PolicyPennings by Dr. Daryll E. Ray

Reforming farm programs: Remember to consider underlying assumptions

Many of the current spate of articles reporting on the Senate's struggles to put together a farm bill talk about the potential—or lack thereof—for radical reforms that would turn away from the farm programs we have had since the 1930s. The basic premise is that we need something new that would avoid the pitfalls of the current program: paying farmers fixed payments when prices are high, making payments to people who have houses on land that was once farmed, and pumping up the profits of crop insurance companies.

Actually farm programs have already undergone radical reform. Reform occurred over a period of years beginning with Earl Butz in the 1970s and culminating in 1996 with the so-called Freedom to Farm legislation. These policies were locked into place with the 2002 Farm Bill. With the reform, the mechanisms of earlier legislation were made ineffective.

What has the three-decade long reform journey included?

- Lower loan rates offered in a vain attempt to "recapture" export markets,
- A marketing loan program that enabled prices to fall below the loan rate and keep it there,
- Export loan programs and subsidies that have been ruled to be trade distorting,
- A plethora of new federally subsidized crop insurance products,
- Elimination of the Farmer-Owned Reserve in addition to taking away the price floor function of the nonrecourse loan program,
- Elimination of the set aside program and therefore the ability to adjust production
- The enabling of users of program crops to buy grains at subsidized prices
- Massive "emergency payments,"
- Direct payments to crop farmers when crop prices are high,
- And on and on the list goes.

So, before we undertake another set of reforms, and we are not defending the current set of policies, we need to look carefully at the rationale for farm programs in the first place.

If markets worked during the unregulated years of the 1920s, there would have been no reason for the farm programs of the 1930s—programs that are often referred to in current news articles and editorials. And if there were good economic reasons for the farm bills of the 1930s, then those reasons must still be true today, unless the economic structure of agriculture has changed between then and now.

That leaves us with three questions. 1) Was there an economically justifiable reason why farm programs were needed in the 1930s? 2) Are those conditions still present today? 3) If they are not present today, what changed?

Let us start with the last question first. The 1996 Farm Bill was called "Freedom to Farm" because its authors believed they had set up a program that would enable farmers to respond to market signals instead of "farming the program." To bribe farmers into accepting the reforms, they offered AMTA payments that were designed to transition to zero, ending farm programs as we know them.

Instead by 1998, crop prices had fallen to below the loan rate, farmers were in dire straits and Congress responded with emergency payments in the form of a "double AMTA." Not only did AMTA payments not transition to zero, the emergency payments continued for three more years before they were institutionalized in the form of Counter-Cyclical Payments.

In response to low prices, exports did not increase as promised and consumers did not increase their consumption either. In the face of low prices, farmers did not treat the AMTA payment as a windfall and reduce production. Instead they farmed nearly every acre possible and continued to use yield enhancing technology when what was needed to right the price ship was to lower production.

Despite the fact that inputs had to be purchased instead of hauled out of the barn, crop farmers tended to plant all of their acres all of the time unless prevented from doing so by weather.

The basic overriding question is: Has the economic structure of crop agriculture changed between the 1920s and today.

That is, do both the total quantity supplied and the total quantity demanded still respond minimally to changes in price? If so, market forces will not return crop agriculture to profitability in a timely manner.

The last three decades of reform assumed that, indeed, the economic structure of crop agriculture had changed. The implication being that external production adjustment and price stabilization programs were no longer needed.

What we learned was that acting on that "things-are-different-now" assumption costs hundreds of billions of dollars in the form of emergency payments and payments from several government check-writing programs.

We agree that there is a need for radical reform of the farm programs that are currently in use. But when changes are made, it is important to remember the economic context within which farm programs operate—that is, the demonstrated nature of aggregate crop markets.

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