

Are past arguments against raising loan rates valid?

In designing the APAC/TFU supply management program for the 8 major storable crops (barley, corn, cotton, grain sorghum, oats, rice, soybeans, and wheat), the corn loan rate was set at 95 percent of the full US cost of production. The loan rates for the other crops, with the exception of grain sorghum, were established based on their historic ratio to corn in order to avoid distorting planting decisions. The grain sorghum loan rate was set at the corn loan rate (<http://tinyurl.com/y92zoevd>).

In the early 2000s when the corn loan rate was \$1.95 per bushel and the target price was \$2.63, we had a discussion with several individuals who had experience serving as staff for the Congressional agriculture committees. In that discussion, we argued in favor of setting a loan rate that was closer to the full cost of production and then annually increasing or decreasing it based on changes in the cost of production.

Though they were strong supporters of farm programs, they wanted nothing to do with supply management, higher loan rates, and loan rates that would increase or decrease with the cost of production. They argued that supply management was no longer a reasonable policy tool, preferring revenue support programs to a price support program like supply management.

We will tackle that debate in a future column and use this article to examine higher loan rates and loan rates that increase over time.

The APAC/TFU supply management program used \$4.21 as the 2017 per bushel cost of production, resulting in a loan rate of \$4.00. To put that number into perspective it is instructive to look at various prices that have been set in legislation over the last 21 years. The loan rate per bushel of corn in 1996 was \$1.86. In 2004 the corn loan rate was increased to \$1.95 where it remains today.

The Counter-Cyclical Program (CCP) was reinstated in the 2002 Farm Bill and the target price for corn was set at \$2.60 for the 2002-2003 crop years and raised to \$2.63 for subsequent years. The target price remained the same for the 2008 and 2014 farm bills.

As the 2014 Farm Bill was being debated, it was clear to some that the target price was not going to provide adequate revenue protection and so the CCP was replaced with the Price Loss Coverage program (PLC), which set a corn reference price of \$3.70.

Several of our colleagues' arguments were made in opposition to setting the loan rate (or other pricing mechanism) too high. It was argued that a portion of the higher loan rates would be captured by input suppliers and capitalized into land, resulting in an ever-increasing cost-of-production.

And to an extent, that is true. But it is also true of every other source of additional non-market revenue that a farmer receives: from off-farm income, to direct payments, to crop revenue insurance income guarantees. The latter two certainly have more potential to be captured by landlords and input suppliers, and capitalized into land than a loan rate that is 95 percent of the full cost of production.

It was also asserted that high loan rates pull more resources, particularly land, into production than is an efficient use of those resources. A corn loan rate of \$4.00 may draw a few additional acres into production. Compare that nationally and internationally to the increase in corn acreage that resulted from the harvest-time revenue insurance pricing option when the corn price was above \$6.00 or \$7.00 per bushel.

When comparing various policy instruments, the critical question is not whether they create a distortion, they probably do, but rather the magnitude of that distortion. Using that criteria, a loan rate set at 95 percent of the full cost of production comes out well compared to alternate policies.

It was also argued that export markets will dry up when prices are supported near the cost of production because our export competitors will supply the export market at lower prices. The corollary being that lowering loan rates would markedly expand export quantities. At the time our visitors were talking to us, that argument had already been shown to be invalid.

US corn exports hit an all-time high during the 1979 crop year, more than triple their 1971 level. The expectation was that corn exports would continue to increase for the foreseeable future. Instead, over the next six years, corn exports declined by nearly one-fourth. The decline in exports was blamed on the loan rate which had increased by nearly a quarter, going from \$2.10 in 1979 to \$2.55 in 1984.

As a result, the 1985 Farm Bill set in motion a deliberate policy of reduction in the loan rate, dropping to \$1.92 in 1986 and falling as low as \$1.57 in 1990. Certainly, corn exports would increase with a lower supported price, it was believed. In the 31 years since the loan rate was lowered, corn exports have averaged 77 percent of their 1979 high. Clearly something other than a “too high loan rate” has been at work in the corn export market.

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