

Farm program considerations: Part 2

Last week we said that a supply management program for the crop sector makes more sense to us than the current combination of revenue insurance with farmers choosing either ARC or PLC as counter-cyclical programs (<http://tinyurl.com/jgmbfzm>). We called for a supply management program because it meets our criteria.

A supply management program sets a loan rate that is between the variable cost of production and the full cost of production and uses a non-recourse loan and storage program to take enough of the crop off the commercial market to cause the price to rise above the loan rate. As a result, the immediate cost to the government is only for the amount of the crop taken off the market plus storage costs for that portion of the crop.

This type of program meets two of our criteria for a defensible crop sector farm program. First, it treats the cause of low prices rather than treating the symptoms by taking a portion of the crop off the commercial market, causing prices to rise above the loan rate. Second, a supply management program pays only for a portion of the annual production rather than shelling out money for every bushel, pound, or bale produced or a large percentage thereof.

Supply management programs have come under criticism and we will address them in coming columns, but first we need to take a further look various elements of the program design we are proposing.

A supply management program works by setting a loan rate (the price at which the commodity is taken into storage) and a release price (the price at which the commodity is made available to the commercial market). By setting these two prices, the program establishes a band within which the commercial market and the forces of supply and demand establish the price that allocates the commodity among various competing uses.

The loan rate serves to establish a floor price that protects farmers from long periods of low prices while the release price protects consumers when supplies are tight as the result of decreased supply or increased demand. Thus the government's investment in the program serves the needs of both the producer and the ultimate consumer by moderating prices at both ends.

In addition, if the loan rate were to be set properly, then the program would be a true Blue Box program under current trade agreements. It would mean that US farmers could not be accused of dumping surplus grain on the world market at prices that are below the cost of production. In addition, particularly for farmers in the least developed countries, this program would put a floor under their prices and provide them with some stability as well.

To establish how the program works we want to limit our immediate consideration to a program design in which the government holds the stocks through a federal government organization called the Commodity Credit Corporation (CCC).

When the commodity, say corn, is sold by the CCC at the release price the government recoups the acquisition costs at the loan rate, interest, and most, if not all, of the storage costs, which is not true of the programs we currently have.

As the crop is received by the CCC, it is put into storage which serves as a crop reserve. History has shown that without setting a ceiling on the amount of the crop held in reserve, the reserve can become unwieldy. In setting that limit, policy makers need to look at the historical variability in supply and set the maximum size of the reserve so that it can meet the needs of the market in tight supply situations.

To keep the reserve from exceeding the maximum size, production will have to be reduced which means reducing acreage. In the past, acreage was set crop by crop which led to

distortions as the relative usage and prices of the various row crops changed. Any future program would have to allow for planting flexibility and instead take a certain amount of acres out of production, allowing farmers to choose their own crop mixture.

We will discuss additional details of and issues surrounding a sound supply management program in future columns.

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