LDPs: Playing limbo by competing with oneself

A recent Washington Post article told the story of a Maryland corn grower who collected $75,000 in Loan Deficiency Payments (LDPs) even though he sold his corn crop for well above the loan rate. In fact in his local area the price of corn may never have fallen below the loan rate during that year.

This anomaly is possible because of a change in USDA policy that minimizes the differences in the posted county price across the nation. The posted county price is the price that the government uses to compute an LDP payment. By posting approximately the same price each week across all the nation's counties, producers in corn deficit areas like Maryland, where farmers receive a price premium compared to the national average price, can collect nearly the same LDP per bushel as growers in corn surplus areas.

That change is a good example of a bad policy mechanism gone worse. From our perspective, LDPs are bad policy because they are not designed to correct an identifiable market problem like lack of price responsiveness that we so often talk about. The Post article and the attention it has garnered give us the opportunity to take a look at the rationale for this program.

LDPs were developed based on the belief that the non-recourse loan rate was preventing US farmers from capturing their share of world exports by holding the US price above the prevailing world price. It was argued that the use of LDPs would enable farmers to capture those export markets by allowing them to sell their grain or cotton at the "world price" capturing lost sales from other international producers. The LDP was used to compensate US producers for the difference between the "world price" and the loan rate.

This reasoning ignores the role that the US plays as the oligopoly price leader and residual supplier in major crops like corn, soybeans, wheat, rice, and cotton. To sell their farm commodities in the export marketplace, other exporters price their products at a discount under that of the oligopoly price leader, adjusted for shipping costs. The strategy works for them because the price leader sets the benchmark off of which they set their price.

With the elimination of the price floor previously provided by the non-recourse loan, prices can and do fall below the loan rate making US farmers eligible to collect LDPs. But our export competitors respond by continuing to price their product at a discount off the US price which allows them to retain their export volume.

Not surprisingly then in such an oligopoly market structure, the shift from price floors to LDP payments did not deliver the predicted boost in total US crop exports.

For the US crop sector, the use of LDPs to allow the US price to match the "world price" is like playing limbo with yourself. The lower you go the lower you have to go.

The real beneficiaries of this program are not US producers, but rather bulk commodity importing countries, commodity processors and other users of these commodities like integrated animal feeding operations. The losers are farmers in countries around the world whose countries cannot afford to protect them with LDPs and US taxpayers who get stuck with a bill that is much larger than the storage payments that preceded the use of LDPs. But, that is a story for the next column.

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Originally published in *MidAmerica Farmer Grower*, Vol. 23, No. 29, July 21, 2006