Physiocracy: A viewpoint of the role of agricultural production in a macroeconomic system

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Physiocracy:
A Viewpoint of the
Role of Agricultural Production
in a Macroeconomic System

by
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Physiocracy: A Viewpoint of the Role of Agricultural Production in a Macroeconomic System

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This is a study of the economic philosophy of physiocracy from its discovery in France in the 1700s to the present. The contributions of several 18th and 19th century economists influenced what could be called 20th century physiocracy. Further research in the area of physiocracy was done by an accountant named Carl Wilken in the 1930s. Premises of 20th century physiocracy were incorporated into agriculture policy in the United States in the 1940s. This policy was called parity economics. Examination of agriculture policy in the United States from World War I to the present provides the context for examining parity and non-parity policies that have developed in attempts to achieve adequate food supplies at fair prices for both consumers and producers.

Parity programs provide the mechanism for 100 percent parity, based upon the ratio of prices that producers receive for their products, to prices that they pay for their inputs, using either the base years 1910-1914 or 1946-1950. These base years have historically been chosen because of the economic prosperity that the United States experienced in those time frames. Parity was generally achieved from 1910 to 1919 and also from 1942 to 1953, with the latest period being achieved with specific legislation designed to accomplish parity. A cheap food program, which in more recent years has been referred to as an export program, has been the policy used in those years when 100 percent parity was not the goal. This is the basic program in existence today, which is up for renewal or change in 1995.

This study further examines the differences between these two basic models based upon an econometric model developed by the Food and Agricultural Policy Research Institute (FAPRI). The model reveals dramatic differences in producer incomes and government costs, as well as minor differences in consumer costs. The author uses Wilken's hypothesis to expand the FAPRI model with an analysis of national earned income that results from each program. The consequences that less than adequate national earned income has on private and public debt accumulation is also examined, again according to Wilken's hypothesis.
Economic Reports of the President of the United States and Economic Indicators compiled by the U.S. Government are the main sources for the empirical data used.

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Acknowledgements

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Physiocracy:  
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Chapter 1  
Early History of Physiocracy

This is an examination of a paradigm that was first expressed by Francois Quesnay, a physician in the court of Louis XV and personal doctor to Mme. Pompadour.\(^1\) Inspired by William Harvey's discovery that blood circulates in the human body, Quesnay hypothesized that wealth originated with production from the land and then flowed from hand to hand with trade transactions providing income for the nation.\(^2\) A belief that agriculture is the first and primary step to survival has philosophical roots dating back to the domestication of plants and animals. There was no need to question this basic premise or even expand upon it until the market system had essentially replaced traditional and authoritative systems of organization. The emergence of national political units and the growth of national loyalties and spirit, in combination with increased


participation in the market system, raised the question of how a nation becomes wealthy.

Mercantilism dominated eighteenth century economic thought with the basic premise that accumulation of gold and silver through any means necessary was the route to national wealth. English, Spanish and Portuguese adventurers sailed to unknown lands seeking great riches for themselves and their countries. Exploitation of the accumulated riches of societies in the New World was equivalent to winning a national lottery. The prevailing sentiment in Europe at this time was that a nation could become wealthy in gold and silver with government involvement in economic activity, especially in international trade.

International trade was manipulated to provide cheap raw material imports and to cause imported manufactured goods to be more expensive. Exports in finished manufactured goods were encouraged while population growth which kept wages low was deemed beneficial. Thomas Mun discovered the Achilles heel in this policy as early as 1630, with the revelation that an increase in gold and silver causes domestic prices to increase which eventually turns the balance of trade against the nation acquiring the bullion. John Locke reiterated this argument in the 1690s, writing that prices vary in definite proportion to the
quantity of money in circulation. Contrary to these arguments, economic activity in the 18th century was still viewed as a zero-sum game where one country's gain was another country's loss. Arguments that were advanced to solve the price dilemma and support the concept of mercantilism included John Law's *Money and Trade Considered* (1705). Law's writing indicated that a highly elastic commodity supply curve would allow for an increase in prices to be accompanied by a large increase in goods offered. Labor that was previously idle would be employed to produce this increased quantity of goods giving rise to new consumer demand. Increases in bullion or money would translate into increased quantities of goods supplied and demanded more readily than into increased prices. Cantillon's *Essay on the Nature of Commerce*, written in the 1720's but published in 1755, explores this mercantilist dilemma further. The nature of the injection of additional money determines the effect on the level of prices and the quantity demanded, according to Cantillon. The differential effect of this injection, sometimes referred to as the Cantillon Effect, was reproduced by Hume in his essay *On Money* (1752). An example that Cantillon gives us is that an increase in money due to an export surplus expands output and effects price increases much less than increased production in gold mines.

at home. Both instances increase demand but apparently in the first instance we are dealing with an elastic supply curve and in the second instance an inelastic supply curve. The dilemma is still not resolved if the supply curve is inelastic, but Cantillon stated,

the comparative power and wealth of states consists, other things being equal, in the greater or less abundance of money circulating in them... and that... every state which has more money in circulation than its neighbor has an advantage over them so long as it maintains this abundance of money.  

This statement still ignores the fact that a nation drained of bullion will have a fall in prices which will turn the balance of trade in their favor.

The mercantilist policies of Colbert during the reign of Louis XIV had left French agriculture in dire circumstances. The great majority of French peasants possessed very small pieces of land on which they had to pay seigneurial dues as well as a multitude of taxes. Cultivation of their land plus hiring out their labor provided only a wretched existence. Another group of peasants possessing larger acreages and some capital were able to live more comfortably on the cultivation of their property. These farmers, who were actually able to exercise entrepreneurial functions, were known as fermiers. Quesnay

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and the physiocrats believed that the removal of practices that exploited agriculture, such as the unfair tax system in France at the time, would allow the flow of capital to agriculture to increase and convert France from small-scale, capital-starved subsistence farming to a more prosperous fermier system.\(^6\)

The physiocrats rejected the mercantile system, also referred to as a system of commerce, in favor of a system of agriculture to increase a nation's wealth. They did not believe that exploitation through commerce was the desired path to national wealth. The physiocrats, which translated means "rule of nature," believed that natural law mandated the accumulation of wealth only through the harvest of agriculture products which nature provided. Exploitation of gold and silver from the New World provided only short term riches that eventually were exchanged for necessary production from the land. For example, Spain was the leader in exploiting New World riches but was unable to maintain its superior position when it exchanged gold and silver for production from outside the country. Gold and silver were not real wealth, but simply facilitated the exchange of real wealth that agriculture annually produced. Agriculture has the ability to yield a disposable surplus over necessary cost which Quesnay called net product.\(^7\) The productive

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\(^6\)Ibid, 25.

\(^7\)Ibid.
capacities of nature, where one planted seed may yield forty to one hundred seeds and livestock can reproduce, provide the mechanism for net product to occur. Economic activity rises and falls with increases and decreases of net product. The theoretical system of the physiocrats used the word "productive" only in the context of "productive of a net product." By contrast, manufacturing and trade were called nonproductive or sterile because they created no new net product but simply transformed it. Net product from production was the source of wealth and reduction of this production in monetary terms was like a loss of blood in the body’s circulatory system and cause for alarm. Quesnay was the first economist to describe economic activity as a circular flow where production and consumption are mutually interdependent variables that follow socially determined laws with the cycle being repetitive. Quesnay’s Tableau Economique, published in 1758, graphically showed the interdependence between three interlocking classes, the farmer, the landowner, and the so called sterile class of manufacturers and merchants. However, as Mark Blaug states in Economic Theory in Retrospect,

the conclusions of physiocratic theory are not deducible from the Tableau, on the contrary, they form the premises upon which the zigzag diagram of the stationary process is constructed.®

®Amacher, PRINCIPLES OF MACROECONOMICS, 48.
®Blaug, ECONOMIC THEORY IN RETROSPECT, 26.
The physiocrats major contribution to the developing economic system was the observation that the economy had a natural beginning with production of a net product from the land. A second observation was that the income received from this production flowed through the rest of the economy. The whole system operated naturally without government interference. This advocation of a policy of laissez-faire was distinctly different from the commonly held viewpoint that governments should manipulate trade to their advantage. Development of these premises elevated Quesnay to the rank of leading economic thinker in France at that time.

England also had a great economic thinker in Adam Smith. Smith had accepted employment as a tutor to Lord Townsend's step-son and in those days an adequate education demanded a trip to the continent. During his stay in Paris, Smith and Quesnay had ample opportunity for detailed discussions. Smith realized that the physiocratic system had imperfections, however he was able to state that it was "perhaps the nearest approximation to the truth that has yet been published upon the subject of Political Economy."

Physiocratic premises that he favored included laissez-faire, especially in regards to international trade, and production and distribution moving in a continuous circular fashion. Adam Smith had difficulty with the physiocratic belief that agriculture alone produced true wealth and that manufacturing and trade merely changed that
original production in a sterile way. There was no
disagreement that labor working in agriculture provided new
wealth by harvesting production from the earth, but Smith
believed that transformation and trade of the initial
production also increased the nation’s wealth. Smith
condemned Quesnay for attempting "to degrade the artificers,
manufacturers, and merchants by the humiliating appellation
of the barren or unproductive classes." However, Blaug
mentions that Smith misrepresents the notion of the sterile
class since "the physiocrats did not regard industry as
useless but simply as a sector that produces no net
additions to income." Blaug also points out that

in the end he (Smith) was forced to argue that
manufacturing is productive because its receipts
are sufficient to pay wages and to replace
worn-out capital, but that agriculture is more
productive because it yields rent over and above
wages and depreciation. But apart from a quibble
on words, this concedes the whole of the
physiocratic argument.\(^\text{10}\)

The failure of the physiocrats to adequately address
contributions made to national wealth by non-agricultural
sectors forced them to play a minor role in future economic
thinking. Even with their disagreements Adam Smith was so
impressed with Quesnay that he would have dedicated his
book, The Wealth of Nations, to him had Quesnay not died
prior to its completion 12 years later in 1776.\(^\text{11}\)

\(^{10}\)Ibid, 25.

\(^{11}\)Heilbroner, THE WORLDLY PHILOSOPHERS, 50.
England during Adam Smith's lifetime was building an empire based upon trade policies that exploited the production of other nations, providing cheap raw materials for her industries, consequently England felt that trade was the source of national wealth. Adam Smith, however believed that agriculture was a principle source of Britain's wealth and thus agriculturally related topics permeated The Wealth of Nations. In Book III, Chapter 1, "Of the Natural Progress of Opulence," Smith states

The cultivation and improvement of the country, therefore, which affords subsistence, must necessarily, be prior to the increase of the town, which furnishes only conveniency and luxury.\(^{12}\)

Smith agreed with the physiocrats that agriculture was a first and necessary step in the economy, and stated that the exploitation of agriculture, through the price mechanism, by manufacturing was harmful to the entire system. Harm could also result if agriculture was allowed to impose restraints upon other employments such as manufacturing and trade. In Book IV, Chapter IX, "Agricultural Systems," Smith indicates that a necessary balance is needed and will occur naturally when he states,

It is thus that every system which endeavours, either, by extraordinary encouragements, to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it; or, by extraordinary restraints, to force from a particular species of industry some share of the capital which would

\(^{12}\text{Adam Smith, THE WEALTH OF NATIONS (New York: Random House, Inc., 1937) 357.}\)
otherwise be employed in it; is in reality subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour.\textsuperscript{13}

Self interest and competition would automatically secure the proper balance between the various forms of employment through a system of self regulation which Smith called the "invisible hand." The physiocrats and Smith though disagreeing on the source of wealth did agree on a policy of laissez-faire. They both believed that in the natural course of events, unhindered by government the market would allow civilization to develop to the benefit of the common man. Later economists, especially David Ricardo and Thomas Malthus, did not share Smith's optimism that a natural balance would occur.

\textsuperscript{13}Ibid, 650-651.
Chapter 2

Failure of the Market to Self Regulate

England had adopted the enclosure system to a much greater extent than France and consequently large aristocratic estates formed England's agriculture base in the 19th century. The landowners were rich, powerful, and controlled the political process of government. David Ricardo, a stock broker, was concerned that profits earned by the landowners were not invested back into production, as the new industrialists tended to do, but instead were squandered by the rich landowners. The price paid for foodstuffs was extremely important to Ricardo since he believed that England's economic system favored the landowners. In 1815, Ricardo wrote, "The interest of the landlords is always opposed to the interest of every other class in the community."

The fact that income from production can be harmful if it is too great contradicts the concept of early physiocracy. Also the idea that this increased income will not necessarily flow to areas where it is most productive contradicts Smith's self regulating markets.

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\(^{14}\)Blaug, ECONOMIC THEORY IN RETROSPECT, 25.

\(^{15}\)Heilbroner, THE WORLDLY PHILOSOPHERS, 82.
Later physiocratic arguments presented by Carl Wilken, an accountant in the United States during the 20th century, expanded upon Quesnay's and Smith's original observations. Wilken agreed with the physiocrats that real wealth was only created with production from the land and that the income generated from harvesting this new wealth circulates through the economy. Wilken also agreed with Adam Smith that division of labor increased a nation's wealth. However, contrary to Smith, Wilken recognized that the market could fail to self regulate as it did during the Great Depression. Wilken contended that this was due to a reduction in income to agriculture and other harvesters of raw materials, at the beginning of the economic cycle. He proposed that the proper balance must occur between income earned from production of raw materials at the beginning of the cycle and the income earned by all the other sectors, just as Adam Smith had proposed earlier, but Wilken did not believe that this would occur naturally. Consequently, agriculture prices that were too low in comparison to other sectors of the economy created problems during the 1930's and agriculture prices that were too high relative to other sectors, such as labor, created problems in England in the early 1800's.

Ricardo and Wilken both agreed that Adam Smith's assumption that markets would always self regulate to the benefit of the common man was incorrect. The proper balance between different sectors of the economy is necessary as Smith suggested but it was not automatic through natural processes. Ricardo and Wilken lived under two entirely different sets of economic circumstances. England, at the time of Ricardo, had a few wealthy landowners with tremendous political power to skew the terms of trade within the country in their favor. The infamous corn laws that the landowners had legislated allowed wheat prices to reach a peak in 1813 of approximately 14 shillings per bushel, which was equal to nearly twice a workman's weekly wage. By comparison, the price of American wheat reached a peak in 1920 of $3.50 per bushel when weekly wages averaged $26.00.\footnote{Heilbroner, THE WORLDLY PHILOSOPHERS, 80-81.} Prices for agriculture products in the United States had dropped so dramatically by the 1930's that farmers were dumping milk down drains, destroying livestock, and burning corn for fuel. In both instances the market had failed to self regulate and the balance was distorted, first with agriculture prices that were too high in Ricardo's time and then with agriculture prices that were too low in Wilken's time.
Ricardo would have been surprised that the scenario of the Great Depression could take place due to low agriculture prices. One of the few areas that he and his good friend Thomas Malthus agreed upon was that population has the potential to increase geometrically while food production potentially increases only arithmetically, causing a problem with population growth. As the population expands, increasing acres of marginal cropland are brought into production. Grain prices rise with the increased demand and the increased costs on the marginal land. This allows the well situated landowner on the good land, that was purchased when the demand for land was less, to reap extra profit. In addition, the laborer must be paid more if he is to afford bread to survive. Ricardo then concluded that the capitalist, whom he believed was responsible for the progress of society, lost because he had to pay higher wages and the landowner gained due to increased grain prices, and this would always be the case as long as the population continued to increase.18

Even though Malthus strongly believed in the problems of population increases, he still questioned Ricardo's conclusions in regards to the landowners. Malthus worried about a general glut due to a flood of commodities without

18Ibid, 96-98.
buyers. Ricardo thought that was logically impossible. A young Frenchman named Jean-Baptiste Say agreed with Ricardo's logic that a general glut was impossible adding that the ability to purchase was guaranteed. Purchasing ability is guaranteed because the costs accrued in production are income to someone else. A general glut could not occur since production also created income to buy the production. This premise that supply creates its own demand became known as Say's Law. Malthus responded that savings might diminish the amount of income spent causing excess production. Ricardo thought that this notion was extremely foolish because the only reason a capitalist would save profits is to reinvest them into more labor and equipment to make even larger profits which would insure that a general glut would not occur.

The United States during the 1930's was experiencing a general glut according to Wilken and many other observers. People were going hungry and needed government sponsored soup kitchens to survive. There were adequate supplies of food available but large numbers of people had very little or no income to purchase the food even though agriculture prices were extremely low. Malthus was correct, a lack of income could cause a general glut. Wilken and his

19 Ibid, 100-101.
20 Ibid.
21 Walters, UNFORGIVEN, 270.
followers argued that this lack of income came about due to cheap imports following WWI which effectively reduced agriculture prices and incomes in relation to other prices. When that diminished income flowed through the economy the nation’s income was also diminished and a general glut occurred. Cheap food imports occurred because contrary to Ricardo’s time, non-agriculture interests had gained the advantage politically in America. Industrialists were becoming much larger and fewer, labor was in the process of organizing, but agriculture was still composed of many small independent units. Agriculture approached Adam Smith’s ideal situation of perfect competition and consequently was open to exploitation by the other sectors of the economy that had established some power over the market.

Adam Smith believed in natural economic laws that would ultimately improve civilization through self interested behavior and perfect competition. Thomas Malthus believed in natural economic laws but said that population growth forecast a pessimistic future for civilization. David Ricardo, agreed with Smith and Malthus that economic laws ruled production and distribution of goods, but added the pessimistic notion that those laws maintained a system where labor received just enough to survive and the capitalist’s profits were eventually reduced to zero while the landowners became rich. The economics of Malthus and Ricardo painted a gloomy picture which became even gloomier with environmental
degradation and extremely poor working conditions that resulted from England's factory system in the 1800's. It was generally believed that the economic laws that these great economists had discovered were irrefutable and the masses were destined to a brutish existence. Hope was revitalized by an economist named John Stuart Mill.
Chapter 3  
Society Determines Distribution

The development of economics was thoroughly surveyed in Mill’s *Principles of Political Economy*. His insight was added to the text when he pointed out that economic law governs production but not distribution. Mills stated that,

The things once there, mankind, individually or collectively, can do with them as they please. They can place them at the disposal of whomsoever they please, and on whatever terms.... Even what a person has produced by his individual toil, unaided by anyone, he cannot keep, unless by the permission of society. Not only can society take it from him, but individuals could and would take it from him, if society...did not...employ and pay people for the purpose of preventing him from being disturbed in (his) possession. The distribution of wealth, therefore, depends on the laws and customs of society. The rules by which it is determined are what the community make them, and are very different in different ages and countries, and might be still more different, if mankind so chose....

Once stated, the common sense of this proposition was so compelling that the followers of laissez-faire economics were dealt a serious blow. Natural laws govern physical production from the earth but how that new wealth was transformed and distributed depended upon man. Collectively mankind could design an economic system that would benefit the masses rather than exploit them. Mills had provided the philosophical framework for governmental activism in the economic arena that would eventually lead America out of the

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Great Depression. Conservative economists as well as the radical Karl Marx refined Mill's discovery by adding that separation between production and distribution is not always so clear-cut. The distribution system that society designs also can determine how natural production at the beginning of the economic cycle is valued or priced. Followers of Carl Wilken maintain that it is this compensation that flows through the system providing the income to purchase the production as it is transformed and traded, just as Say perceived. However, society can inflate this initial price as it did in Ricardo's time or society may restrict this price as it did in Wilken's time. Wilken was a contemporary of John Maynard Keynes and shared some similar views. In his discussion on John Maynard Keynes, Robert Heilbroner states in *The Worldly Philosophers*,

> When most of us individually (and therefore all of us collectively) enjoy high incomes, the nation is well off; when our total individual (or national) income drops, we are in depression. But income--national income--is not a static concept. Indeed the central characteristic of an economy is the flow of incomes from hand to hand.\(^\text{23}\)

A depression occurs if this income is diminished because a substantial number of businesses decline to use savings to invest in new production, according to Keynes. Businessmen that perceive the future outlook to be poor, for any number of reasons, will postpone investment decisions, and a downward spiral begins. As income contracts further,\(^\text{23}\)

\(^{23}\)Ibid, 266.
savings contract as well and are eventually used to replace lost income. In 1929 the American public saved $3.7 billion of its income; but by 1932 and 1933 Americans were saving nothing and drawing down their previous savings. Investment was desperately needed but investment requires available savings at low interest rates. The solution according to Keynes was for government to increase government spending, even though that required government deficits. Government spending need only be increased on a temporary basis to move the United States out of the depression, but the funding needed to be substantial. Roosevelt had increased government spending by 1934, two years before Keynes published his solution in *The General Theory of Employment, Interest and Money*, but it wasn't until America's entrance into WWII that these funds became substantial.

The physiocratic concept that a nation's income circulates through the economy through trade transactions is in agreement with Keynes. New physiocrats such as Carl Wilken believed that the income that individuals were exchanging diminished when agriculture prices were reduced in relation to other prices. Keynes believed that the income that individuals were exchanging diminished when businesses failed to invest the nation's savings. Perhaps,

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24Ibid, 272.

these are two sides of the same coin. The physiocrats believe that a reduction in income at the beginning of the cycle reduces the nation’s income which reduces saving which in turn reduces investment which then reduces income. Keynes did not discuss the origination of the initial income as the physiocrats had, but instead started with a reduction in savings, then proceeded just as the physiocrats did, with reduced investment, reduced income, and further reduction in savings. Perhaps, a balance between savings and investment to maintain national income is another way of looking at a balance between different sectors of the economy to maintain national income. The key is that society must use its power to maintain a balance within the economic cycle and not allow diminished individual income to start a downward spiral.

The Great Depression of the 1930s provided staggering evidence of the failure of the economic system to be self regulating for the benefit of society, as Adam Smith believed. If society determines the distribution system as Mill suggested then society had caused the problem and society could correct it. Carl Wilken began a through analysis of Economic Reports of the President of the United States to determine how a nation with such vast resources and an educated, industrious work force could find itself in such dire straits. He determined that a proper balance between the price for production from nature in relation to
the other prices in the distribution system is necessary to achieve the greatest benefit for the common man. The determination of this reasonable price involves the producer as well as the consumer. Wilken found that approaching the determination of this price from the producers' viewpoint to be the most revealing.
Chapter 4
Producer Income

The producer needs to cover his production expenses plus a reasonable profit to compensate him for his managerial inputs and his risk taking. This provides adequate income to meet reasonable living expenses for the farm family. If a fair price is symbolically designated as one dollar per unit, then the following sequence takes place. When the producer earns this dollar he puts it back into the economy by purchasing those items his family needs and desires. The dollar may go to a retailer who uses it to pay a wholesaler, who pays a manufacturer, who in turn must pay labor. Labor then completes the cycle by returning a portion of his earnings to the producer by purchasing food. This example is greatly simplified but it illustrates two major principles, according to the physiocrats. The first principle is that there is indeed a beginning to the economic cycle. The earth provides the original source of wealth in the form of raw materials. Approximately seventy per cent of this new wealth comes from agriculture.\(^{26}\) Either barter or compensation for this new wealth is necessary for the economic cycle to begin. Without raw materials there are no products to consume or trade and no

\(^{26}\)Walters, UNFORGIVEN, 157.
resources for labor to transform into more useful products. The price paid for these materials at this critical first step becomes the income that circulates through the economy. As the original dollar is exchanged its effect is multiplied.
Chapter 5
Consumer Income

The first premise of physiocracy is that nature provides the original wealth. The second premise deals with the turn-over effect of the original dollar paid to the producer of the raw materials according to Wilken and his followers, the new physiocrats. When Carl Wilken analyzed Economic Reports of the President of the United States he determined that the ratio of total national earned income when compared to gross returns to producers of raw materials is approximately 5 to 1 in the United States, based upon government data from 1910 to 1967. Thus, according to Wilken, if the producer in the United States receives a fair price of one dollar then the economy has approximately five dollars to spend due to the turn-over affect. An examination of what occurs when agriculture is exploited and a fair price is not paid to the producer helps tremendously in determining the correct price.

The agriculture industry comes closer to meeting the requirements of perfect competition than any other industry in the United States. There are many agriculture producers that individually have no control over the market and they are producing raw materials that are generally standardized, which results in an industry of price takers. The individual farmer has no effect on the market price.
regardless of whether he sells his entire crop or not, because his production is only a very small percentage of total production. When the agriculture industry produces an adequate food supply, especially in corn and wheat which dominate acreage in the United States, the price drops dramatically. This is due to the inelasticity of the demand curve for food, or in other words, as long as an adequate supply is available then even significant decreases in price cause very little increased consumption. The new physiocrats believe that in the short run, individual farmers respond to the resulting low prices by attempting to produce even more product to come up with the same amount of total dollars needed to pay their fixed costs, production expenses, and earn a living for their family. This added production puts even more pressure on prices. The downward sloping supply curve that is implied by this short run scenario is rectified in the long run when the lower prices finally force the individual farmer to reduce supply by going out of business.

The competitive nature of agriculture production and this built-in incentive to increase production in the short run when prices are low leaves the productive American farmer at the mercy of the market. The United States Department of Agriculture reveals the relative position of agriculture in the market by comparing agriculture prices to non-agriculture prices with a parity index. This parity
percentage reflects the prices that farmers receive for their products as compared to prices they pay for goods that they purchase. The government’s calculations show a parity ratio very close to 50 percent in the 1990s. The followers of Wilken, which I shall call the new physiocrats, view this with alarm since the relative strength of agriculture is diminished by 50 percent compared to the index base year. The base year currently used is an average of the previous ten year period. The new physiocrats, also point out that at 50% parity, agriculture is not earning its symbolic dollar but instead is earning much closer to 50 cents. According to Wilken’s turn-over affect, the result is an economy earning five times 50 cents or $2.50 rather than $5.00. This leaves a deficit in earning power of $2.50. The new physiocrats, however have not addressed the possibility that increases in quantity produced per acre may generate enough additional revenue over and above the increased production costs to alleviate some or all of the price decrease. The problem is not as great as it first appears since non-agricultural enterprises are using similar technology to achieve comparable gains in productivity therefore causing little affect on the parity ratio. If the new physiocrats are correct and today’s farmer is underpaid, then according to Wilken there are only three options.

available. Measures taken to adequately pay the farmer is the favored option of the new physiocrats, failing this, then according to Wilken, the nation must either reduce its standard of living or go into debt.\(^{28}\)

If the option to reduce the standard of living towards the $2.50 level is pursued then a recession is encountered when earning power drops below the five dollar level and a depression would develop as the $2.50 level is approached. Since the depression of the 1930s, policy makers have been very reluctant to pursue this policy, especially beyond the recession stage. Wilken's remaining option is the substitution of debt to make up the loss in earned income due to low agriculture prices. This has been the favored option of the United States since the early 1950s. A general adaptation of Keynesian economics by a majority of economists has been used to justify this debt injection. However, rather than using debt injection as a short term stimulus as envisioned by John Maynard Keynes, it has now become a long term necessity. Both private debt and public debt have increased until the combined debt exceeded 10 trillion dollars in 1988.\(^{29}\)

\(^{28}\) Walters, UNFORGIVEN, 72.

There are major consequences to running an economy based upon debt injection rather than sufficient earning power. The most obvious difference is that borrowed money must eventually be paid back. To pay back the debt, sufficient earning power must eventually be realized through adequate pricing of agricultural products, according to Wilken. In the meantime, ownership of land, natural resources, and the means of production become increasing controlled by fewer and fewer individuals as the debt grows larger. Individual producers become managers and laborers rather than land owners. As long as those who owe the debt are relatively powerless to increase their earning power the trend of debt injection and its consequences will continue. Another major difference between earning power and debt is that interest continually accumulates on the debt. Over many years this has the effect of increasing the total debt well beyond original intentions magnifying the problems associated with debt.

Economic policy makers must also face the difficult problem of how much debt to inject if the producers of raw materials are continued to be underpaid. If too little debt is injected then we are back to the problem of recession and even depression if the restriction is great enough. If too
much debt is injected then we end up with too many dollars chasing too few goods which results in inflation.

The new physiocrats believe that fair prices to the producers of raw materials is of the utmost importance, not only to the producers, but to the economy as a whole. Fair producer prices insure that the monetary system functions properly and the economy earns its way to prosperity through production. They point out that past economic history reveals that the economy prospered when adequate prices were paid for raw materials. The two historical periods of 1910-14 and 1946-50 provided economic prosperity with fair prices paid for raw materials. This was especially true for agricultural production which accounts for the lion’s share of raw material production. Either one of these periods could be used as a base period to determine proper production prices since both will produce the same results.\(^\text{10}\) Using the latest period of 1946-50 as the base period, and then indexing raw material prices so that prices for items the farmer has to sell increase as rapidly as prices for those items which he must purchase, determines a fair current price for those resources. This procedure is the same as cost of living adjustments (COLAS) that millions of Americans depend upon to keep their wages, retirement benefits, and social security payments from declining in

\(^{10}\)Walters, UNFORGIVEN, 95-96.
purchasing power. Although these COLAS are privately negotiated, increases in social security benefits along similar lines occur through the government.

Given the importance of adequate pricing of raw materials to the economy, it would be in the interest of the United States to use a similar mechanism to determine a fair price for major agriculture products, such as wheat and feed grains, and then develop a program to establish this price, according to the new physiocrats. Such a program was drafted and proposed by the new physiocrats when they came together in St. Louis on September 10-13, 1986. The following groups comprised the steering committee for what was called the United Farmer and Rancher Congress:

- American Agriculture Movement
- Family Farm Organizing Resource Center
- Farmers Fair Credit Committee
- Federation of Southern Cooperatives
- Iowa Farm Unity Coalition
- National Catholic Rural Life Conference
- National Council of Churches
- National Farmers Union
- National Grange
- National Save the Family Farm Coalition
- North American Farm Alliance

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31 United Farmer Rancher Congress, Delegate Approved Resolutions (St. Louis, 1986).
Women Involved in Farm Economics

The American Farm Bureau which is often recognized as America's largest farm group was not a member of the steering committee, although many of their members were in attendance.

The new physiocrats believe in Quesnay's major premise that all new wealth is derived from nature but they have expanded upon this premise by incorporating Wilken's trade-turn into their basic philosophy. Thus, they believe that a nation's earned income is determined by both the income generated from nature as well as the number of times this income exchanges hands or turns over in the economy. Non-agricultural sectors such as manufacturing and distribution are not sterile but do contribute to a nation's income. However, the contribution that these sectors make to national income is determined by the value placed upon Quesnay's net product and Wilken's trade-turn. Many factors such as technology, specialization, productivity of labor, and the extent of transformation of the raw materials determine the trade-turn and consequently the contribution of sectors not involved in raw material production. The new physiocrats are in disagreement with laissez-faire policies recommended by both Quesnay and Smith. They argue that non-agricultural sectors of the economy have developed more power within the market through industrial concentration and labor unions, allowing agriculture to be exploited.
Laissez-faire allows this situation to continue and the new physiocrats believe that steps must be taken to provide the proper balance by insuring that agriculture receive its fair share. An investigation into historical agriculture programs helps provide the necessary information to examine proposed policies to achieve fair agriculture prices. Perhaps Socrates said it best when he stated, "no man qualifies as a statesman who is entirely ignorant of the problems of wheat."\(^{32}\)

\(^{32}\)Dan Morgan, MERCHANTS OF GRAIN (New York: Penquin Books, 1980) 27.
Economics is a very young discipline, where its more formal aspects date back less than 300 years. Economics that is involved in definitive agriculture policy is much younger yet, with agriculture policy established since the depression of the 1930s being the most instructive. During the depression of the 1930s, Carl Wilken analyzed the economy of the United States in an attempt to determine how a nation so rich in natural endowments and blessed with an educated and motivated workforce could end up in such dire circumstances. He found that the trade-turn for earned national income in relationship to gross income from raw materials was five to one for the 1910-14 time period and remained at five up to and during the depression. Wilken also determined that if earned national income is computed on the basis of farm income only, then the ratio is seven. This makes sense since farm income accounts for approximately seventy per cent of total raw material production and consequently, a larger ratio results when total income is compared to just farm income. This is easy to see mathematically as follows:

If GNP/GRM = 5/1 (where GRM = gross income from raw materials)

\[^{33}\]Walters, UNFORGIVEN, 30.
Then GNP/70% of GRM = 5/.7 = 7 = GNP/GAP
(where GAP = gross income from agricultural products)

Doing research with Economic Reports of the President of the United States, Carl Wilken determined that from 1929-33, gross farm income fell by $6.8 billion and that national income fell by $47.6 billion. Thus, seven dollars of national income was lost for every dollar decline in farm income. He further determined that from 1928 to 1953, the trade-turn for agriculture averaged 7.04. However, Wilken offered no proof that the one to five and one to seven relationships were causal relationships. These relationships could be more completely examined with input-output analysis. The concept of input-output analysis has a long history, in fact, "the circular flow and general equilibrium concepts and the emphasis on interindustry relations may be traced back to Francois Quesnay's TABLEAU ECONOMIQUE of 1758,...." The first empirical application of the input-output model in the Anglo-American world dates from 1936 when Leontief published an input-output system of the United States economy. "Repercussions of changes in the level of expenditures on total income can be estimated via the concept of the

34Ibid, 30-31.
36Ibid.
multiplier."\textsuperscript{37} However, aggregate multipliers such as the original Keynesian income multiplier and economic base multipliers fail to distinguish between the sectors in which the initial expenditure changes originate. "Input-output models, on the other hand, enable us to derive sets of multipliers the main feature of which is that they are disaggregated, recognizing that the total impact on income (output, employment) will vary according to which sector experiences the initial expenditure change."\textsuperscript{38} Carl Wilken testified at many Congressional Hearings and gradually some members of the Senate and House became aware of the tremendous impact that his ideas could impart if implemented. However, those forces that were benefiting from the accumulation of wealth into fewer hands were very reluctant to use their power to share the wealth. Adequate pressure to change did not come from the people because the vast majority of the people were uneducated in the field of economics. It took an event whose impact was so great it superseded all others to cause the entrenched power group to briefly share the wealth. That event was the entrance of the United States into World War II.

Those that had studied raw material economics believed that to produce the necessary goods to win a war required adequate prices for raw materials as well as adequate wages

\textsuperscript{37}Ibid, 31.

\textsuperscript{38}Ibid.
for labor. To do otherwise would result in a continuation of the depression and tremendous debts to pay for the war. The new physiocrats maintain that legislation that insured fair agricultural prices during and after World War II was one of the major reasons for post WWII prosperity in the United States. The debts that were incurred during first the depression and then the war, were reduced from 122.5 percent of GNP in 1945 to 38.6 percent of GNP by 1970. The United States also financed the Marshall Plan but still had enough earned income following the war to bring about this tremendous debt reduction as a percent of GNP. What brought prosperity according to the new physiocrats was a government mandate known as the Steagall Amendment which required that key agriculture commodities receive no less that 90% parity prices, ending two years after the President declared an end to hostilities. This legislation was acted on by Congressional banking committees rather than agriculture committees because banking committee members understood that the amendment would increase income for the entire nation. The path which lead to the adoption of the Steagall Amendment was extremely difficult even with the impending crisis of war.

39 Amacher, PRINCIPLES OF MACROECONOMICS, 272.
40 Walters, UNFORGIVEN, 254.
In 1938 the Agriculture Adjustment Act provided a loan rate of not less than 52% of parity on all agriculture commodities except corn which was slightly higher.\textsuperscript{41} The Department of Agriculture almost invariably fixed the loan rate at the minimum allowable. Many Senators and Representatives requested a loan rate nearer the maximum of 75\% of parity. Then on May 26, 1941 loan rates were set at 85\% of parity by an Act of Congress. In 1942, during the opening months of the United States' involvement in World War II, farm bloc law makers were working for a 110\% ceiling and a 90\% floor for grain prices. However, public sentiment and the national press were so opposed to a fair price for agriculture that they labeled such statesmen as John H. Bankhead of Alabama, Guy M. Gillette of Iowa, Elmer G. Thomas of Oklahoma, Richard B. Russell of Georgia, and Scott Lucas of Illinois as traitors to the war effort due to their support of parity legislation.\textsuperscript{42}

In July 1942, farm prices were only 54 percent above the 1910-14 period, whereas the average factory wage was 397.1 percent above the 1910-14 level.\textsuperscript{43} Still the farmer was represented as dreaming of great riches while men were dying in war, even though all he requested was a fair price. The new physiocrats proclaimed that the public did not

\textsuperscript{41}Ibid, 253.

\textsuperscript{42}Ibid.

\textsuperscript{43}Ibid, 256.
understand that fair farm prices were necessary for the consumer's prosperity, as well as the farmer's, and that it was essential for a successful war effort. They believed that it was a lack of fair farm prices that had caused the depression of the 1930s just prior to World War II. Farmers were destroying crops and livestock during the depression because of rock bottom prices. At the same time Americans were going hungry because they did not have the income to purchase food. Low farm prices could not generate adequate national income and the United States experienced hunger in the midst of plenty. Congressman Rankin of Mississippi stated that the Wagner Act and the Wages and Hour Act had raped the farmers because it provided the labor sector with minimum wages and time and a half for overtime while farmers continued to receive less than fair prices. The public understood the importance of labor having proper income, and thus purchasing power in the economy, but they did not understand that labor's income was dependent upon farm prices. With the proper balance between agriculture prices and wages for labor, as the United States had in 1910-14 and in 1946-50, the nation prospers. Remove that balance by attempting to pay other segments of the economy, such as labor, more than the nation earned through raw material production and the books didn't balance, according to Wilken, with results like the depression. During the debate
over the Steagall Amendment, Congressman Charles S. Dewey argued that it was all quite simple,

If farm prices advance over parity, the wage earners dollar will buy less, hence his real wages are lower. If, on the other hand wages increase too rapidly, parity gets 'out of kilter' as far as the farmer is concerned because manufactured articles increase in price to cover wage raises.44 Another argument which helped to bring about passage of the Steagall Amendment was the fear that the United States might lose its farm production when it was desperately needed for the war. Congressman H. Carl Anderson reinforced this fear by revealing that one weeks' issue of a newspaper in his district had 42 farm auction advertisements. Even if the lawmakers did not understand the economic impact of parity, they did understand that food and fiber production might lag without adequate prices.

President Roosevelt also contributed to the debate, but his messages were not always the most consistent. However, two quotes from the President did have an impact on final passage of the legislation. President Roosevelt stated that,

The farmer, instead of looking forward to a new collapse in farm prices at the end of the war, should be able to look forward with assurance to receiving a fair minimum price for one or two years after the war. Such a national policy could be established by legislation.45

44Ibid, 259.
President Roosevelt also understood what a fair price entailed because he said,

After all, parity is, by its very definition, a fair relationship between the prices of things farmers sell and the things they buy. Calculations of parity must include all the costs of production including the cost of labor.\textsuperscript{46}

Despite Roosevelt's quotations favoring parity he still threatened a veto, but the measure passed with only three dissenters in the Senate and 13 in the House, leaving no chance for a veto. The legislation required the Secretary of Agriculture to make loans at 90% parity through the Commodity Credit Corporation for a period of two years after the first of January "following the time when the President proclaims an end to hostilities." Prices at 90% parity on storable commodities at harvest time generally rose to 100% of parity through the market system later on in the year. Farm bloc law makers had wanted permanent parity but had won only a temporary victory that would end shortly after the war.

On May 18, 1947, Representative Charles B. Hoeven of Iowa introduced legislation for permanent parity. This legislation called for 90% of parity loans on the seven basic farm crops at that time, cotton, flax seed, wheat, rye, corn, oats and barley, with July 1, 1925 to July 30, 1929 as the base period. It also provided for a 35% permanent reserve to protect the livestock industry against

\textsuperscript{46}Ibid.
liquidation because of drought periods, and imposed a flexible tariff at parity on all farm products. Thus, the tariff would be zero when the world price equaled the domestic parity price level.

Exportable surpluses would be sold at world price levels; the difference between the parity price and world prices being assessed against the duties collected on imports of needed farm products.

according to Wilken. Supporters of this legislation argued that it would not weaken free enterprise but would strengthen it. They said that competition can be unethical and so severe that it destroys national income, reducing consumption. For instance, if farmers produce an adequate supply of grain and that grain is, to a large extent, available at harvest, then competition from sellers results in prices that are much too low. The legislation that Representative Hoeven introduced, with the support of all the Iowa representatives, was to act as a governor to control the excesses of our free enterprise system.

By June, House Agriculture Committee Chairman Hope stated that he wished to report out a bill that continued 90% price supports through loans, purchases and methods other than direct payments to farmers. The house approved the direction with only three representatives dissenting.

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48Ibid.
49Ibid, 328.
The Senate approved the Aiken Bill with its provision for 60 to 90 per cent of parity for agriculture. The bill also used a 10 year moving average to provide the base year, which at less than full parity would have the effect of continually lowering base year prices. If passed the Aiken bill would go into effect 18 months later on January 1, 1950. The conference committee that was appointed to work out a compromise between the House and Senate bills met three times in three days with no progress. Then Representative Reid F. Murray of Wisconsin resigned as a conferee and George W. Gillie was appointed. After the new appointment the conference committee met for a fourth time and the House Democratic members remained faithful to the House version but the Republican members went over to the Aiken Bill. Proponents of the Aiken Bill argued that since the bill would not take effect immediately, farmers would have parity for one more year and there would be plenty of time to amend it to bring it up to full parity later. In June of 1948, the conferees accepted the Aiken Bill from the Senate and the conference report was accepted by the House 147 to 70.\textsuperscript{50} The legislation, which was referred to as either the Aiken Bill or "sliding scale" because it would effectively start sliding parity from 90 percent to 60 percent, was signed by President Truman.

\textsuperscript{50}Ibid, 330.
In the fall of 1948, Harry S. Truman carried his "give'em hell" campaign into the countryside and in campaign speeches rejected anything less than full parity. On April 7, 1949 Secretary of Agriculture Charles E. Brannan appeared before a joint meeting of the Senate and House Agriculture Committees to tell lawmakers how the Truman promise could be kept through what came to be known as the Brannan Plan.\textsuperscript{51} Brannan proposed a support system based on direct subsidy payments in place of price supports on perishable commodities. Thus, the government would attempt to pay in cash what the market price failed to provide. Without tariffs the Brannan Plan would allow U.S. prices to move to world levels. However, world prices were too low to provide the necessary national income and purchasing power needed for U.S. solvency and prosperity, according to Wilken. To attempt to use taxpayers money to make up the difference was like robbing Peter to pay Paul and the results were likely to be quite inadequate and very inefficient. The plan promised cheap food to the consumer and prosperity to the farmer, but when additional taxes to the consumer and bureaucratic distribution of subsidies to the farmer are considered it would achieve neither. The money used by the consumer to pay the additional taxes could have been used for other consumer items and thus the national income that is generated by the Brannan Plan, even if the subsidies to

\textsuperscript{51} Ibid, 333-334.
the farmer fully make up the difference in price, is less than if a proper farm price is paid to begin with. Physiocrats believe that net income cannot be increased with low food prices because income diminishes when farm prices decline. The debate had moved from arguments on full parity versus less than full parity to a choice between the existing Aiken Bill due to take effect the following year and the Brannan Plan, neither of which offered fair farm prices.

By 1949 Congress was still having difficulty deciding whether to repeal or postpone the Aiken measure and replace it with the Brannan Plan. Finally, Democratic Senator Russell of Georgia and Republican Senator Milton Young of North Dakota used their influence to restore 90% price supports for one more year. With the arrival of the Korean War in 1950, this became the modus operandi and the full Aiken formula was not put into effect until 1954.
Chapter 8

Post World War I versus Post World War II

Both World War I and II provided the impetus for higher farm prices that provided sufficient national income for the economy to prosper. However, entirely different approaches with regards to farm policy were taken after each war with dramatically different results. During World War I, the Allies, namely England, France, Holland, and Italy, borrowed large sums of money to finance their efforts, with $15 billion being borrowed from the international bankers, especially J.P. Morgan and Company of America and the Rothschilds of England, and another $15 billion from the United States government.\(^5^2\) By 1919, with the completion of the war, the popular cry in the United States was that "Europe pay US what she owes US." The American taxpayer did not realize that the US that was to be repaid was the international bankers. Europe had destroyed its factories and consequently the only means they had of raising the money was through the production and sale of agricultural goods. Tariffs were lowered in the United States to provide a market for European agricultural goods even though we were supplying a sufficient amount with domestic production. From 1919 to 1929, we imported a total of more than $43

\(^5^2\)Ibid, 2.
billion in European goods.\textsuperscript{53} This effectively destroyed our agriculture sector and the national income that relied upon it. The United States government began to call the American farmers' crops that had been replaced with European imports a surplus. After studying the economic situation that the United States had allowed to develop President Coolidge informed the American public "I choose not to run." President Hoover took office in March 1929 and passed an executive order declaring a moratorium on the collection of war debts, since the international bankers had been paid back and the method used to repay them was harming the country much more than helping it. However, England, France, Holland and Italy had approximately $3.5 billion in credits, from their exports, in U.S. banks.\textsuperscript{54} When the $3.5 billion was withdrawn from the banks, the banks were unable to collect that large a sum from their borrowers quickly and consequently, they were forced to sell stocks and bonds that they owned. This helped to precipitate the great stock market crash in October 1929.\textsuperscript{55}

In May 1917, one month after the American declaration of war on Germany, United States wheat was selling for $3.17 per bushel. In 1920 the United States removed price

\textsuperscript{53}\textit{Ibid, 3.}
\textsuperscript{54}\textit{Ibid, 4.}
\textsuperscript{55}\textit{Tom Linder, Georgia Commissioner of Agriculture, in testimony before the House Ways and Means Committee, 1947.}
controls on wheat and prices plunged. By 1921 Nebraska farmers were burning corn for fuel and the prosperity of the previous decade faded into memory. Hope of price recovery evaporated when the bottom dropped out of the wheat market in October 1929. It became known as Black Thursday on the Produce Exchange. Wheat futures lost a tenth of their value in two hours and kept dropping. The crash destroyed the income base for farmers and the nation.

Instability - the very thing that had made the unregulated world commodity markets so appealing to speculators and merchants all through the 1920s - had ravaged the agriculture upon which so much of the North American and European economics depended, said investigative reporter Daniel Morgan.

The new physiocrats believed that the collapse in prices for raw materials worldwide precipitated a dramatic decline in incomes which in turn caused a decline in trade. Worldwide imports dropped over 10 percent before passage of the Smoot-Hawley Tariff Act in 1930. By the end of 1932, worldwide imports had declined by over 50 per cent. Economists continue to blame the Smoot-Hawley Act for much of the depression of the 30s, however, the act was a response to low incomes brought about by low prices for raw

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56 Morgan, MERCHANTS OF GRAIN 4-5.
58 Ibid.
59 Walters, UNFORGIVEN, 238-239.
materials, especially agricultural products. As prices and incomes continued to decline, imports also declined with the Smoot-Hawley Act receiving much of the blame. When incomes declined in the United States many Americans were unable to purchase their usual food stocks. This lack of income caused agricultural supplies to increase while people were going hungry. Smoot and Hawley simply reacted to this increased supply by introducing legislation to limit imports.

By 1932 wheat had fallen to 50 cents a bushel in Kansas City. Presidents Harding and Coolidge believed in laissez-faire economics and consequently, the government did nothing to provide stability and support for national income with fair farm prices. After World War I, there was no attempt to continue to support national income with adequate farm prices. The new physiocrats believe that the depression that resulted was not natural or inevitable, it was man-made and could have been avoided.

There had never been a better example of the feudalistic structure of the grain trade than the 1930s, when the contrasts between the poverty of those upon whom the whole system depended - the farmers - and the prosperity of the shippers and processors were probably the greatest in history, according to Morgan.

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60 Morgan, MERCHANTS OF GRAIN, 117.
61 Ibid, 131.
In contrast, the United States followed a completely different course after World War II with passage of the Steagall Amendment that supported farm prices into the early 1950s. There was no depression, in fact, great prosperity was experienced. Consumer demand that was not fulfilled during both wars provided increased spending immediately after the wars but that prosperity lasted much longer after WWII because of the Steagall Amendment, according to the new physiocrats. However, in the 1950s, the Aiken Bill was still on the books and ready to take effect reducing farm prices and national income. The effects of trade in farm products at world prices and the substitution of debt for earned income were soon to play prominent roles.
Chapter 9

Recent Farm Policy: Decline of Parity Concept

An event which occurred in 1949 was to have significant future impact. England had kept the pound sterling at $4.05 through the 1930s and through World War II even though the Roosevelt Administration raised the price of gold to $35 an ounce from the previous $20.67 an ounce. When England devalued the British pound by 30% to $2.80 in 1949, the price of goods being produced in England also dropped 30% to the rest of the world. As a result of the devaluation, the United States became the high market in the world. In the five years following the devaluation of the British pound according to Wilken’s computation, the United States imported $6 billion more in farm products than were exported. The American economy had imported its surplus. Thus, agricultural raw materials were perceived to be in surplus as Dwight Eisenhower considered running for the Presidency.

In 1948 federal, state and local budgets enjoyed about an $8 billion dollar surplus, but the country was still using about a $16 billion dollar debt to expand the economy. The United States was still reconverting from a war economy and reopening a lot of business units that had

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62 Walters, UNFORGIVEN, 341.
63 Ibid, 361.
been closed because of rationing. The Korean War began in 1950 and debt expansion increased from $18 to $40 billion a year.\(^6^4\) Pressure on farm prices, which was aided greatly by the increase in farm product imports that had been occurring since 1949, did not allow the legislative efforts of Senators Russell and Young to maintain parity to be effective. This resulted in the same type of situation that had lead the United States into the depression of the 1930s. However, the country had experimented with debt injection, as recommended by John Maynard Keynes, during WWII under President Franklin Roosevelt. Consequently, when farm prices were pressured down, the response was to increase debt to make up for the lost income according to the new physiocrats.

When the Korean War ended, debt expansion dropped from $46 billion in 1953 to $30 billion in 1954 without any corresponding increase in farm prices to maintain national purchasing power and the United States experienced the 1954 recession.\(^6^5\) Rather than raise farm prices the United States injected $72 billion dollars of debt into the economy in 1955 and a new era of debt creation had begun.\(^6^6\) Eisenhower’s Secretary of Agriculture, Ezra Taft Benson, and his Assistant Secretary, Earl Butz, were in charge and a

\(^6^4\)Ibid.

\(^6^5\)Ibid, 400.

\(^6^6\)Ibid, 362.
cheap food philosophy now dominated instead of fair agricultural prices.

Between 1950 and 1960 the United States doubled its private and public debt. Financial advisors were not concerned with what the new physiocrats perceived was the root cause of the problem, namely, inadequate income due to low farm prices, but instead occupied their time dealing with the amount of debt that needed to be injected. In 1957 the Fed used tight credit to cool the economy and unemployment went from 4 to 7 percent. This result shocked the Eisenhower administration which hastily unveiled a program to build $2 billion worth of post offices and the Fed allowed credit to again flow more freely. In 1961 full parity would have given the United States a national income of $486 billion but low farm prices resulted in a national income of only $430 billion. The United States needed $56 billion more income to pay payroll and capital costs. Wilken maintained that unearned income through debt expansion was again substituted for earned income from fair farm prices by raising mortgage debt by approximately $55 billion. Still most agriculture experts believed that farm prices should be the same as world prices which were approximately 60 percent of parity.

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67 Ibid, 392.

68 Ibid, 394.
President Kennedy's Agriculture Secretary, Orville Freeman, believed lower prices for wheat and feed grains would induce deficit production so "surplus" holdings could be sold. He also believed that thousands of small and "inefficient" farms should be eliminated with rural manpower moving into factory jobs. In addition 34 million acres of cropland were to be converted into parks, forests, grasslands, and wildlife refuges by 1969 and 68 million by 1985. The Kennedy administration drafted an emergency measure in 1962 that involved both price supports and export subsidies on feed grains (corn, barley, sorghum and oats). Farmers were guaranteed a minimum $1.20 a bushel for their corn if they agreed to plant 20-50 per cent fewer acres of the crop than they usually did.69

Most farmers and economists considered the program, which reduced government costs and governmental stocks of grain, a success, but Cargill officials felt it was a disaster. They maintained that the price support of $1.20 a bushel priced Americans out of world markets.70

No one was concerned that U.S. grain prices were approximately 60% of parity and therefore too low to produce adequate income according to the new physiocrats. In early 1962, Cargill's William Pearce, a lawyer who headed the firm's public affairs department and Melvin Middents, their

69 Morgan, MERCHANTS OF GRAIN, 149.
70 Ibid.
wheat trader drafted the Middents Plan. The plan called for price supports to be reduced to world levels and an end to corn export subsidies. Farmers were to receive a government check to make up for the lower prices. The plan received serious consideration but was not adopted.

As well as pursuing a policy of ever lower grain prices in the 1950s and 60s, the government was also actively engaged in efforts to increase international markets for these products. In the 1950s tremendous efforts were made to get people around the globe to eat like Americans did. Millions of rice-eaters were converted to wheat bread. President Chiang Kai-shek's government in Taiwan advertised that "wheat eating is patriotic." Biscuits made from soft white wheat produced in the Pacific Northwest were promoted in Korea. Bread was fed to school children in Japan. Pressure was exerted by the United States government to reduce transportation costs for U.S. wheat to make it competitive with Canadian wheat in the Japanese market. Pressure was also applied to Japan, with good results, to reduce its trade surplus with the United States by buying American wheat. Prior to this the United States and Canada, which together dominate international trade in wheat, had cooperated in international pricing. The

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71 Ibid.
72 Ibid, 145.
73 Ibid.
atmosphere became much more competitive during Kennedy's administration and prices moved lower.

In 1962, in the town of Novocherkassk, Soviet school children, housewives, workers and shopkeepers demonstrated against increases in the price of meat and butter. Slogans used in the demonstration included "Down with Khrushchev!" and "Use Krushchev for Sausage Meat!" Seventy to eighty people died when soldiers fired into a crowd and the families of the killed and wounded were deported to Siberia.74 Aleksandr I. Solzhenetsyn wrote in The Gulag Archipelago, that "without exaggeration, this was a turning point in the modern history of Russia."75 It was evident that there were political dangers involved if food imports were inadequate. The Soviet Union began to import grain in 1963, first from Canada and then later from the United States. There was a great deal of opposition to selling grain to the Russians, including opposition by Richard Nixon, but on October 9, 1963 Kennedy authorized that four million tons of wheat and flour be sold to Russia.76 Other countries were encouraged to increase beef, hog and poultry which were fed with corn and soybeans from the United States. Frozen broilers were shipped to Germany until the Europeans put up high tariffs to protect their new broiler

74Ibid, 156.
75Ibid.
76Ibid, 152.
industry, then the United States sold them corn and soybeans to feed their broiler industry.

Public Law 480 was passed by Congress in 1954 and has since become a permanent fixture of both farm and foreign policy. There was much opposition from conservatives and southern Democrats but proponents such as Senator Hubert Humphrey and Secretary of State John Foster Dulles assured passage of the legislation. P.L. 480 uses excess American food stocks to provide food aid to foreign countries in need. The program assists American farmers and grain trading companies as well as supplying the government with a foreign policy tool. The actual mechanics of P.L. 480 work as follows: Foreign governments receive authorization from the United States government to purchase, with American loans, certain quantities of American farm commodities. The foreigners handle the actual transactions, contracting with private exporters to obtain the goods. Payments for these goods come from the United States Treasury in the form of loans, the money is then forwarded to commercial banks in the U.S., and then to private exporters when the ship is loaded. These payments are loans that the foreign country is obligated to pay back, but the terms provide grace periods and long maturities, and in some cases the United States eventually just forgave the loan. An average of 20 percent of U.S. wheat exports were financed with P.L. 480

\[77\text{Ibid, 147-148.}\]
funds during the first years and close to 80 percent by 1959. Even with all these efforts; lower farm prices, intensive export promotion and P.L. 480 the United States was still not alleviating the perceived "surplus" problem and farmers were worse off than before.

The Committee for Economic Development (CED) that represented the views of some 200 business leaders revealed their perspective in a report entitled "An Adaptive Program for Agriculture". The report listed the problems of agriculture as they saw them: rapidly rising productivity; diminishing use of labor rather than capital; inelastic demand; lack of response to price changes; and unsuitable flow of human resources out of agriculture.

Carl Wilken appeared before the House Committee of Agriculture to refute the CED report on grounds that it constituted economic charlatanism. Using his balance sheet approach, he sought to show that elimination of farmers in order to turn them into factory hands did nothing to repair the income equation, that is, the inevitable requirement that private enterprise earn enough to pay the wage and capital cost bill. Indeed, were all the farms to be liquidated and turned into corporation entities, the parity requirement would still have to be met simply because the wage bill and the capital cost bill would have to be met.

Business leaders believed that if farm prices and consequently the price of food was reduced that consumers would have more money to buy manufactured goods. They did not understand or believe Wilken's hypothesis that the

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78 Ibid.
79 Walters, UNFORGIVEN, 398.
80 Ibid, 399.
economic cycle started with the harvest of raw materials, 70 percent of which came from agriculture, and that a fair farm price was needed for the trade-turn to provide enough national income. If the price did not keep pace with what the farmer had to buy from other sectors of the economy then there would be insufficient national income.

The CED report was falling back on an old argument dating back to mercantilism which assumed that if you wanted a bigger piece of the economic pie, then someone else had to receive a smaller piece of the pie. Not only were certain sectors of the economy within a nation exploited but colonies were established to be exploited as well. The European countries did not realize that cheap raw materials acquired from their colonies established a correspondingly cheap market for their own manufactured products. Fair prices for raw materials would have benefitted the colonies tremendously and the European countries would have also received increased income. The new physiocrats believe that post WWII economic history has demonstrated that the size of the economic pie can be increased. The key to increasing the economic pie, which in this case represents national income, requires the proper balance between prices for raw material production, and goods and services that the farmer purchases. They believe that periods of price supports for agricultural goods, that were not undermined by cheap foreign imports, were the major reason that the United
States with approximately 6 percent of the world's population enjoyed approximately 50 percent of the world's income.\textsuperscript{81}

The CED report was concerned about a surplus of both production and farmers. However, what was referred to as a surplus in agriculture would generally be referred to as an inventory in other industries. For instance, in 1961 the manufacturing, wholesale and retail trade had an inventory of $96 billion which no one perceived as a problem. At the same time agriculture had an inventory of $8 billion which was immediately perceived as a tremendous problem by businessmen making up the CED.\textsuperscript{82} Agriculture's inventory was easily misrepresented as a surplus for several reasons. Agriculture products have inelastic demand as the CED report indicated. Therefore, when production exceeds normal demand by even small amounts, large reductions in price occur. Conversely, if production is below normal demand, assuming no carryover in inventory, large price increases occur. It is prudent and beneficial for a nation to carry enough inventory to meet trade and population needs in those years when production is reduced due to adverse conditions. However, this reserve inventory is easily perceived as a burden due to inelastic demand and tremendous downward pressure is put on prices for the entire crop. The problem

\textsuperscript{81}Ibid, 400.

\textsuperscript{82}Ibid, 401.
is compounded because immediately after harvest there is at least a 365 day supply available for only day to day demand. The weak financial position of many farmers and the overall perception of surpluses with potentially lower prices prohibits them from holding grain and spreading sales out evenly during the entire year, creating even more downward pressure. Even if the United States produced only enough grain for its domestic and trading needs, it only takes importation of a small quantity of product at lower world prices to break the price structure of American producers. This was not uncommon and the effects are easily strong enough to negate government price supports as it did from 1950-1954. Rather than labeling agriculture inventories as surpluses and promoting a program to eliminate farmers and reduce national income, advocates of parity declare that it would be far more helpful to recognize the benefits of a reserve and devise mechanisms to manage inventories without tremendous price swings in either direction. A reserve should not be allowed to depress farm prices and national income to the point where debt injection must be used to make up the difference.

In 1964, Walter Bowers, former assistant to the Under-Secretary of Treasury and former Chief Fiscal Officer in the War Department released a study that compared returns to capital for various segments of the economy. The net return on capital investment was 0.5 percent for farmers, 4
percent for railroads, 4 percent for utilities, 8 percent for manufacturing and 8 percent for distribution. Low farm prices resulted in very weak returns on investment for farmers which had tremendous impacts well beyond the farmer. In an address to the Agriculture Committee of the Independent Bankers Association in February 1965, Wilken stated

... the loss of national income that had resulted from low returns to the farmer had been made up with increased debt expansion. The gross public and private debt for the nation stood at near $566.4 billion in 1950. By 1960 that figure had doubled to near $1 trillion. By 1970 it had doubled again to near $2 trillion.®

Total private and public debt was approximately $10 trillion dollars by 1988.®

Agriculture policy since the Eisenhower era has abandoned the idea of fair prices for farmers in relation to other segments of the economy. The only governmental activity that remains in this area is the parity index that is still computed based upon a 10 year moving average. The focus in agriculture policy had shifted dramatically to what is perceived as the United States' perennial problem of surplus grain and the possibility of alleviating that surplus through various mechanisms, especially world trade. Policy advisors believe that enhancement of exports requires low prices so that the United States can maintain or

® Ibid, 440.

® Jacobson, AMERICAN TRADE AND COMMERCE NEWSLETTER.
increase its share of the market. Before World War II, international trade in grain seldom exceeded 30 million tons a year, but by 1975 trade had grown dramatically to 160 million tons. Many countries that had once fed themselves began to depend on the United States for a substantial part of their food supply. Russia and India, which formerly exported large quantities of grain to England became net importers. The United States became the superpower in grain exports. No country came close to the United States in corn production and Kansas and South Dakota produced more wheat than all of Australia.

85 Morgan, MERCHANTS OF GRAIN, 34.
The importance of food was dramatically emphasized in the bloody rioting that took place in Poland when the government attempted to raise food prices before Christmas in 1970. The price increases were withdrawn when dockworkers burned the party headquarters in Gdansk and the shipyards were seized in Szczecin. The food riots in Poland encouraged the Soviet Union to cover its grain deficit with imports and to continue increasing the size of Soviet cattle herds. This process was aided when President Nixon, in June of 1971, removed the requirement that exporters obtain licenses for grain transactions. The requirement that a minimum of 50 percent of the grain be shipped on American vessels was also eliminated. The stage was set and in 1972 the Soviet Union began buying large quantities of grain from the United States. World production was down that year and the magnitude of the Soviet purchases caused prices to rise dramatically. Since most of the price increase came after the Soviet purchases, the event became known as "the great grain robbery" of 1972.

For twenty years prior to 1972 the American farmer had experienced low grain prices due to an inelastic demand curve where even small increases in inventory resulted in drastically lower prices. The Soviet grain deal now reduced
inventory to critical levels and the inelasticity of the demand curve began to work in favor of the American farmer. Grain prices equaled the parity levels that previously had occurred in 1910-14 and 1946-50. The American public immediately became concerned with rising food prices. However, the new physiocrats pointed out that these parity farm prices would allow the rest of the economy to dramatically increase national income without increased debt expansion. The American government and the American public did not understand this concept and debt injection continued, opening the door to greater inflation than had been experienced with previous debt injections, hurting both the consumer and the producer.

By 1975 grain prices had declined significantly and were continuing to decline. President Ford had vetoed higher price supports, but by July 24, 1975 the Soviet Union had bought 12.8 million tons of North American grain which was more than their first purchases in the "great grain robbery" of 1972. As prices began to rise the reaction from government and consumers was predictable. Chairman Arthur Burns of the Federal Reserve Board at a hearing before the Joint Economic Committee on July 29 said that the grain selling "frightens me." Two days later in Chicago, President George Meany of the AFL-CIO charged that the grain sales were a product of "a calamitous, one-way detente." The International Longshoremen's Association, with Meany's
approval, announced its intention to boycott the loading of grain bound for Russia. Prices did not reach parity levels.

In June 1975, U.S. agricultural policy introduced target prices, loan rates and deficiency payments, which we continue to use today. Each year before spring planting the United States Department of Agriculture (USDA) announces adjustments that will be made in target price levels, loan price levels and required set-a-side. A farmer wishing to participate must set-a-side the required percentage of his base acres, which must remain idle, earning no income for the farmer. Base acres are determined by the acres the farm has historically planted to that particular crop. He is then eligible to receive a loan on his production from the government at the specified loan rate, for a period of nine months. At the end of the nine months he may either sell the grain and pay the loan plus interest or he may forfeit the grain, which he has used as collateral, to the government. The government must by law keep this acquired grain off the market until it reaches a specified release price.

The loan rate acts as a price support, but the loan rate is generally set below USDA cost of production estimates, especially in recent years. Therefore, additional income support is needed to keep America’s farmers solvent. Consequently, the program allows farmers to receive deficiency payments equal to the difference
between the target price and either the market price or the loan rate, depending on which is higher, multiplied times the established yield determined by USDA. Table 1 and Table 2 show farm parity percentages, average market prices, loan rates per bushel, the target rate per bushel, USDA's production costs per bushel, government payments per bushel and the percent of required acreage reduction for wheat and corn from 1975 to 1993. The tables were compiled from Agricultural Stabilization and Conservation Commodity Fact Sheets.
**WHEAT (Table 1)**

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<th>Year</th>
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*Source: Agricultural Stabilization and Conservation Commodity Fact Sheets.*
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Source: Agricultural Stabilization and Conservation Commodity Fact Sheets.

Target prices are used to calculate deficiency payments which are needed to provide sufficient income to farmers when the market fails to do so. However, some problems interfere with achievement of this goal. The largest...
problem is that target prices are set too low to provide adequate compensation to the farmer compared to other sectors of the economy where the farmer purchases labor and other necessary inputs. Also assigned county yields are often lower than actual yields which further reduces income when deficiency payments are paid. Farmers do not like receiving deficiency payments from the government but low loan rates and adequate supplies guarantee low market prices and consequently the deficiency payment is necessary for survival. Farmers would rather receive their income from the market than from the government, but to do so requires an orderly marketing program. Farmers have been unable to organize themselves to provide supply management on their own and thus a USDA administered supply management program is needed. However, there is a major problem encountered by the government when designing a supply management program. For instance, the United States has restricted its set-a-side requirements to insure adequate supplies are available, both domestically and for export, even if less than ideal growing conditions prevail. Since grain has an inelastic demand curve, a little extra grain production to insure adequate amounts reduces the price dramatically, as well as total revenue. Any attempt to maintain a reserve to cover those years with unfavorable growing conditions results in much lower market prices unless the reserve is insulated from the market.
Another problem concerns our share of the international export market. From 1977 to 1985, the U.S. share of the world's net wheat exports declined from 41.9 percent to 28.8 percent, while the European Common Market (EC) share rose from -1.6 percent to 15.1 percent. The EC had negative exports for 1977 because up through 1977 the EC was importing wheat. The EC philosophy is to support agriculture prices for goods sold within the Common Market but any surplus produced beyond the needs of the Common Market are sold at very low prices on the world market. This procedure is referred to as "dumping" and is a major point of contention between the United States and Europe in General Agreement on Tariffs and Trade (GATT) negotiations. The U.S. wheat export price generally exceeded the EC export price between 1978 and 1985 which resulted in the change in export market shares.

The decline in export shares was a major factor for changes in farm policy that were written into the 1985 farm bill. To be more competitive in world markets, loan rates no longer were allowed to trend upward but instead were forced downward. Market prices moved downward when loan rates that provided a price floor moved downward. Target prices remained fixed at $4.38 per bushel from 1985 to 1988.

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87 Ibid.
and then were moved downward to $4.10 in 1989. Consequently, deficiency payments escalated rapidly and agriculture program payments reached record levels under the Reagan Administration.

To further improve the United States market share in the export market, the Export Enhancement Program (EEP) was also enacted in 1985. The EEP allows the USDA to give government commodities to private exporters at no cost. This allows these exporters to sell U.S. commodities on the world market at prices below U.S. market prices and thus compete with the EC. EEP was designed to target those countries where entities like the EC were dumping and therefore hurting U.S. markets. Our EEP program really was a response to the EC's export program, which is part of their Common Agricultural Policy (CAP), that was put into place in 1962. The policy first became effective in 1978 when the EC began exporting grain rather than importing it.

The agriculture policy that the United States has today is a continuation of the legislation that was passed in 1985 with a few modifications. One modification introduced in the 1990 Farm Bill was a concept called "triple base", which expanded the categories of acreage for wheat and feed grains, for program participants, from two to three. In

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addition to (1) those acres fully eligible for loans and deficiency payments and (2) those acres required to be taken out of production (set-a-side) and placed into conserving uses as part of any annual acreage reduction program that the USDA may announce, the government now required that (3) participants in the grains program will lose eligibility for deficiency payments on 15 percent of their crop acreage base. This land may be planted to any crop except fruits and vegetables. While wheat and feed grains planted on this acreage will not be eligible for deficiency payments, they will be eligible for government loans. Triple base was enacted for the savings it produced in the USDA budgetary process and had the effect of transferring much more risk to the farmer. Consequently, as loan prices and market prices were reduced to improve the U.S. export position, the government was forcing the farmer to receive an even greater loss than before. This loss of income had tremendous consequences in the United States, first in rural areas and finally for the nation as a whole. As parity levels for farmers dropped, public and private debt escalated dramatically which according to Wilken's hypothesis was a cause and effect relationship. However, current agriculture policy has experienced some major successes involving exports, and to a small degree applied pressure for changes within the GATT negotiations which need to be examined.
The primary goal of adding EEP to U.S. agriculture policy was to increase the volume of exports. Wheat exports did increase dramatically, growing by about 60 percent in 1987. By 1988 the U.S. share of the world's wheat market increased from 28.8 percent in 1985 to an estimated 41.6 percent in 1988. This dramatic shift was partly accomplished by eliminating the EC's export price advantage. The dumping policies of the EC would have caused their wheat export price to be $30-40 per ton lower than the U.S. price if it were not for EEP which offset this difference by approximately $33 per ton. An analysis by Kenneth Bailey found that EEP was responsible for about one-third of the increase in wheat exports from 1985 to 1987. The rest was due to lower loan rates, reductions in yields of competing exporters and increased imports by the Soviet Union and the Peoples Republic of China. The lower value of the dollar was also a factor analyzed but the effect was minor. The major positive achievement of the present program is the increase in U.S. export shares, although adverse weather in both exporting and importing countries must receive much of the credit. Another objective of the present program was to apply pressure on the EC to change its policy of dumping. The strategy was that EEP would

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90Coughlin, DUBIOUS SUCCESS OF EXPORT SUBSIDIES FOR WHEAT, 43.

increase the EC's agricultural support program costs to such an extent that they would be open to changing their policy of dumping during the GATT negotiations. The United States did apply pressure to the EC with their EEP program but how effective that pressure was, is still open for debate because of some inherent problems pointed out by Coughlin and Carraro. They preface the examination of these problems by stating that

Contrary to a world of perfect competition with many agents each too small to influence the market outcome, agriculture trade policy can be viewed as a strategic environment that can be altered by governmental decisions.

The United States and the EC are the primary players and adversarial trade policies by each entity can easily expand into a major agriculture trade war, which is exactly what happened. Rather than cooperatively pursuing agriculture policy that could be beneficial to both the U.S. and the EC, they are instead pursuing policies that are harmful to each.

Tangemann argues that in attempts to inflict harm on the EC, the U.S. causes even more harm to itself. He states that if the U.S. had decreased world grain prices by 10 percent in 1982, that the EC could have maintained its export volume by an increase in its agriculture budget of

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92 Coughlin, DUBIOUS SUCCESS OF EXPORT SUBSIDIES FOR WHEAT, 43.
93 Ibid.
only 0.8 percent. Paarlberg pointed out that the United States has much larger foreign markets to defend in a trade war. Consequently, Paarlberg estimates that the U.S. would have to out spend the EC by 50 percent just to maintain its market share. In addition, the EC is a major importer of goods from the U.S. and cutbacks would increase the costs to the U.S. even more if the EC retaliated with import restrictions.

The trade war between the U.S. and the EC in agricultural goods and the resulting low world prices has been strenuously objected to by the Cairns Group, which is made up of 13 agriculturally oriented nations. Oleson noted that U.S. and EC policies caused the price of wheat to fall, imposing major losses on such grain exporters as Canada, Australia, and Argentina. These countries question the true motive of the U.S. when its policy makers talk about cooperation through GATT while they pursue a policy of extreme cut-throat competition prior to enactment of a new GATT Agreement. These problems have diminished the major advantage that current U.S. agriculture policy has


96The Cairns Group consists of Canada, Australia, New Zealand, Indonesia, Malaysia, the Philippines, Thailand, Brazil, Uruguay, Argentina, Columbia, Hungary, and Chile.

achieved in the political arena, which is that high program costs, to both the U.S. and the EC, finally forced them to reach a compromise within the GATT negotiations in December of 1993. Several problems have been brought forth in the presentation of the advantages gained by current agriculture policy. An examination of the disadvantages of current agriculture policy expands upon these problems and their consequences.
Chapter 11
Problems with Present Policy

The major disadvantage of current U.S. agriculture policy is the cost involved. These costs can be measured in a variety of ways such as explicit costs to the government, costs to the U.S. farmer, which in many cases were high enough that he lost everything, and loss of income to the nation. The magnitude of the cost is very large when all three methods of estimation are employed. Explicit costs of the USDA's price and income supports (loans and deficiency payments) reached a record $25.8 billion in FY 1986. Then these expenditures declined steadily to $6.5 billion in FY 1990, but rose to $10.1 billion in FY 1991 and $10.6 billion in FY 1992.\textsuperscript{98} The reduction in budget outlays that took place from 1987 into the 1990's reflects a decline in deficiency payments due to lower target prices and a further decline in deficiency payments due to triple base. Government costs are expected to average approximately $10 billion per year in the future.\textsuperscript{99} Wheat and feed grains should account for approximately 50 percent of this budget outlay and export programs another 15 percent. These explicit costs are large, especially when compared to the parity farm program that the United States had in the 1940s.

\textsuperscript{98} CRS Issue Brief (1992) 2.
\textsuperscript{99} Ibid, 1.
and early 1950s. Other than the normal administrative cost, parity programs cost the government nothing and in fact earned 13 million dollars in interest when farmers repaid their loans.\textsuperscript{100} Though today's budget outlays are large, they still represent only a portion of the costs to the nation.

Under the current program, farmers in the United States have generally been faced with wheat and feed grain prices that are less than the cost of producing those products. The government is aware of this condition and consequently enacted the concept of target prices and deficiency payments in an attempt to keep America's farmers solvent. Although target prices are generally higher than market prices, especially in recent years, they too are often set below cost of production. The problem is compounded since farmers only receive a deficiency payment on a portion of their acreage, 85 percent at most and less if the Secretary of Agriculture calls for a reduced acreage program. This resulted in over 400,000 farm families leaving the land from 1985 through 1989.\textsuperscript{101} In 1986 the United States lost one


\textsuperscript{101}Helen Waller, "Reportcard 85 Food Security Act" THE PLAINS TRUTH (November, 1989) 6.
farm every four minutes.\textsuperscript{102} Not only was this loss devastating to these rural families but the small towns which they helped to support were devastated as well. It is unlikely that substantial alternative employment was found in these depressed agricultural areas. Consequently, there has been a migration from rural areas to the metropolitan centers. These changes in population caused Montana to lose one of their representatives in Congress, which is an example of the realignment that has taken place in political power. The agriculture sector and rural America will remain depressed as long as low agriculture prices significantly reduce purchasing power. Without adequate income from the production of raw materials that the earth provides at the beginning of the cycle, it becomes impossible to have full employment, at adequate wages, unless debt is substituted for the decline in income, according to the philosophy of the new physiocrats. This is more discernible in rural areas because they see the impact from changes in agriculture prices very quickly. If Wilken is correct and the nation's loss in earned income is made up with increased debt it would be advantageous to construct an agriculture program that provides proper price and supply parameters to insure fair market prices and adequate incomes for agriculture and the nation.

\textsuperscript{102}National Family Farm Coalition (Winter 1990) 80 F Street, N.W., Suite 714, Washington D.C.
Chapter 12

Parity Program versus Present Program

A major proposal was presented in 1990 that would have changed the direction of the 1985 farm bill. Many farm groups such as the National Save the Family Farm Coalition, National Farmers Union and the American Agriculture Movement, which are composed of family farm members, demanded legislation that would save the family farm. Thus, the Family Farm Act of 1990, sometimes referred to as the Harkin/Gephardt Bill was introduced. To correct the problem of low income for family farmers this proposal would have set price supports on program crops at 75 percent of parity, as established by the USDA, with a 3 percent per year increase, up to 90 percent parity. The supply management mechanism employed restrictions on bushels sold per farmer rather than acres planted. These bushel quotas were presented as marketing certificates where the greater the farm's production, the smaller the percentage of marketing certificates issued. Farmers were to participate in a producer referendum which would determine whether they were willing to accept this agreement to restrict their sales for a better market price. A 51 percent affirmative vote would require a mandated program with full compliance. Trade must also be considered since the United States' grain market is dependent upon the export market as well as the domestic
market. It does not benefit the U.S. to have a supply management program if other countries do not, and consequently, increase their exports at the expense of the United States. Therefore, the Family Farm Act of 1990 instructed the Secretary of Agriculture to conduct trade negotiations with other major exporting nations, to achieve international commodity agreements which would ensure that the U.S. and other exporting nations retain their fair global market share as defined by GATT and that export prices remain equal to or above costs of production of the exporting nations. The proposal further states that if the Secretary is unable to negotiate such agreements within a reasonable period of time, no more than twelve months, then export restitutions such as bonus bushels or marketing loans, shall be authorized to maintain the U.S. market share at a level equal to the rolling average of the previous five years. A concept of using bonus bushels would be very similar to the U.S. export enhancement program used today. To solve the problem of insulating a grain reserve to keep it from depressing market prices the bill proposed a Food Reserve Coordinating Agreement to be negotiated through GATT. In conjunction with this agreement the U.S. would have a farmer commodity reserve. Commodity Credit Corporation grain that the government currently owns would be the initial deposit in the farmer commodity reserve. Farmers would be allowed to draw on this reserve in adverse
years when their production is less than their marketing certificates and add to it when the reserve needed to be increased. Agreements between exporting countries must stipulate that all reserve grain be isolated from export dumping. This program would have moved the nation much closer toward parity and the philosophy of the new physiocrats, however, the legislation failed to pass.

The 1985 Farm Bill was known as the Food and Security Act of 1985 (FSA-85). A little over a year after FSA-85 became law, an independent analytical group called the Food and Agriculture Policy Research Institute (FAPRI) compared that program with one similar to the Harkin/Gephardt Bill. FAPRI is sponsored by Congress and the Universities of Missouri and Iowa State and does not endorse or denounce any particular farm bill. A large scale econometric model of the United States and international agricultural economies was used in their analysis. Their general economic outlook was based on a world forecast provided by Wharton Econometric Forecasting Associates of Philadelphia. The program that they compared to the Food Security Act of 1985 was called the Commodities Supply Management Program (CSMP). CSMP differed from the Harkin/Gephardt Bill by setting support prices at 71 percent of parity in 1987 to be escalated by 1 percent per year to a maximum of 80 percent of parity, whereas, the Harkin/Gephardt Bill started at 75 percent of parity with increases of 3 percent per year up to
a maximum of 90 percent parity. CSMP, like Harkin/Gephardt assumes a cartel arrangement is established with major competitors in the world market to insure current levels of trade shares at the higher support prices. Also assumed is the implementation of tariffs for wheat and feed grains to prevent foreign markets from undercutting the domestic agricultural sector. CSMP was evaluated over the ten year period of 1986 through 1995. FAPRI concluded that net farm income would average $46.3 billion with CSMP versus $25.4 billion under FSA-85, an average increase of 82 percent. The increase would have been even more dramatic with the Harkin/Gephardt Bill due to higher support prices. Further, the model indicated that farm income would decline at the end of the projection period for FSA-85 but increase through the 1990s with CSMP. The model projects $20.9 billion more farm income per year with the Commodities Supply Management Program. If the trade-turn is 7, the nation earns $146.3 billion more income per year. These figures would be more dramatic if the model had calculated the difference when 90 percent of parity is reached. Legislation that raises support prices towards 90 percent of parity would move the U.S. farm program closer to the desired goal of economic stability for farmers. If the program is targeted toward family farms as the Harkin/Gephardt Bill was, then family farmers gain the most. Not only do family farmers gain increased economic stability, but the nation's consumers do
as well through the affect of the trade-turn. However, there are both government and consumer costs that must be considered.

Government costs for the mandatory production control program averaged $10.3 billion compared to an estimated $15.7 billion under FSA-85. This average difference of 34 percent was even greater during FY-89 and FY-90 because government stocks were reduced. In these two years, total cost for commodities is 13.0 billion versus $33.4 billion for FSA-85. Costs increase near the end of the program as the government purchases higher-priced grains and oil seeds for hunger programs. The maximum level projected for hunger programs in FY-95 is $6.7 billion. The overall result of legislation along the lines of Harkin/Gephardt dramatically reduces government costs. The FAPRI model also analyzed the impact that FSA-85 and CSMP would have on consumer food purchases. Legislation similar to Harkin/Gephardt, such as CSMP, would cause total food expenditures to average 7 percent above FSA-85 levels for the 10 year period. This computed to an increase of $33 billion per year at the beginning of the 10 year period and $65.5 billion per year at the end of the period. Therefore, to gain $146.3 billion additional income per year and save approximately $5.4 billion per year on farm programs, the nation expends only $33 billion to $65.5 billion in increased consumer
costs. The overall effect would benefit the nation between $80.8 billion to $113.3 billion per year.

The effect of a Commodity Supply Management Program on the livestock industry was also analyzed. It was concluded that sharply higher feed costs would result in an immediate reduction in the breeding herds for pork and beef. With these substantially lower supplies, prices for beef, pork, and poultry move upward. The model projected that at the end of the 10 year period, beef prices would be 30 percent above the FSA-85 level projected for 1995, pork prices 43 percent above, and poultry prices were to rise as well. Another consequence to the livestock industry, that the model did not analyze, concerns the possible change in who raises the livestock. Very low grain prices have encouraged tremendous concentration in the livestock industry in recent years. The mandatory supply management system that accompanies increased price supports should encourage more livestock to be raised where most of the feed is raised, on family farms. Consequently, a program of this type also benefits the livestock industry, especially the portion that is operated by family farms.

Another factor that must be considered is whether there is any affect on inflation. Rising agricultural prices have historically been blamed as one of the causes of inflation. Regardless of whether agricultural prices have remained stable or even declined, while nonagricultural items
increased in price, any future increases in agricultural prices are still condemned, even though they are simply playing catch-up to the rest of the economy. It must be remembered that the new physiocrats believe when the U.S. experienced a decline in earned income, public and private debt was substituted to maintain the standard of living. If the increased debt injection is not reduced when agricultural prices increase then inflation will occur. However, if debt injection is decreased as agricultural prices rise, the economy will not become overheated, according to this premise. The transition from debt injection to earned income will, however, create a redistribution of income from the wealthy class, that have money to lend, to the productive sectors that are generally forced to borrow money when the nation’s earned income declines.
Chapter 13
Conclusion

Original physiocratic thought from the 18th century still forms the foundation for today’s proposed parity farm programs. John Stuart Mill’s premise that the distribution system is determined by society rather than natural law is the basis for legislating farm programs. The direction that this legislation has taken since the mid 1950s reveals the current rejection of physiocracy. A rejection that occurred without fully examining its original two premises that (1) all new wealth originates with production from the earth and (2) that the income received for this production circulates through the economy with each successive trade transaction providing income for the nation. Physiocratic thought has represented a minority viewpoint throughout history and even at times seemed to have been completely forgotten. It has, however, survived and the new physiocrats, rejecting laissez-faire, present arguments for adoption of its other basic premises into current farm programs. The United States has the advantage of having actually legislated both parity farm programs, that generally incorporated physiocratic beliefs, and non-parity programs. Comparisons between these two basic program philosophies should be considered when national farm programs are debated every five years. A similar process is needed to compare a trade
policy that focuses on cooperation between countries that provides adequate farm income for each country versus present trade policy which promotes increased competition that exploits the producers in each country and, according to physiocracy, reduces each nation's income base.

Econometric programs comparing parity and non-parity farm programs must become more comprehensive and include input-output analysis to explore the effect that primary production from nature has on national income. The results of the econometric model run by FAPRI indicate greater rewards with parity programs, but more comprehensive research needs to be undertaken.


Family Farm Act 1990, sponsored by Senator Harkin and Representative Gephardt.

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