of resources in agriculture. However, direct payments might impede efficient resource use less than some other farm program proposals. Given the level of price supports, resources would be free to move to their most profitable uses.

In summary, direct payments which raise farm incomes received above long-run free market levels do not offer a real solution to the problem of imbalance between supply and demand for agricultural resources. Neither will they offer a solution to the low income problem of inefficiently organized farms. Used in conjunction with appropriate adjustment programs, however, they may be a feasible method of support while basic resource adjustments are being made.

Multiple Pricing?

Multiple pricing means the setting of two or more prices on the same commodity with the objective of increasing or stabilizing returns to farmers.

To achieve this objective the market for a product is divided into segments which are determined on the basis of sales response to price changes. The market in which sales respond least to price changes is called the primary market whereas the market in which sales response is greatest is called the secondary market. The primary and secondary fluid milk markets illustrate the market division proposed.

A price would be administratively set for a commodity in the primary market and all supplies that buyers will take would flow to this market at the established price. The remaining supplies will move to the secondary market at whatever price this market will return. Prices in the secondary market may also be set, but they must be low enough to insure movement of the remaining supplies.

Prices may be established through the supply allocation route. Limiting supplies to the primary market automatically results in different prices in the two markets. The proportion of the individual farmer's sales going to the primary market would be determined by either historical bases or a direct proportion of sales.

Returns to farmers can be effectively stabilized or increased under the multiple pricing plan. However, possibilities for increasing returns are greater for the short run than the long run. Over the longer run, higher prices may encourage consumers to substitute other products for the farm products being supported.

Consumers pay the cost of increased farm returns from multiple price programs. Higher prices will be paid for products sold in the primary market. Some benefits will accrue to consumers, however, from lower secondary market prices.

Higher domestic primary market prices will require import quotas or tariffs to restrict imports. These may result in retaliation by foreign countries. Also, a program using export outlets as secondary markets will result in lower prices to farmers in importing countries as well as to farmers in competing exporting countries. Thus, multiple pricing tends both to create barriers to international trade and to aggravate international tensions.

Multiple price programs would tend to fix patterns of resource use and thereby retard the growth rate of the whole economy. The tendency of such programs to lower output per man and per farm would contribute to a lower rate of productivity for the nation. However, it would be possible to reduce the retarding effects of the program to some extent by making the historical production bases fully transferable. With transferable bases production would probably shift to areas better adapted to produce the particular commodity and some farmers would shift to nonfarm occupations.

The cost to the Government for supporting farm incomes could be reduced from current levels under the program but this cost would shift to consumers in the form of higher food prices.

All multiple price programs would limit the flow of commercial trade between nations and aggravate international relations.

Free Prices?

The possibility of returning agriculture to a free price system continues to receive attention. It is assumed that such a system would mean the end of production controls and that all products offered for sale would be purchased. Major export commodities would be sold on a competitive basis without the use of subsidies.

Basic objectives of such a program would be to free agriculture from production and price controls, to reduce government costs of price support activities and to permit consumers to express their preferences for goods and services in the market place more effectively. Free prices would also lead to a more efficient adjustment of the nation's productive resources. Such adjustments would increase output efficiency throughout the economy.

A return to free prices would require some government activity during the transition period. An orderly system

of getting loose from present programs and the storage holdings resulting from them would be desirable to lessen the impact of the return on world markets and allow time for international adjustments. Also, domestic programs to implement full employment and provide wage incentives to permit younger operators to move into nonfarm occupations would be needed.

The immediate effect of free prices would be to intensify the cost-price squeeze in agriculture. Net farm income would decline. In the short run the decline would depend upon the amount of production adjustment that occurred from the changed prices. It would require several years after farm prices declined for farm inputs and production to go down. New technology, however, that is not related to price, such as improved breeding, would eventually tend to increase production irrespective of price levels.

It is estimated that free prices in the absence of production controls would result in a decline of at least 25 per cent in realized net farm income over the next few years

from the 1954-58 average. In addition farm income would be less stable. The gap between low income and high income producers would widen. Some small producers would be pushed into the noncommercial farm class. This would create social problems. Eventually, however, the farm labor force would probably decline enough to bring per capita farm and nonfarm incomes closer together for comparable skills and abilities.

Under a free price system, farm products would be competitively priced in the world market. More United States commodities would be available for foreign use, and exports of many, including cotton, wheat, soybeans, and feed grains, would be expected to increase. Consumers would gain in the short run both from cheaper food and fiber and from reduced Government expenditures. Over the longer run, with the adjustment of production to demand, consumers might pay more for farm products, but they would more quickly benefit from future discovery and use of agricultural technology.

Recovery Forces In The Economy—Continued from page 5

increased demand for liquidity from both the banking and nonbank sectors of the economy tends to bid up the prices (yields fall) of liquidity instruments, such as Treasury bills and commercial paper.

Residential Construction

In past recessions expenditures on construction, especially residential construction, have tended to move in a contracyclical manner. In prosperous periods long-term interest rates and construction costs tend to rise. At some point, usually in advance of the general downturn, expenditures on residential construction have begun to fall off. During a recession long-term interest rates, including mortgage rates, usually decline and terms on mortgages become substantially

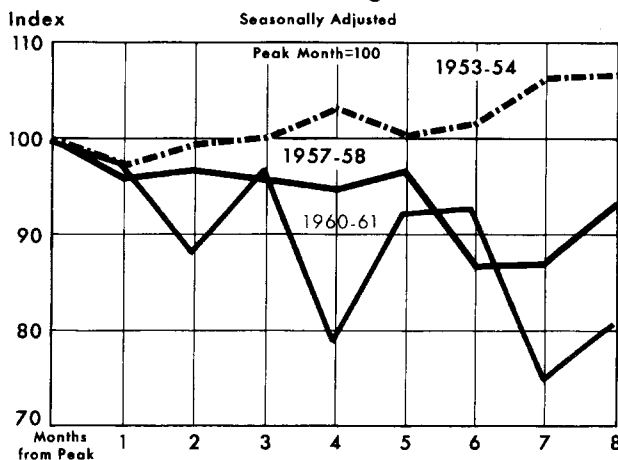
easier, especially those guaranteed or insured by the Government. Considerably more favorable terms for purchasing a home can usually be arranged during a recession. Thus, the behavior of interest rates, and perhaps building costs, tends to make housing sales and building fluctuate contracyclically. In the two previous recessions, for example, housing starts (non-farm) expanded before each upturn in general business activity. In January there was an increase in housing starts, but it is too early to say whether the January change marks the beginning of an upturn (see Chart 5).

Summary

The decline from the recent peak in business activity has been milder thus far, according to many indications, than the declines during a like number of months in the two previous recessions. Nevertheless, it appears that the current recession may be as severe as the two preceding ones when compared with full utilization of the country's resources, since this recession started with economic activity at a lower level relative to capacity.

Numerous forces are operating to bring about a recovery. Government expenditures, both discretionary and automatic, have expanded somewhat and are expected by many analysts to increase even more. At the same time certain government receipts are declining. In addition, the nation's economy is being bolstered by many individual actions of businesses and consumers. How effective the automatic stabilizers may be is a major consideration in determining monetary and fiscal policy.

Chart 5
Nonfarm Housing Starts



Source: United States Department of Commerce