

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

## How farm policy used to work

In the period between the 1930s and 1992, farm bills generally instituted compensation policies that took the form of price supports. These policies were designed to manage the surplus production that resulted from centuries of developmental policies while allowing US farmers the chance, with hard work and good management skills, to provide their family with a livelihood. Compensation policies also allowed farmers to remain on the land until labor demands in other parts of the economy enticed them and/or their children to leave the farm and earn their livelihood in another way.

While price support policies varied in form over the years, they were generally used tools that in one way or other managed the supply of various agricultural products.

For the major row crops, the price support policies were based on a non-recourse loan rate—established in legislation or a formula written into the legislation—that allowed the producers of storable grains and fibers to take out a loan with the Commodity Credit Corporation (CCC)—a government corporation—instead of having to sell the crop at harvest, a time to pay off production expenses. The harvested crop served as collateral for the loan.

This was important because prices at harvest were generally at their lowest point of the year. With the loan farmers could market their crop later in the year at what they hoped would be a higher price. The period of the loan was usually for 9 months and bore an interest rate that was lower than farmers could get from a local lending institution. Those taking out loans were responsible for the storage of the crop and keeping it in marketable condition.

Farmers were permitted to sell the crop at any time—the rules for the Farmer-Owned-Reserve (FOR) were different—and pay off the loan plus interest. They could then keep the difference between the loan repayment costs and the sale price.

In the event that farmers were unable to sell the crop at a profit, they could forfeit the ownership of the crop to the government and deliver it to a CCC storage facility. The delivery of the grain served as full payment of the loan plus interest and the government had no recourse to force farmers to pay the difference between the value of the loan and the current value of the crop, thus the term non-recourse loan.

Thus the loan rate served as a floor price for the covered crops because farmers could always take out a loan at the loan rate and deliver the crop to the CCC. The CCC would then hold the crop until the market price reached a pre-determined release price at which

time it would begin liquidating its holdings.

To protect against the CCC holdings becoming too cumbersome, various mechanisms—that varied from time to time—were used to take land out of production and thus reduce overproduction and allow the price to remain above the loan rate.

If the loan rate and the release price were reasonably set, this mechanism served the interests of producers by ensuring a minimum price and doing what farmers could not do on their own—reduce production to ensure that supply and demand were in balance at a lower price limit that at least allowed them to remain in production. It also served the interests of consumers in the US and abroad by assuring them of a reliable supply of grains and fibers—at a pre-determined upper price limit—in the event of a reduction supply or a surge in demand.

Because the US is a major economic, political, and agricultural power, the US serves as the oligopoly price leader for many agricultural products and their substitutes with other countries selling their crops at a discount to the US price plus shipping. This relationship between the US price and price elsewhere remains the same whether the loan rate is high or low or whether the price is high or low. Others are always price followers.

The FOR was a variation on the CCC program with the major exceptions being that the loan period was longer and farmers were allowed to retain ownership of the crop, were paid a storage fee, and were allowed to capture the difference between the loan rate and the release price that was otherwise captured by the CCC.

While this type of storage/supply management system worked well for crops that had a long shelf-life, it was ill-suited for other crops. Crops like fruits, vegetables, and nuts, instead, are eligible for marketing orders which are authorized under the Agricultural Marketing Agreement Act of 1947 and subsequent amendments.

Marketing orders, under the oversight of the USDA, allow a majority of producers of a given crop like cranberries to manage the supply of their crop through mechanisms like specifying the grade and quantity of their crop that can be shipped to market. They also can establish mechanisms for handling surplus production, provide for reserves, and establish sanitary standards and standardized sizes of marketing containers.

With these tools producers can affect the supply of their product going to market thus influencing price. Marketing orders work best for crops that are grown

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in a limited locale, have limited substitutes, and have a consumer demand that is relatively stable through a range of prices.

Milk producers also used marketing orders while tobacco used marketing quotas for many years. In the past, sugar was most often protected by import quotas.

Livestock, unlike crops, have historically had production cycles that reflect the nature of production as well as the ability of producers to manage the supply going to market. Unlike crops where the major asset—land—is fixed, with livestock the major asset—the cow or sow—can be sent off to town when prices are low. When prices are high livestock producers can keep an extra female or two to increase production in the medium-run.

These policies weren't perfect. Not by a long shot. There were times in which grain stock levels became burdensomely large. There were times in which politics overtook reason (examples include some of the support price levels and issues relating to

stocks, usually relating to the timing and government costs of stock disposal, for example, the elimination of stocks just before they are most needed like before the price run-ups in the 1970s and use of expensive stock disposal schemes like payment-in-kind).

But in retrospect, the overall approach, even with its well-publicized warts, seems more defensible as a public policy than the programs of the last couple decades. Also, the earlier commodity programs—though highly criticized for their government costs and market interventions—on average cost less and arguably cause less economic disruption than current commodity/safety-net programs.

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