Farm program considerations: Part 6

In this series of columns, we have argued that a) governmental farm program programs are necessary because of the inability of aggregate agriculture on both the supply and demand sides to adjust to low prices in the short-to-medium run, b) current farm programs are ineffective in dealing with the price/income problems that result from extended periods of low prices, c) current farm programs are more expensive than alternative policies that treat the cause of these low price periods, and d) a government supply management program that puts the relatively small amount of a crop that is in excess of current demand into a reserve deals with the cause of chronic low prices (for a fuller discussion of these and related ideas, see www.agpolicy.org, columns 845 to 850).

Early on in the supply management program in the US, when farmers forfeited the portion of their crop used as the basis for a government crop marketing loan in lieu of paying off the loan plus accumulated interest, the ownership of that portion crop was transferred to the Commodity Credit Corporation (CCC), a government entity. Upon forfeiture of the crop, the farmer would deliver the crop to a bonded warehouse, usually a local elevator that was authorized by the federal government to receive the crop.

The bonded warehouse, which was compensated for the storage of the crop, then held the grain until authorized by the government to sell the crop into the commercial market. The sale was made at the release price. With this sale, the government recouped a portion of the cost of the program, though in a subsequent fiscal year.

Over time, farmers began to argue for a change in the design of the program. They felt it was not right that the government received the higher price for the crop that they grew. They also said that they would benefit if they could hold the grain and have the government give them the storage payment.

In response to pressure from farmers, Congress established a Farmer-Owned Reserve program (FOR). With the FOR, the loan that farmers took out on the crop could be extended beyond the normal 9-months period so that they retained ownership of the grain. They would have to store the grain and keep it in proper condition. In exchange for storing the grain, the farmer was paid a storage payment.

The farmer was not able to sell the crop until a release price was reached at which time the farmer was could sell the crop and use the proceeds of the sale to pay off the loan plus interest. The farmer would be able to keep the difference between the sale price and the loan payoff.

Now let's look at the difference between the two ways of holding the reserve.

When the CCC held the reserve, if the price was not reached, even if it was just a nickel or a penny away from that level, the crop was not sold. The interest of the government in this program was to provide a reasonable, predictable, stable price band that benefitted both producers and crop consumers and was not in receiving the immediate profit. Crop users may have wanted to gain access to the crop, but until the release price was reached it remained in storage.

Compared to that, let us look at what happened with the FOR when it was in effect. Let us begin by remembering that the purpose of a supply management program is to address a market failure by providing a price band within which the price would be set by market forces.

Now suppose that the market needs to ration the crop in response to a change in either supply or demand. Further suppose that the price gets to within a penny of the release price in one crop year and then falls back in the next when production and demand are in closer balance. And suppose it stays that way into another crop year.

Let's now look at the interest of farmers who are holding the crop in the FOR. The financial interest of individual farmers is to receive the profit at its highest point so they would and did argue for the release price to be lowered a bit so they could have made the sale.

And that is exactly what happened. Originally the release price was set to provide a reasonable price band. But bit by bit, Congress and/or the USDA responded to lobbying by farmers, others who wanted a freer market, and those opposed farm programs altogether and the release price was lowered. Eventually, the release price was essentially abandoned making the FOR ineffective in its original purpose to protect farmers from prices that were too low and consumers from prices that were too high.

If a price management program were to be reinstituted, the challenge of determining who is to hold the crop must be addressed. If farmers are willing to understand that they benefit from the loan, the storage payments, the protection from low prices, and a stable release price then an FOR would work. If either Congress or the USDA were likely to respond to lobbying by lowering the release price, then the CCC would be the proper entity to hold the crop.

Next week we will begin our column with a discussion of ways to reduce production when the amount of the crop in the begins to reach its upper limit.

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