APAC Agricultural Policy Analysis Center

The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

Two issues may shape the 2007 Farm Bill

As I look at the issues that cannot be avoided as we prepare to lay the groundwork for a discussion of the shape of the 2007 Farm Bill, several things come to mind. The first is the federal deficit and the second is the pressure that is being put on WTO negotiators to eliminate agricultural subsidies. These two factors have the potential to significantly affect the nature of the 2007 Farm Bill discussion.

While these two issues may seem to be unrelated, one domestic and the other international, they in fact stem from a common cause. If crop prices in the 1997-2004 period were at the same level that they were in early 1996, we wouldn't be talking about either one. However, because of low market prices for the eight major US crops, spending on the farm program zoomed to over $20 billion a year and recently has settled back into the mid-teens. Much of the time over the last nine years, crop prices have been well below the cost of production. When these crops are sold into export markets at low prices, farmers and governments around the world accuse us of dumping our excess production on international markets at a price that is below the full cost of production. As a result we have seen a growing chorus of those who, as a part of WTO negotiations, are calling for the elimination of all subsidies in the US and other developed countries.

The issue that has to be addressed, then, is the part that recent US farm policy may have played in bringing about these low prices. I would argue that the low prices are the consequence of basing farm policy on an incorrect set of assumptions about the nature of the agricultural sector, particularly crop agriculture. Going into the 1996 Farm Bill, it was assumed that (1) the agricultural sector behaves more like other economic sectors than it did when farm programs were first adopted in the 1930s; (2) exports are the key to a prosperous US agricultural sector, after all 95 percent of the consumers of food live outside the US; and (3) government farm programs are the problem, not the solution, and if the government would get out of the way and allow markets to work, US agriculture would be on the road to a market-driven prosperity. Let us look at these one at a time.

In other economic sectors, low prices stimulate two responses—consumers increase their purchases while manufacturers reduce production quickly returning to industry to profitability. Low food prices, however, do not stimulate consumers to increase their food intake from three meals to five meals a day. Similarly, it is not in the best interest of individual crop farmers to measurably reduce their acreage or use of inputs in the face of lower prices. Any income they receive above the variable cost of production can be put toward the fixed costs.

US farmers have enjoyed an export driven prosperity three times in the last century—WWI, WWII, and the mid-to-late 1970s—and none of them were triggered by US farm policy instruments. These periods of surging exports lasted a total of no more than 14 years out of the last hundred. Most countries view their domestic food production in the same way that US residents view the military, it is a matter of national security. Most nations that have an adequate amount of arable land would prefer to grow their own food rather than become dependent on imports. The level of US exports of crops like corn are more a function of production variations in other nations than it is a function of price.

Under government farm programs in effect prior to the adoption of the 1996 Farm Bill, the non-recourse loan rate set an effective floor on program crop prices by taking production out of the commercial market and placing it into government storage. With the extension of Loan Deficiency Payments (LDP) to crops like corn, soybeans, and wheat, prices could fall below the loan rate, farmers could collect the difference between the posted county price and the loan rate while still retaining possession of the crop that could then be sold at prices well below the cost of production. A comparison of corn prices before and after the implementation of the FAIR Act shows that for the same year-ending stocks-to-use ratio, prices in the post 1996 period were 34 cents a bushel lower than they were when government policy put a floor on corn prices. Before the adoption of the FAIR Act, government policy worked in a manner so as to ensure that farmers received the bulk of their income from the marketplace and at the same time maintained lower government costs. With a floor on crop prices, other nations had little reason to accuse the US of dumping.

If a variation of the pre-1996 farm programs were in effect today, crop prices would be higher, government farm program costs would be significantly lower, farmers would receive more of their income from the marketplace, the volume of our crop exports would be virtually the same as it is today, the value of our crop exports would be higher, and farmers around the world would be receiving higher prices for their crops making the accusations of dumping moot.

For all of their weaknesses, farm policies in effect prior to 1996 had fewer negative side effects than the policies in effect today. We would contend that the reason for this is that the earlier policies took into account the unique economic characteristics of crop agriculture and were designed to work both in periods of stable to declining exports and increasing exports.

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