

Benchmarking ag policies

Two weeks ago, we used this column to describe six preferences (<https://tinyurl.com/yaa3akak>) that we use in our analysis of various commodity policies that have been or may be implemented in the US or elsewhere in the world. Beginning with this column, we are going to use these six preferences to analyze the major policy instruments that have been written into law by the US Congress.

As a reminder our six preferences are for policies that:

1. Support an agricultural production capacity that exceeds current demand and maintains supplies that can be used in the case of widespread production problems;
2. Do not contribute to the dumping of agricultural commodities on the export market at prices that are below the full cost of production;
3. Take the low price-elasticity of both supply and demand into account;
4. Seek to eliminate negative externalities like air and water pollution;
5. Allow farmers to decide what to produce based on agronomic requirements and economic signals among the possible crop and livestock alternatives; and
6. Are counter-cyclical, providing support when prices are below the full cost of production and no financial support when crop prices are above the full cost of production.

The 1996 Farm Bill represents the first major shift in crop commodity policy since supply management programs were first introduced in the 1930s. Many US farmers hailed the legislation referring to it as Freedom to Farm and declaring that with the end of supply management's stock-holding and acreage-reduction programs, they could out-compete any farmer in the world.

Their enthusiasm was, in part, influenced by the high prices they were seeing in what was the tail end of the 1995 corn crop marketing year and the expectation of most analysts that China would be importing corn and by 2002 would need 500 million bushels per year. It was also believed that farmers would be more likely to reduce crop acreage in response to low prices. Two reasons were given for this shift. First, farmers were using more purchased inputs than they did in the past when most inputs like the manure that was used to fertilize crops were the result of agricultural operations.

In addition to the end of supply management, the new farm bill introduced planting flexibility so that farmers did not have to worry about maintaining their base acres in various program crops. Because the 1996 Farm Bill was viewed as the "farm bill to end all farm bills" and because there would be no farm program costs related to supply management instruments, but with a budget baseline, Congressional leaders converted the available budget to provide farmers with Agricultural Market Transition Act (AMTA) payments that would decline to zero over time. Some spoke of these as weaning farmers off their dependence on farm program payments.

Congress did leave the marketing loan rates alone while expanding the Loan Deficiency Payment (LDP) program to all program crops.

In the months after the 1996 Farm Bill was adopted, prices began to fall as it became clear that the 1996 corn crop would come in with above trendline yields. By the 1988 crop marketing year, in addition to trendline corn production and in the absence of any signs that China would begin importing corn, most crop prices were well below the full cost of production and farmers were in trouble.

What was once called Freedom to Farm was now called Freedom to Fail. Congress responded to pressure from farmers by providing them with emergency payments each year for four years.

With this brief history in mind, let's begin our analysis of various provisions of the commodity title of the 1996 Farm Bill.

In ending supply management programs with no replacement, Congress ignored the low-price elasticity of both supply and demand, and this was fatal. It turns out that purchased inputs vs. farm-supplied inputs made no significant difference in the price elasticity of supply. Farmers continued planting all their land all the time. As long as there is an expectation that a crop's price could be above the variable cost of production, any revenue above that level can be used to cover fixed costs that are incurred whether a farmer plants or not. Even with low prices, farmers have every incentive to plant all their acres.

While the AMTA payments were not linked to production, it was argued that in the face of low prices, these payments would substitute for farm program payments and farmers would use them to reduce production. They didn't. In addition to being ineffective, AMTA payments were not counter-cyclical. They were paid to farmers whether prices were high or low. They became baked into the farm household operating budget, just like off-farm income. During the time that crop prices were below the full cost of production, AMTA payments contributed to the dumping of US agricultural commodities on the world market at a price below the full cost of production.

The marketing loan program was a key element of the supply management programs that predated the 1996 Farm Bill. It worked by allowing farmers to take out a 9-month, low-interest loan with the government at harvesttime. Farmers could then pay the loan off at any time during that period. If the market price was below the loan rate plus interest, the farmer could forfeit the crop as full payment of the loan. The government, through the Commodity Credit Corporation would then store the crop in a bonded warehouse and then sell it once the market price reached the release price.

By isolating the crop from the commercial market, the loan rate became a floor price, preventing the crop from being sold into the export market at a subsidized price. In addition, the marketing loan program provided reserves that could be accessed in the case of a significant production problem.

With the elimination of the supply management program and the functional end of government crop storage, the marketing loan program was modified to allow farmers to have their cake and eat it too. If the price fell below the loan rate, farmers who took out loans could pay off the loan at any time during the 9 months at the posted county price, keep the crop, and claim the difference between the loan rate and the market price as a marketing loan gain (MLG).

Farmers who didn't take out a marketing loan could benefit as well. All they had to do is pick the time when they wanted to take what was called a loan deficiency payment (LDP) and notify the local ASC office which would then issue them a check for the difference between the loan rate and that day's posted county price. And again, they maintained ownership of their crop. In both cases, farmers did their best to claim the MLG/LDP at the lowest posted county price.

The MLG/LDP program benefitted farmers only when prices were below the full cost of production—the loan rate was always below the full cost of production. But by supplementing farmer income at the difference between the loan rate and the posted county price, it allowed US farmers to sell their crops into the world market at prices below the full cost of production.

And then there were 4 years of Emergency Payments. And while neither they nor the AMTA payments, nor the LDPs were the cause of the low crop prices during the 1998-2001 period, they did result in dumping.

The one bright light of the 1996 Farm Bill was the introduction of planting flexibility, allowing farmers to adjust their acreage allocations in response to changes in demand. This allowed farmers to respond to China's decision to begin importing soybeans. Even so, planting flexibility and increased soybean exports were not sufficient to bring crop prices up to profitable levels.

In 2002, Congress ended the 7-year 1996 Farm Bill a year early, adopting the 2002 Farm Bill in a bid to stabilize crop agriculture in the US.

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