From: Manuel Otero  
Minister Counselor, Agricultural Affairs  
Embassy of the Argentine Republic  
Re: Ahalt's Argentine Agriculture

Mr. Ahalt has done an excellent job of describing, in a very dynamic way, recent changes in the Argentine government's farm policy. However, I disagree with him regarding the factors which brought about these changes.

Mr. Ahalt claims that pressure from Argentine farm organizations forced the Alfonsin Administration to modify its agricultural policies. This is not quite right. Of course, these are powerful and representative organizations but their pressure, by itself, would not have been enough to bring about such a deep reform in Argentina's agriculture economy. I believe the main reason for the changes in the Argentine farm policy has more to do with the critical situation of the Argentine economy, which is burdened by an enormous external debt and handicapped by the steep drop in world agricultural prices stimulated by the United States enactment of the 1985 Farm Bill.

The Argentine farm economy is extremely sensitive to every signal coming from the markets; our farmers are totally unprotected by any kind of subsidy. Therefore, when international grain prices dropped as they did in 1986, Argentine grain exports, measured either in volume or value, declined almost 40%, seriously aggravating the crisis in our economy and further deteriorating our ability to meet our foreign obligations.

It is important to keep in mind that whereas Argentine farmers were forced to live with new market conditions, American farmers have been insulated from them thanks to the agricultural subsidy programs which in 1986, cost the American taxpayers $25 billion dollars.

Part of the Alfonsin Administration's response to the country's economic crisis has been to implement a deep structural reform in agricultural policy which even the most avid "pro-farm" administrations of the past, in which the influence of farm organizations was at its peak, never attempted.

It is also wrong to say that the impotence of the Argentine Government to cope with the crisis is the reason why the Government decided to "pin the blame on the export subsidies practices of the EEC and US". I will not make the obvious error of attributing all our ills to U.S. and EEC policies. Actually, many of our problems are the direct result of inefficiencies, for example, those that plague our commercialization system.

But the fact remains that Argentina, a taker of world prices that exports more than 50 percent of its grain production, is being affected by the unfair trade practices of developed countries which depress grain prices and displace my country from third markets. The 12 million metric tons of subsidized wheat provided to the USSR during 1987/88 with a subsidy level of $40 dollars per ton is a clear example of this practice.

RAPPING The Farm Credit System

From: Marvin Duncan  
Member Farm Credit Administration Board  
Re: Banner and Barry's RAPPING The Farm Credit System

Banner and Barry are correct; the effects of Regulated Accounting Practices (RAP), including their continuing costs, will be felt by the Farm Credit institutions for years to come. However, I disagree with them about their impact. That impact is almost certain to be costly, unpleasant, and burdensome for institutions using RAP accounting.

Through 1987, nearly $800 million of losses have been deferred by Farm Credit institutions. The carryover of costs will burden these institutions for up to 20 years into the future, adding to the already demanding burden of building an adequate capital base, the additional costs associated with borrowers rights and mandatory loan restructuring, assessments by the newly created Farm Credit System Insurance Corporation, and the requirement, after an initial grace period, to participate in repaying federal financial assistance.

Most discouraging, however, has been the accelerated financial deterioration of institutions utilizing RAP. But, that was not unexpected. First, despite statutory language, RAP did not necessarily trigger concerted and effective action by an institution to correct its problems of loan pricing, credit administration and financial management. To the contrary, RAP all too often relieved the institution of the immediate necessity to take corrective action.

Second, RAP was a classic example of "taking from Peter to pay Paul." Institutions that used RAP continued to retire the stock of borrowers at par value, even though the stock's actual value was less than par. That process could go on only if the stock of remaining borrowers was further devalued to provide funds to retire the stock at par. Thus, using RAP as a means to retire stock at a price above its actual worth actually served to accelerate the deterioration of a troubled institution's capital base.

Of course, borrowers leaving the Farm Credit institutions were pleased to have stock retired at par. However, borrowers who remained in the Farm Credit institutions became increasingly concerned about each institution's solvency, adding to their previous concerns regarding the liquidity of their stock investment.

I agree that from the perspective of hindsight, RAP accounting will be regarded as imaginative. I suspect, as well, that RAP will be regarded as having substantially increased the taxpayer's and the stockholder/borrowers' costs of rescuing the troubled Farm Credit institutions.

From: Delmar K. Banner and Peter J. Barry  
Re: The Authors Respond

Marvin Duncan has considered some of the longer term, financially unfavorable consequences of RAP accounting. We largely agree with the theme of his letter and see no basis for his disagreement with our article. Our intent was to explain the workings of RAP accounting, while highlighting some of the near term effects. While not explicitly considering longer term impacts, our observations...
that "RAP permits banks to mortgage their future" and "for some banks RAP will only postpone their day of reckoning." Clearly are consistent with the points raised in Duncan's letter.

Domestic Agriculture

From: Fred H. Sanderson
Resources for the Future
Re: Grennes' Multilateral Decoupling

Tom Grennes makes an eloquent case for lump-sum annual payments to replace government interventions in agricultural markets. However, his contention that such payments would have a neutral effect on production and trade would seem to be valid only for the long run.

We all understand the theoretical argument that once payments are no longer linked to a farm's current production, production decisions should be guided by market prices. Indeed, it has been suggested that decoupling can be accomplished in the U.S. simply by freezing the farm base. One flaw in this reasoning is that the American farmer has learned by experience that his base can be adjusted; he will therefore continue to produce to protect his base and, hopefully, to enlarge it when the opportunity is offered.

The credibility of the "once-and-for-all" nature of the payments would be enhanced if they were divorced from the farm's current production. Acreage reduction requirements could then be phased out at a pace that would preserve the principle of production neutrality. That version of "decoupling" would also meet the criticism of those who consider that permanent entitlements mainly benefitting a small minority of relatively well-to-do program-crop farmers are difficult to justify--particularly at a time of mounting budget pressures.

From: Harold F. Breimyer
University of Missouri-Columbia
Re: Grennes' Multilateral Decoupling

Thomas Grennes declares that governments can decouple payments to farmers from farmers' production decisions and thereby relieve farmers from acreage controls, save the government money, and free up international trade. It's an attractive promise.

There's only one flaw. Governments may decouple, but farmers won't.

Grennes believes that if their amount is not related to volume of current production, the making of payments to farmers will not affect production. It's just not so. It's not possible to pay out money to farmers, while allowing them latitude in production decisions, without thereby funding an appreciable part of operating costs, and sometimes some capital investment too.

In his theorizing, Grennes fails to take farmer psychology into account.

Or maybe the theories themselves are faulty. Classroom instruction has it that farmers match up marginal cost with marginal revenue. It may be more empirically accurate to say that farmers are notably influenced in their production decisions by availability of financing.

The 1980s provide a case in point. A few years ago many farmers, finding themselves strapped for cash, cut back on the rate of applying fertilizer and other variable inputs. To their surprise they found yields not to diminish much. They concluded that they had previously been over applying.

In those years access to operating capital sometimes rivaled distributors' recommendations as a guide to application rates.

Grennes is justified in observing that the secondary effects of any payment scheme would be affected by its design. He properly looks into various kinds of design. But he doesn't quite admit that any scheme chosen, if locked into place, would quickly be capitalized economically and politically--politically in the form of a focus of political pressure. That, though, is how it would be.

It hardly need be added that insofar as decoupled payments pay for intensified production they will be partially self-defeating. By holding production up and prices down they could fail to alleviate the low-income situation that gave rise to them.

The final irony in the Grennes argument is that it would prove operationally sound only if accompanied by a program device Grennes is quick to spotlight, namely, Senator Harkin's general supply control. If farmers were required to market within mandatory quantity quotas, they would indeed spend nearly all their payment largess on new clothes, holidays, and their kids' education. Failing such a restriction, they would divide payment monies between personal and farm outlays.

From: Thomas Grennes
Re: The Author Responds

Fred Sanderson points out that a program of making government payments to farmers solely on the basis of past production (freeze land base and yield) may affect current output if farmers do not believe that their production base will remain frozen. The effect of all programs depends on their credibility, and the credibility of the U.S. government could be increased by an international agreement to refrain from revising the production base. The commitment could be made in the current Uruguay Round of GATT negotiations, and other participants would be expected to make comparable commitments. Countries violating such an agreement would be subject to the same kind of sanctions as a country violating an agreement to bind a tariff at a particular level. Under GATT rules all injured parties are authorized to engage in an appropriate retaliation against the exports of the offending country. Thus, multilateral decoupling would provide incentives that would increase the credibility of national governments.

Sanderson's second point is that decoupled payments may influence production because the money will remain in agriculture. Breimyer makes the same point and refers to "farmer psychology." "Farming is what a farmer does best" and any subsidy "will be plowed back into the farm." One interpretation of this statement is that, unlike other businessmen, farmers do not compare marginal revenue and marginal cost in determining output. Presumably, an additional dollar would be spent on production even if the additional revenue would be only
Re: Lowell Hill's Grain Grading

Dr. Lowell Hill is certainly the expert.

The use of lump sum payments permits parameters at any level (including economic incentives. Whether program spending is $26 billion per year forever or $1 for one year. Conditional on output.

The purpose of my paper was to provide a framework for transferring separated from current production. If this condition is met, trade will be the same whether program spending is $26 billion per year forever or $1 for one year. Conversely, under traditional policies the size and duration of programs would have a direct impact on surpluses and trade. The use of lump sum payments permits politicians and bureaucrats to set policy parameters at any level (including Sanderson's prescription) without distorting economic incentives.

I will grant you that the grades need to be refined and improved. The National Corn Growers Association is working with Dr. Hill and others in this regard. Corn Growers have even funded some of his work. It is important to set meaningful standards for moisture and to decide if blending is really adulteration or if foreign material is really foreign material. Also, what is dockage, splits, broken corn, or broken corn and foreign material, etc. But, let's figure it out and establish a reliable, deliverable set of export grades (or grade) and then get on with the more important job of selling.

We spent as much time and energy educating our customers on how and what to buy and what quality is really worth in dollars and cents, we would have fewer complaints. It is always interesting to note that out of all the ships leaving U.S. ports filled with our grain and soybeans, there are very few complaints. It is also interesting that the quality concerns seem to increase along with grain prices.

Let's get these grades squared away once and for all and then get on with the important job of education and selling. Satisfied customers are the key. They are not unlike you and me. We tend to shop for reliability, service, quality, friendliness (otherwise known as people who want our business) and, of yes, price. Let's not lose sight of the market (big picture) as we try to fine-tune this magnificent food machine.

Historically farmers pay the price of bad grades, bad grain and a bad marketing system. They will in this instance as well. Right on, Dr. Hill, and good luck.

From: Jeffrey W. Gain
National Corn Growers Association
Re: Lowell Hill’s Grain Grading

If you want to know about grain grading, Dr. Lowell Hill is certainly the expert. His article is right on target as to the problems in setting and keeping meaningful grades. Perhaps it will always be a problem, but it does not need to be one.

Forgive me, but I must ask are we really focusing on the proper target? Seems to me the basic question is can the buyer get what he or she wants? Presumably a certain quality product at a reasonable price. The answer is a resounding yes. All you have to do is pay for it. You must also define what that “certain quality” is.

One day soon instead of #1 or #2 yellow it may be oil, protein, or starch levels.

Of course, customers are going to complain if they continue to shop for bargains and take #3 or lower corn grades. Opportunities for continued degradation of quality in the lower quality grades is usually higher than with good quality grain, i.e., the old rotten apple in the barrel theory and blending problems.

Re: The Author Responds
University of Illinois

I express my appreciation to Jeff Gains for his many years of support for improving grain quality. He and the associations he has represented have had a major influence on the actions to revise grades and standards and to separate the “real problems” from the “perceived problems” of grain quality.

I would like to elaborate on one issue raised in his letter. The industry response has often been “we will deliver any quality the buyer wants if he is willing to pay the price.” This comment overlooks the economies of scale in information achieved through federal grades, uniformly available throughout the industry. If the buyer desires a higher test weight corn he need only change a number on the contract. Information on test weight is available through the market channels and a price differential will direct the higher test weight to the buyer. In contrast, a request for higher oil requires an identity-reserved-contract specifying variety, growing location and perhaps cultural practices. The cost of information on oil content at each point in the market channel is borne by the single shipment, not spread across the entire crop. The difference in cost of information on test weight and oil content is due in large part to oil being excluded from grades and standards.

The key to Jeff Gains question is the phrase “reasonable price”. Dry millers in Japan or German oil crushers do not consider an identity-reserved-contract specifying variety, growing location and perhaps cultural practices. The cost of information on oil content at each point in the market channel is borne by the single shipment, not spread across the entire crop. The difference in cost of information on test weight and oil content is due in large part to oil being excluded from grades and standards.

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From: Ralph E. Heimlich
Economic Research Service
Re: Taff and Runge's Leaner and Meaner CRP

Steve Taff and Ford Runge correctly diagnosed a problem with highly erodible land. Many policymakers, and some of those who advise them, confuse economically marginal land with physically marginal land. My research shows that an index of net returns to crop production is as high on highly erodible soils as on nonerodible soils. Significant acreages with all levels of productivity can be found at all levels of erodibility. Long-term retirement of some of this land will incur high opportunity costs, as Taff and Runge point out.

Unlike Taff and Runge, however, I think that highly productive, highly erodible land should be included in the CRP. Soil erodibility is a continuum, measured by separate erodibility indices (EI) for sheet and rill erosion and for wind erosion. The original definition of highly erodible land developed by the Fragile Lands Working Group (see McCormack and Heimlich, "Erodible Soils: Definition and Classification," Assessment and Planning Staff Report No. 85-2, Soil Conservation Service, March 1985) set a limit of EI greater than 15. This limit corresponds to the highest level of erosion reduction which could be achieved under stringent management and still produce row crops. This corresponds to high-residue no-till farming systems, implying an upper limit of 15 on the erodibility index. That is, even using the most stringent management, highly erodible soils (EI greater than 15) will still erode above soil loss tolerance levels.

As currently defined in regulations for the Food Security Act, highly erodible soil is that with EI greater than 8, implying a much less stringent test for retirement. If we were to return to the more stringent level of EI greater than 15, we would truly be retiring only land that could not be used for crop production without excessive erosion. Land with EI between 8 and 15 could continue in production if proper cropping and conservation practices are used.

This would still be far from a true benefit-cost test for retiring fragile land, however. Existing soil loss tolerance (T) values do not correlate well with actual losses of soil productivity and there is no analogous measure of off-site damage. An appropriate limit on EI is an imperfect measure of damages. However, it does identify soils which if farmed within the limits of our technology will lead to substantial erosion. It is an appropriate function of society to retire such land from production whether the opportunity cost of doing so is high or not, as long as the benefits are felt to be greater than the costs. We delude ourselves only if we believe that retiring all highly erodible land ought to be inexpensive.

From: Steven J. Taff and C. Ford Runge
University of Minnesota
Re: The Author Responds

Ralph Heimlich advocates including highly productive land in the CRP because that is the only way to retire all highly erodible lands. We have no quarrel with this. But can Congress afford it? As Heimlich notes, highly productive land is expensive to retire.

Harking back to our productivity-damage diagram, Heimlich would offer CRP eligibility to lands in the upper left quadrant (high damage, high productivity). We, on the other hand, would restrict eligibility to the lower left quadrant (high damage, low productivity).

By definition, all soils along any vertical line in the diagram are equally "damaging," in whatever sense (soil loss, off-site clean-up costs, etc.) one wishes. So, we say start at the lower left and work up. If you still have money left by the time you get into highly productive (but still damage-causing) soils, then by all means, retire them too. But take out the cheapest first.

One could think of a cost-per-ton-reduced dimension perpendicular to the diagram. This surface presumably has its lowest point in the lower left corner and its highest point at the upper right, but its shape in between is not yet determined. It might be that the route of slowest ascent is to the right rather than up. Optimal targeting then, would concentrate on low productivity lands because they're cheaper to retire, and forego the retirement of higher productivity lands, even if these are more damaging. (We hold with Heimlich that conservation benefits ought to be the sole objective of the CRP. Surplus commodity control is better lodged with more flexible annual set aside programs.)

Heimlich also argues that we (society) ought to retire all lands that can't be farmed without causing excessive erosion. Our approach is amicable to such a restriction. If, for example, the damage gradient is calibrated on the basis of the erosion index, then the CRP could be targeted to those lands located to the left of the EI-15 mark. All we ask is that even here retirement start at the lower end of this range and sequentially move up into lands of ever-increasing productivity (cost). A true CRP bidding process would accomplish this ordering quite nicely.

From: Cathy L. Jabara
U.S. Department of the Treasury
Re: Nicole Ballenger's PSEs

Nicole Ballenger’s informative article on producer subsidy equivalents (PSEs) raises some interesting questions about what a PSE actually measures and, consequently, its role in the GATT trade negotiations.

First, there appears to be some confusion on a conceptual level. In one instance, Ballenger defines the PSE as an "estimate of the effect of government policy on gross producer returns (a net income concept)." Yet, elsewhere she defines the PSE as "the effect of government policies on [beef producers'] revenues" (a gross income concept). In reality, however, the PSE is hybrid measure containing elements which can influence both a producer’s net income (e.g., input subsidies) and his gross income (e.g., price supports).

This apparent confusion results from a misspecification of the PSE denominator. To maintain consistency with the benefits specified in the PSE numerator, the PSE income base should be composed of revenues from production (which includes income from tariffs and price supports), transfer payments, and other government expenditures, such as research, marketing, tax incentives, etc. It would also be correct to exclude taxes paid from the denominator, assuming that these taxes would be unaffected by any reduction in expenditures. With this correction, the PSE becomes a straightforward measure of transfers to the agricultural sector, as a proportion of (adjusted) gross agricultural income.

Second, the PSE calculation ignores the possibility that consumers, not producers, may be the ultimate beneficiaries of some producer subsidies. For example, to the extent that government expenditures on agricultural research and on input subsidies stimulate production and lower commodity prices, the benefits
from such subsidies will be shifted from producers to consumers. Similarly, without government expenditures for marketing assistance, consumer prices would be higher, reflecting increased producer expenditures and costs, and the ability of producers to pass these expenditures through to buyers of agricultural products.

Whether or not consumers actually benefit from these producer subsidies depends upon: (1) price elasticities of supply and demand, and (2) whether or not a country maintains floor prices (price supports) which prevent higher production from being translated into higher prices. Given the econometric evidence which suggests that the long-run U.S. agricultural supply curve is elastic, and that demand for agricultural products tends to be inelastic, the benefits from these programs in an unrestricted market are more likely to be captured by U.S. consumers through lower prices. Where price supports (or other policies) prevent lower producer costs from resulting in reduced agricultural prices, then producers get the full benefits from expenditures on input subsidies and higher output prices.

The PSE is a useful indicator of the degree of government intervention in agriculture, but it does not estimate the effects of government policies on producers' income. Thus, its value as a vehicle for negotiating specific reductions in agricultural subsidies in the GATT agricultural trade round is questionable. However, as an indicator, the PSE could be used to categorize agricultural policies and to indicate the nature and extent of a country's agricultural sector support. It would be useful to recalculate the PSEs during the process of policy adjustment, as suggested by Ballenger in her discussion of the PSE as a monitoring device, but solely for the purpose of examining the progress being made in reducing subsidies to agriculture.

From: Nicole Ballenger
Re: The Author Responds

Both the strengths and weaknesses of the PSE framework relate to its flexibility and simplicity. Its flexibility makes it adaptable to the policy profiles of different countries and commodity markets and to the interests of the user. Its simplicity makes its calculation a practical empirical exercise. Its flexibility also makes it difficult to be precise about what a PSE measures. If a PSE contains only policies that have their effect on producer income (both gross and net) through their effect on output prices, then it is clearly a gross income concept. For example, the subsidy equivalent of a tariff is a rough estimate only of the revenue effects of the tariff, although we also know that a tariff affects costs and, consequently, net income through its effects on output. If a PSE also contains policies that have their effect on income through their effects on input prices or unit marketing costs, then, as Cathy Jabara suggests, it might be more appropriate to think of the PSE as an 'adjusted' gross income concept. The important thing, for the purposes of the agriculture talks, is that when PSEs are used to make cross-country comparisons that the policy coverage and estimation techniques be as similar as reality and data permit.

The choice of a denominator for a PSE depends on the story to be told. Following Josling, ERS and OECD use (along with other denominators) producer farm revenues with direct income payments, such as U.S. deficiency payments, added in. This approach allows us to relate the total value of policy transfers to a commonly understood concept and a readily available figure. Also, it facilitates cross-country comparisons. It should be noted that this denominator reflects the impacts of all policies on revenue through their effects on either output prices or quantities produced.

The calculation of PSEs is facilitated by the simplifying assumption that the benefits (or costs) of transfers from taxpayers to producers accrue entirely to producers. Clearly the PSEs and CSEs, as currently calculated, are not the best indicators of the incidence, or distribution of benefits, of government programs. They can only be considered a starting point. The distribution of the benefits associated with supply shifting programs depends on a number of factors including market structure as well as on whether the country is large or small, and open or closed to trade. In the small, open economy case, supply shifts would leave consumer expenditures unaffected.

I leave Jabara's suggestion that PSEs have little value as a vehicle for negotiating specific reductions in agricultural subsidies to the debate of the Choices readership. She suggests they do not because they are not an adequate estimate of the effects of government programs on producer income. Traditionally, trade negotiations have been based on tariffs, another measure for less than adequate for measuring the effects of government intervention in agriculture on producer income, production, or trade.