PolicyPennings by Dr. Daryll E. Ray

# Using LDPs flood markets and crash prices

In last week's column we examined the rationale for using loan deficiency payments (LDP) as an agricultural policy tool. We noted that from our perspective LDPs are bad policy because they are not designed to correct an identifiable market problem like lack of price responsiveness.

In fact, in times of low prices, LDPs make the situation worse by shelling out government money while allowing the excess supply to remain on the market. This overhanging supply drives prices even lower for farmers in the US and around the world while costing the taxpayer a bundle.

Unlike the prior non-recourse loan payment program, where the government incurred non-loan costs only on those bushels farmers forfeited to the Commodity Credit Corporation as a loan repayment and the Farmer Owned Reserve (FOR), LDPs are potentially paid on every bushel grown during a crop year in which the posted county price drops below the loan rate. A significant portion of the runaway costs of the farm bills since 1996 can be attributed to LDPs.

If we look at the 25 years prior to the adoption of Freedom to Farm, a moniker often applied to the '96 bill, we find that non-commercial stock levels averaged 9.1 percent of production per year.

Over that 25 year period, the government storage program incurred costs on 16.7 billion bushels of corn (both CCC and FOR). These 16.7 billion bushels are a far cry from the 176 billion bushels of corn produced in those years. Buffer stocks increased in seven of the 25 years prior to the 1996 Farm Bill. That means, that during each of those years, excess supplies would have flooded the market, crashed prices and likely would have resulted in LDP on over 53 billion bushels.

The number of bushels covered by LDPs would most likely have been considerably larger than the 53 billion bushels over the twenty five years. That is because prices often (usually) drop below the loan rate sometime after harvest allowing farmers to collect LDPs even in years in which the average price over the marketing year is well above the loan rate.

To make this point. Get this! The season average price for the 2004 corn crop was $2.06, eleven cents above the loan rate. And still, LDPs were collected on 92 percent of the 11.8 billion bushel crop for a total payout of $2.9 billion!

While the general public may be shocked and outraged to discover that farmers are able to collect LDPs even though they sell their crop at or above the loan rate, it is no surprise to farmers. Commodity marketing services regularly advise farmers on strategies that allow them to maximize LDPs while extracting as large a market price as possible.

If LDP supporters had seen this as a problem, the 2002 Farm Bill would have been the time to correct the problem. In fact, during the discussion of the 2002 Farm Bill, farmers who managed to net prices well above the season average price were hailed as good managers by USDA officials and policy makers alike.

All in all, the Loan Deficiency Payment program, including Marketing Loan Gains, has not lived up to its billing as a means of reducing government costs while expanding the US penetration of export markets.

As we said last week: the real beneficiaries of this program are 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.

Just because LDPs do not correct a market problem that does not mean that there is no market problem. Indeed, aggregate agriculture has no more ability to self-correct now than it did 8 decades ago. The fact that LDPs do not address that problem only means that more appropriate policy instruments should be used.

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