

Payment Limitations

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Commission on the Application of Payment Limitations For Agriculture

USDA Jefferson Auditorium, Washington DC

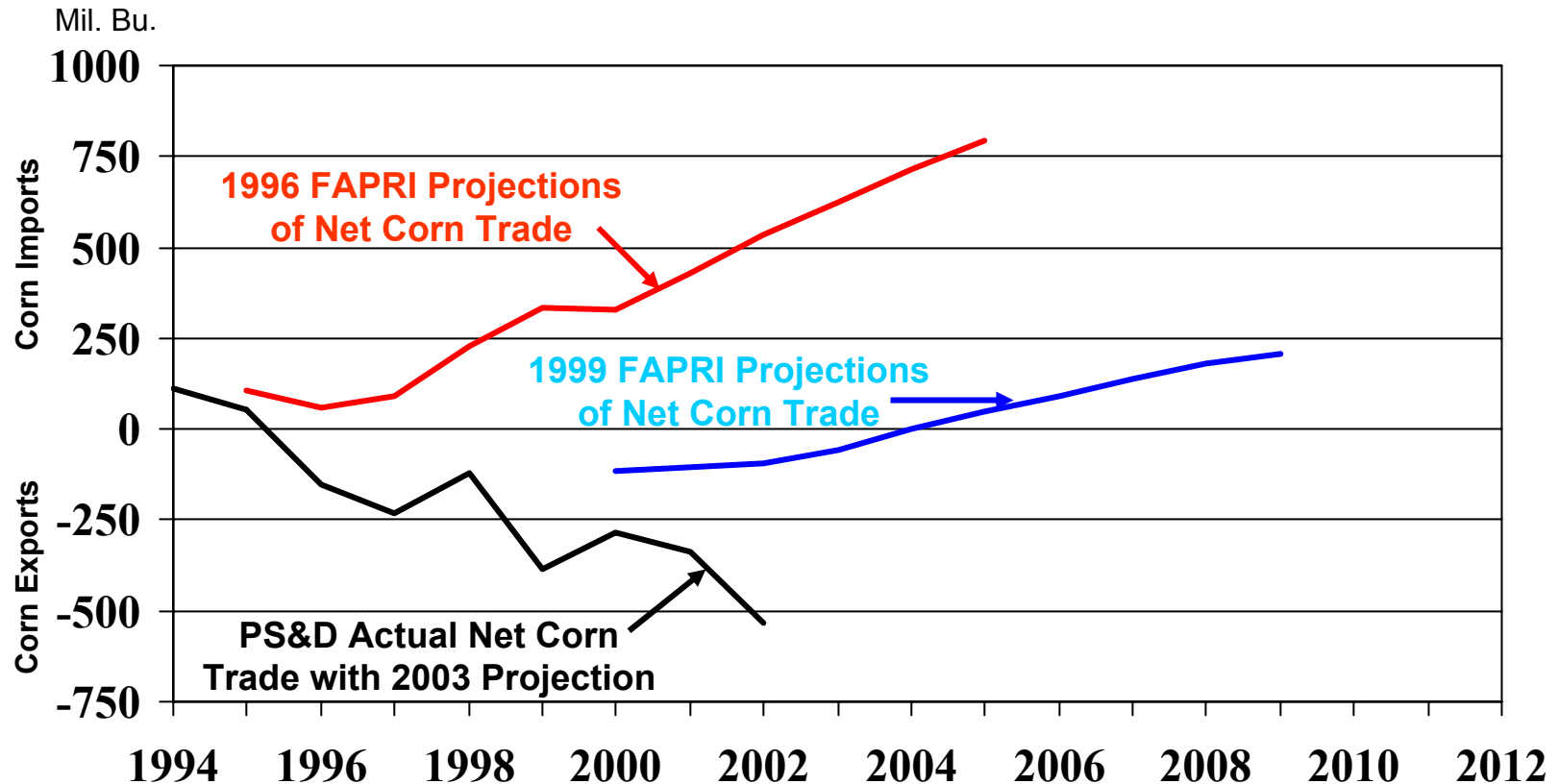
Tuesday June 17, 2003

First Things First

- Symptoms versus the disease
- In 1996 thought the disease had been cured
- Thought agriculture would be “1995/96” prosperous because:
 - **New-era demand expansion:** Demand growth will exceed supply growth with China taking the lead

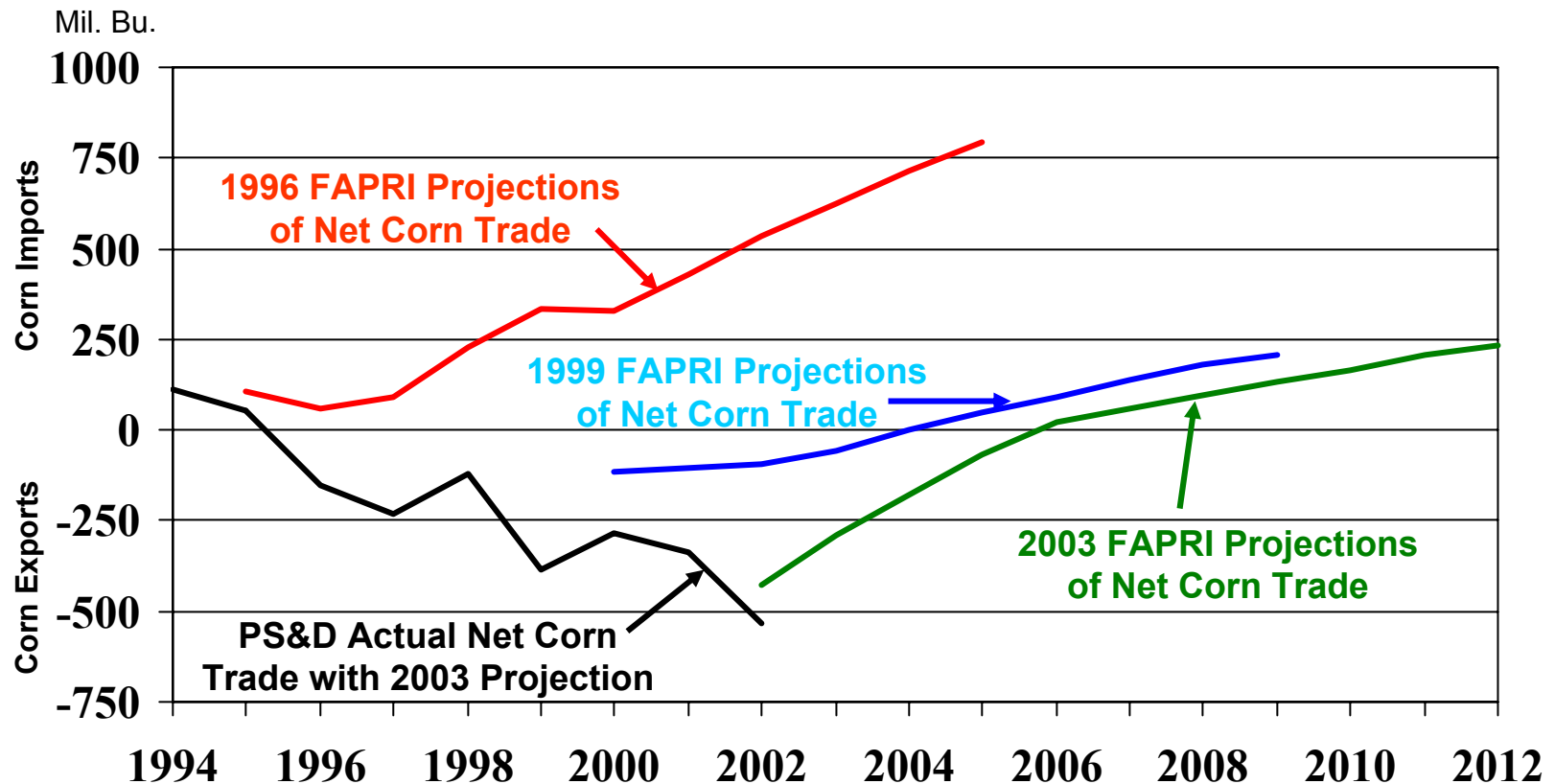
China Net Corn Trade

Comparison between 1996 and 1999 FAPRI projections and PS&D actual



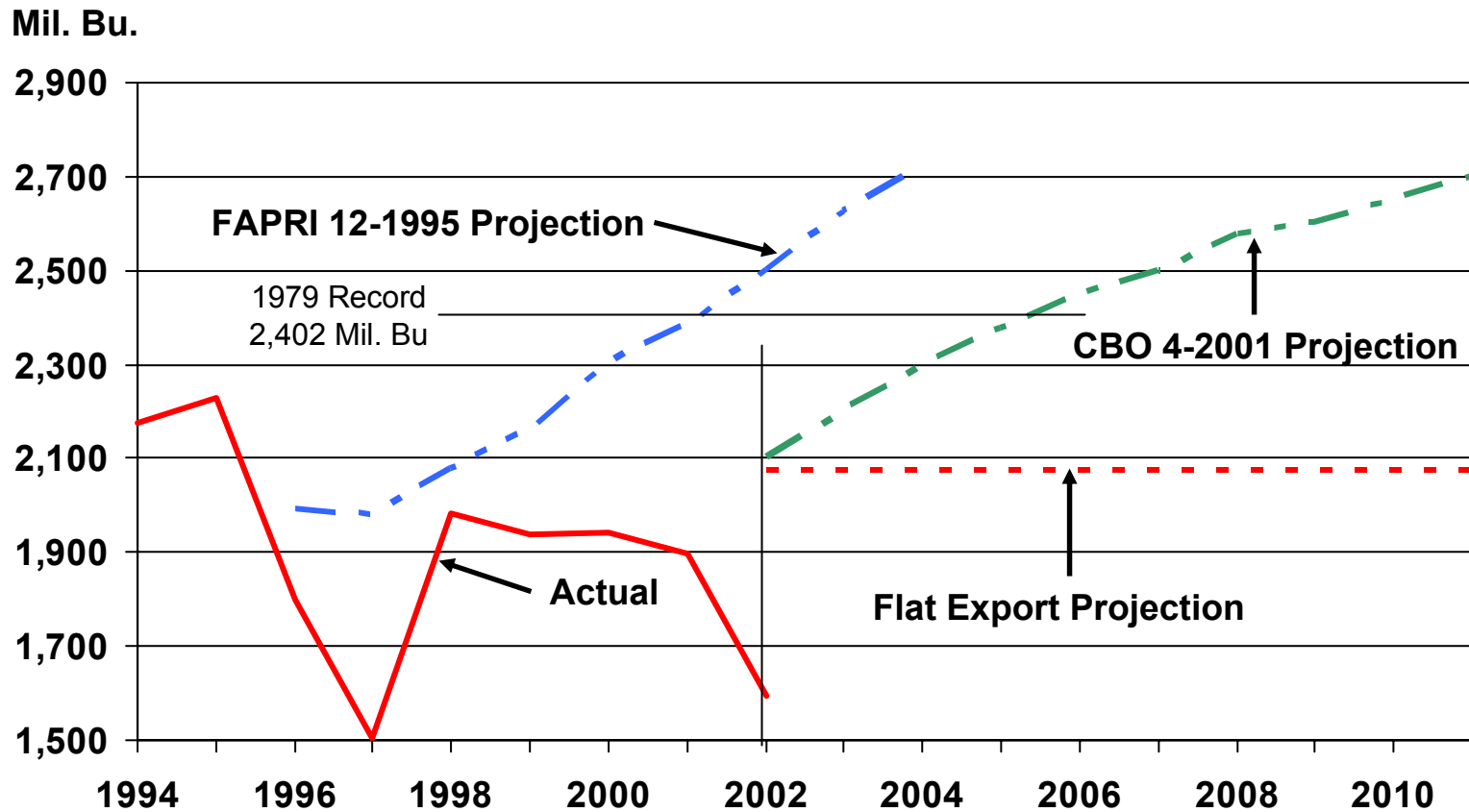
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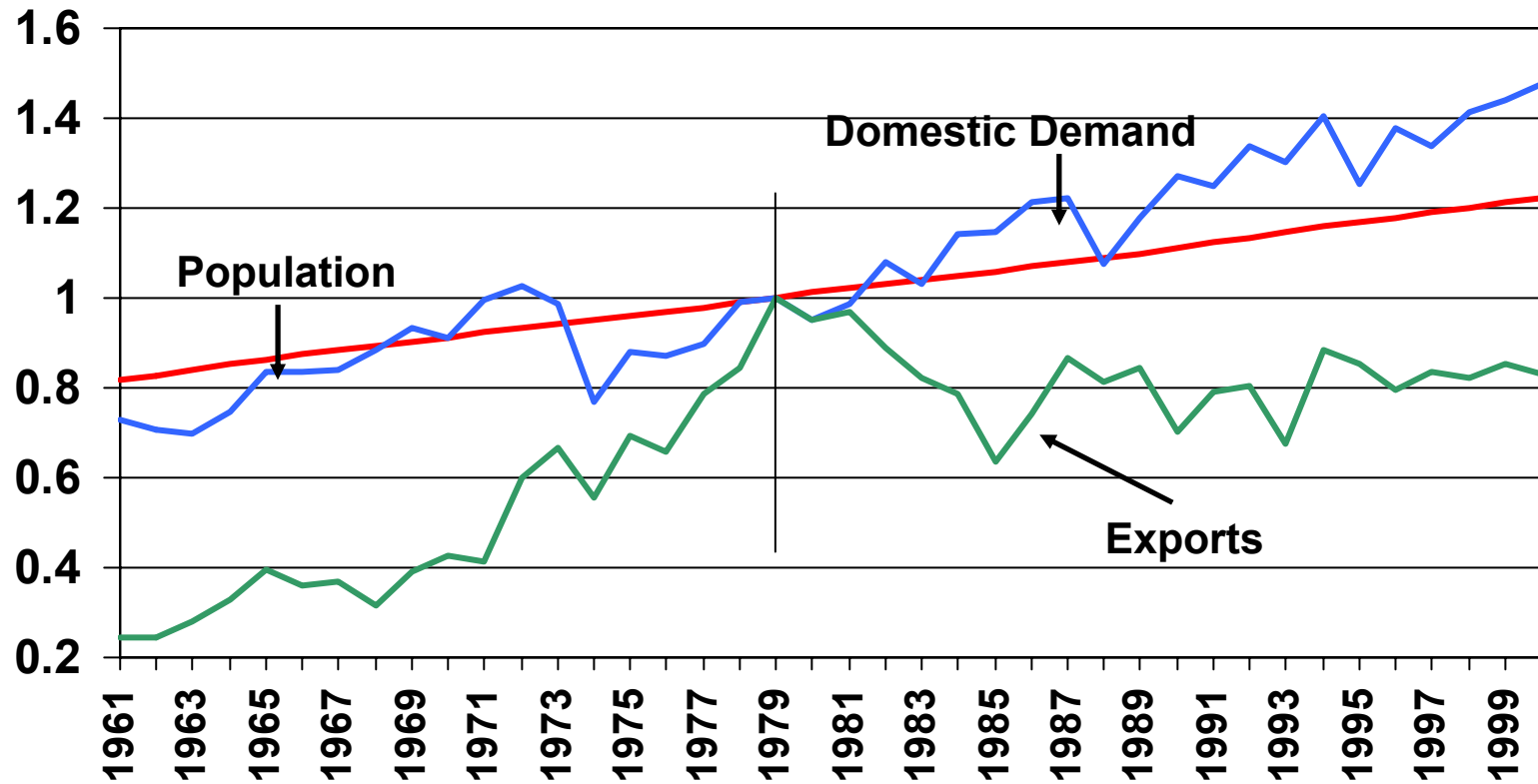
Corn Baseline Projections

U.S. Exports

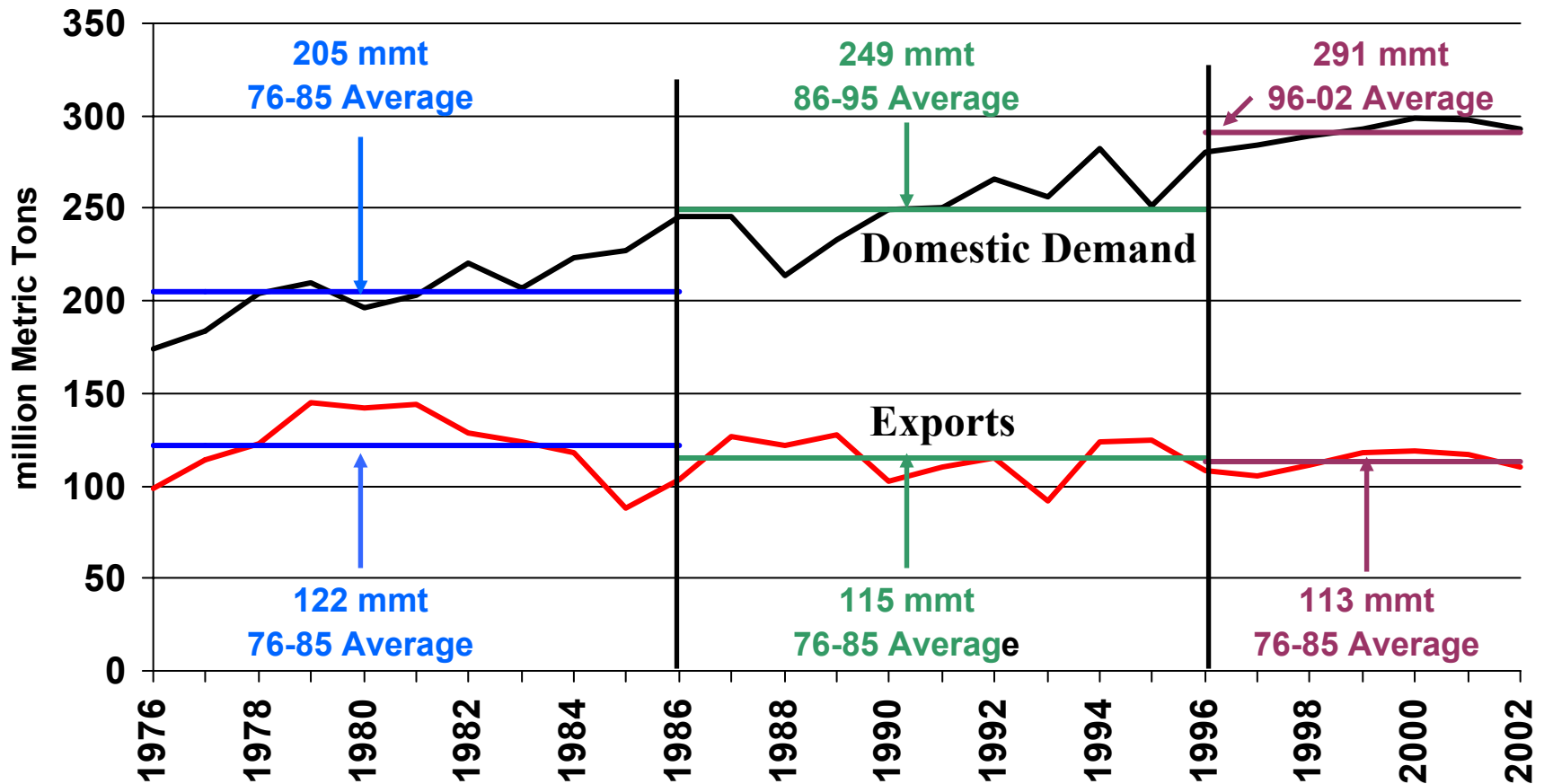


Domestic and Export Demand for Total Grains and Seeds, U.S. Population

1979=100

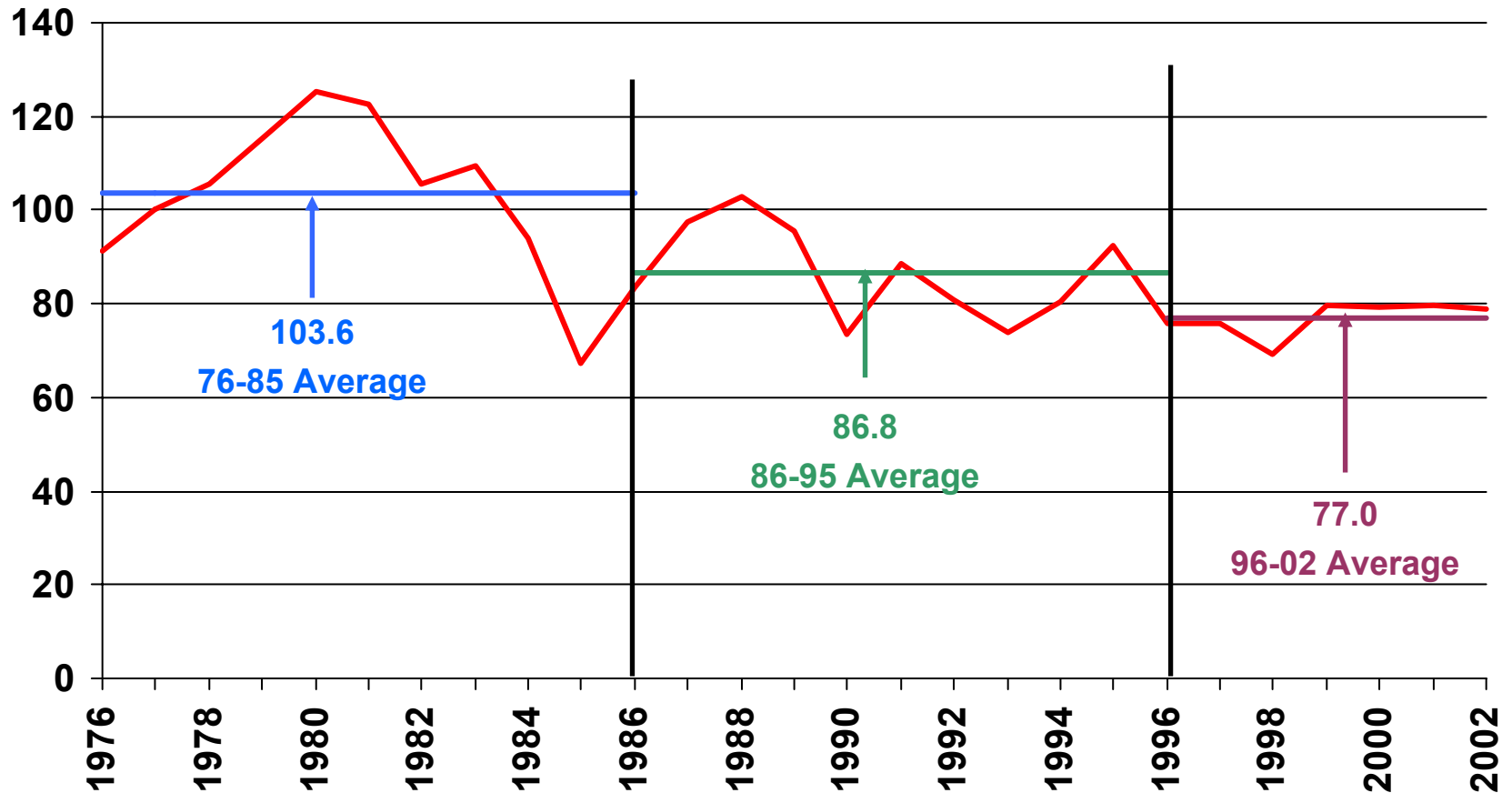


Net Export and Domestic Demand for 8 Major Crops



Net Export Acreage for 8 Major Crops

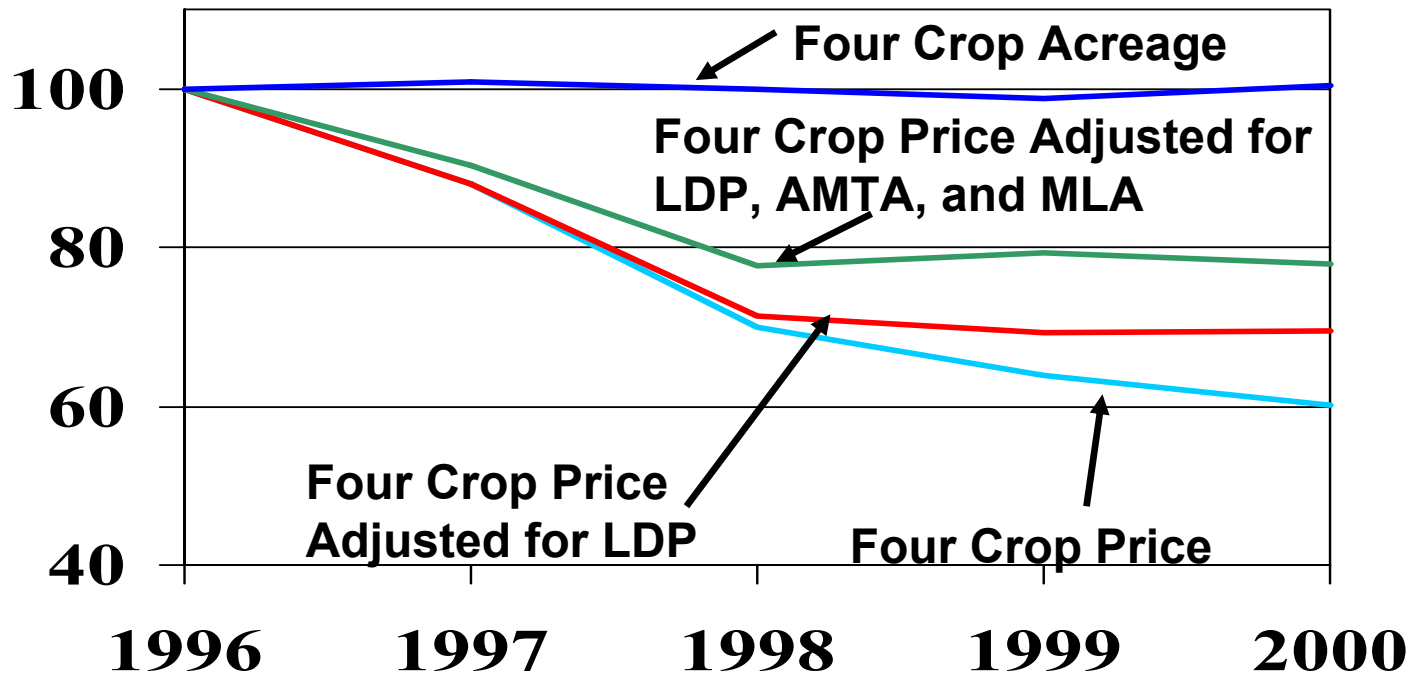
Million
Acres



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 - **Supply is more price responsive:** Decoupled payments and production flexibility will make it so

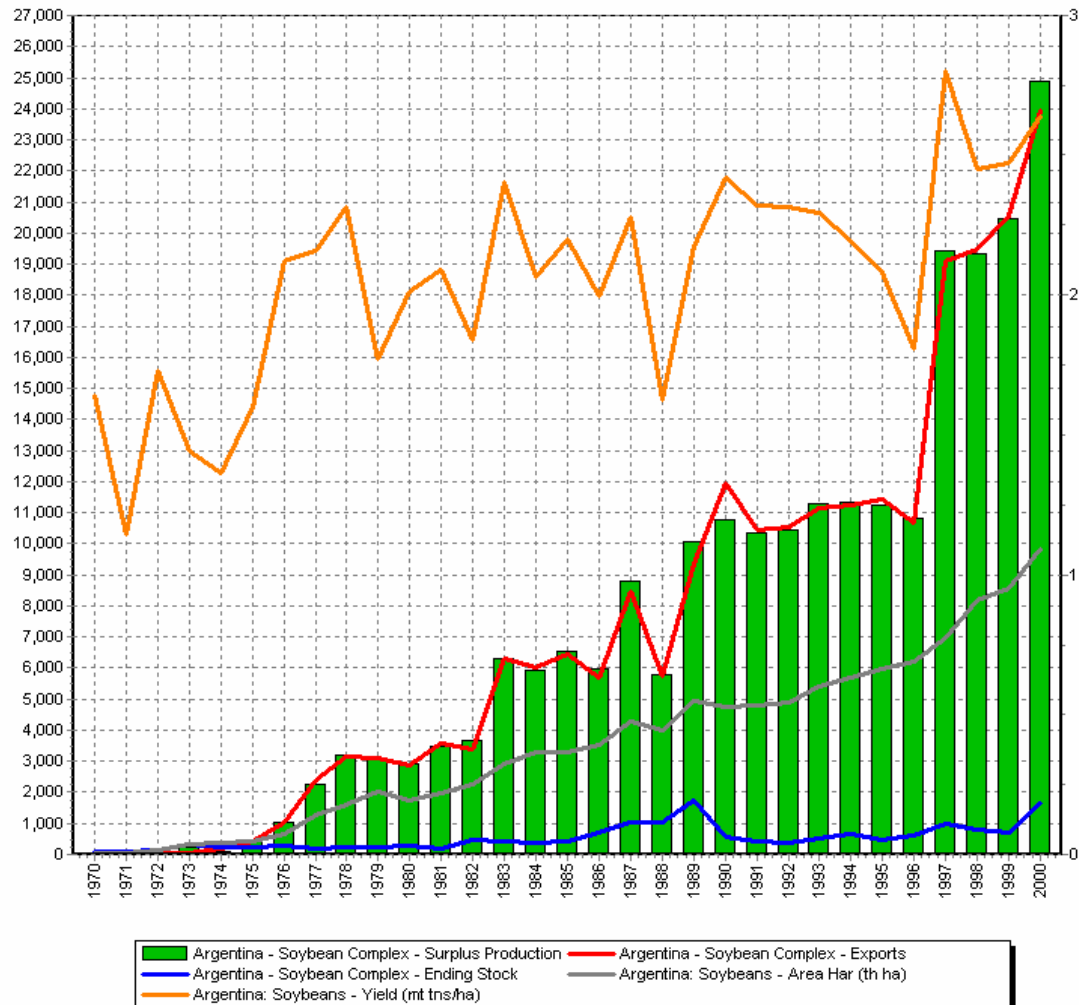
Indexed Four Crop Acreage, Price and Price Adjusted for LDP and Contract Payments



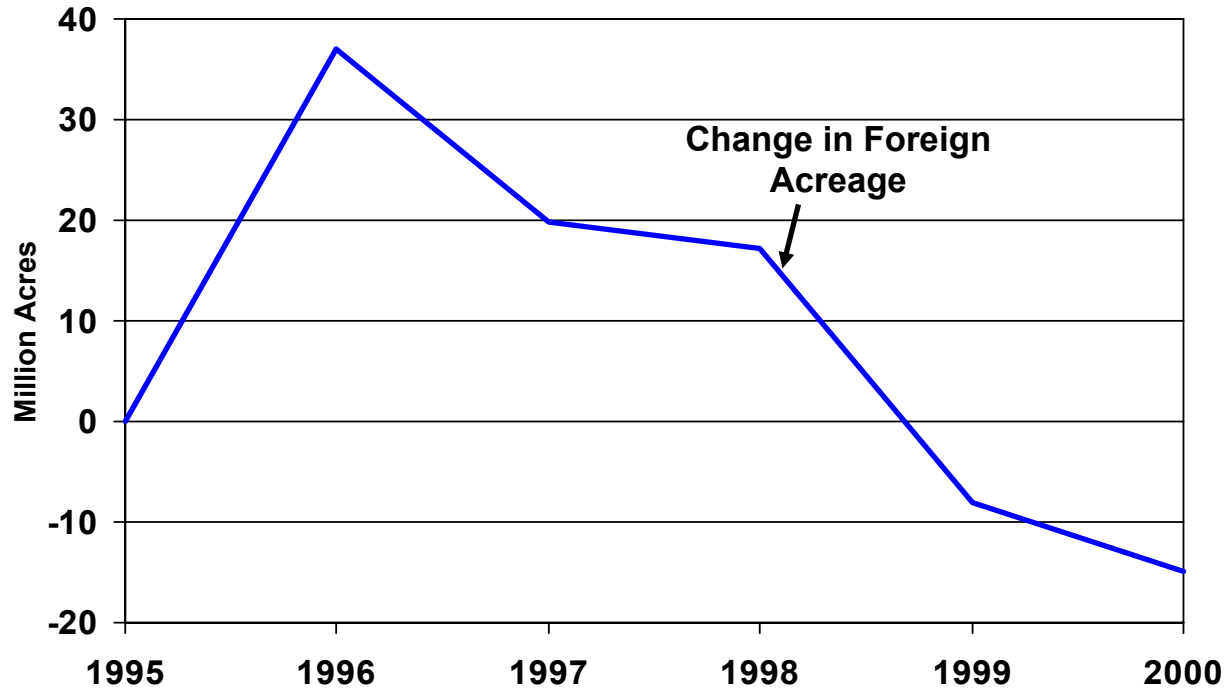
First Things First

- Symptoms versus the disease
- In 1996 thought the disease had been cured
- Thought agriculture would be “1995/96” prosperous because:
 - New-era demand expansion: Demand growth will exceed supply growth with China taking the lead
 - Supply is more price responsive: Decoupled payments and production flexibility will make it so
 - **Demand is more price responsive:** With no price supports, lower prices would cause export competitors to reduce production and importers to reduce or not increase production

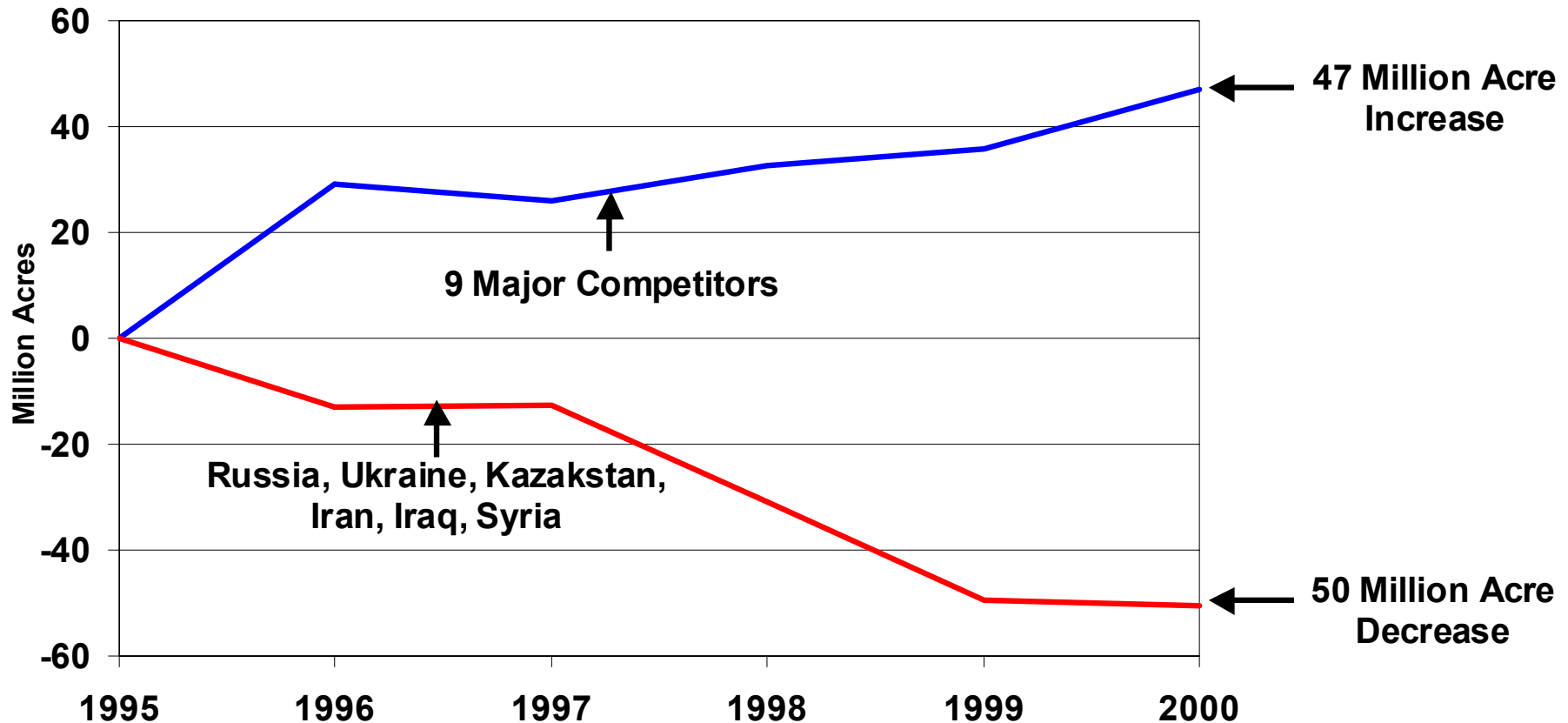
Argentine Soybean Complex Exports and Surplus Production



Foreign Crop Acreage



Change in Foreign Crop Acreage



What is the Problem?

- Technology expands output faster than population and exports expand demand
- Market failure: lower prices do not solve the problem
- No self-correction on the demand side
 - People will pay almost anything when food is short
 - Low prices do not induce people to eat more
- No self-correction on the supply side
 - Farmers tend to produce on all their acreage
 - Few alternate uses for most cropland

Criticisms of U.S. Farm Policy & Payment Limitations Issue

- Encourages consolidation of farms
- Bolsters land prices benefiting land owners, owner/operators; disadvantages renters
- Depresses market prices
- Major benefits flow to integrated livestock producers, processors, sellers on farm inputs, and export customers
- Caused incomes of farmers worldwide to collapse
- Too expensive to be sustainable

How Would Strict Payment Limitations Affect: **Commodity Prices?**

- Overall, not much—acreage changes are the key
- Stricter payment limitations would NOT significantly reduce acres used to grow crops
- Mix of crops would change
 - Less acreage devoted to cotton and rice
 - But more acreage devoted to soybeans, corn and wheat
- Prices would increase for cotton and rice
- Prices would decrease for soybeans, corn and wheat

Prices changes would be similarly felt in other countries

How Would Strict Payment Limitations Affect:

Consolidation?

- Rate of farm consolidation to mega-size crop farms would be slowed in all areas
- The wording of the legislation and administrative regulations would determine how existing large farms would react
 - Change crop mix
 - Sell off acreage to another farmer who is under limit
 - Reconfigure operation to meet the letter, but not necessarily the intent, of the law
- Would not slow down and would likely exacerbate concentration in the livestock industry

How Would Strict Payment Limitations Affect:

Land Prices?

- Downward pressure, ditto for cash rents
- Initially, additional land would come onto the market, depressing prices
- Through time, payment limitations would reduce “discretionary” income of larger farm operators—the very operators that buy land

How Would Strict Payment Limitations Affect:

The Real Beneficiaries of the Farm Bill?

- Prices of grain and soybean meal would be pushed even further below cost of production
- Agribusiness
 - Negative for cotton and rice ginner/mills/processors
 - Positive for grain and soybean processors/transporters
 - Positive/negative for input suppliers
- Still would subsidize integrated livestock producers, agribusiness and export customers

Summary Comments

- 1996 & 2002 Farm Bills failed to recognize that:
 - Timely self-correction does not take place in agriculture
 - Aggregate demand of major crops responds very little to price
 - Aggregate supply of major crops responds very little to price
 - Crop exports are NOT going to provide the ever-increasing rate of growth agriculture needs to be prosperous on its own
- The policy choice was to:
 - reject these realities
 - allow prices to plummet
 - write very large checks to cover losses; which, in turn, has raised all kinds of distributional issues including the issue facing this commission

Summary Comments (cont.)

- Gov't payments are large by any standard but they are not ballooning total crop incomes
- Consider allowing payment limits to vary geographically to reflect cash and fixed costs differences by crop type
- Yes, large operations with “low” per unit costs and “high” discretionary income are major players in the agricultural land market

Summary Comments (cont.)

- Effective Payment Limitations would:
 - Dampen upward pressure on land prices
 - Reduce, perhaps significantly, farm consolidation but favor continued livestock concentration
 - Cause changes in price ratios among crops
 - Any affects on index of prices received by farmers and food prices are more likely to be downward than upward—but will likely be swamped by other effects
- Final Comment: Those who have beat the drum the hardest for free markets have usually been the ones who believe they are the lowest-cost producers
 - Once volume levels are reached that drive down per unit fixed costs—given these producers' self-proclaimed low marginal costs—it seems contradictory for them to claim to be disadvantaged under any and all payment limitation alternatives