

PolicyPennings by Dr. Daryll E. Ray

Are the five oft-cited reasons for farm programs actually symptoms of a more basic reason?

We recently ran across an article that discussed five reasons why the US has farm programs. The five objectives that the article listed were (1) reduce poverty on the farm, (2) reduce farm income variability, (3) increase export competitiveness, (4) provide for food security, and (5) promote rural development. One by one, the author then debunked each of the five objectives, leading the reader to conclude that US crop agriculture would function just fine without any program at all.

While elimination of farm programs would be welcomed by many, it is important that the recommendation is made for the correct reason. That is, because the core problem of aggregate agriculture has disappeared. So has the fundamental “farm problem” gone away? Well if it has, such a self-healing event should be the focus of the article. But, no such discussion was included.

Completely missing was any acknowledgment of the unique dynamics of crop markets that underlie “the” fundamental rationale for farm policy: the issue of market failure on the part of aggregate crop agriculture. Without successfully arguing that the fundamental problem is no more, it is impossible for discussions about the five symptoms to lead to any meaningful policy conclusions.

Let us take a look more closely at the first of the five “reasons” that were given for farm programs. The list begins with the oft repeated line that farm programs were started in the 1930s because rural incomes were a fraction of urban incomes at that time. And as far as the story goes, it is true that farm income in the 1930s was below the national average. Without a knowledge of agricultural history it would be very easy to conclude that the 1930s farm income problem was simply associated with the Great Depression.

The low farm incomes of the 1930s did not begin with the Crash of 1929. By the time the Great Depression hit, US farmers had been experiencing their own depression for more than a decade. World War I had brought with it unprecedented prosperity to US farmers as the government adopted policies to encourage farmers to engage in all out production to help with the war effort. Farmers responded and the significant amounts of US agricultural products were shipped to European nations whose agricultural sectors had been devastated by the war.

When the war ended, European farmers resumed agricultural production and exports shut off abruptly. US prices plummeted as the market for agricultural commodities was flooded with excess production. Corn which sold for \$1.44 in 1919 a bushel went for 54 cents in 1920 and 46 cents in 1921.

What we saw in the Post-WWI period is only a part of a longer-term story that can be traced back to the end of the Civil War. In 1867 the price of corn was 78 cents a bushel. Over the next 30+ years the price of corn trended downward, reaching a low of 28 cents in 1898.

Corn prices did not reach their 1867 price again until 1916 and the outbreak of war in Europe.

The pressure for national legislation to relieve farm income problems comes not simply from the problems associated with the Great Depression, but more completely from 60 years of low farm prices punctuated by a year or two here or there of relief.

When Henry A. Wallace took over the reins of office as Secretary of Agriculture in 1933, he was well aware of this history and of the many attempts that had been made to deal with the symptom of low agricultural commodity prices relative to other products in the national economy. Henry A used his skills as a farm economist to identify the underlying problem, a problem that went beyond railroad rates, the lack of farm credit, the need for better training of farmers, and other contributing circumstances.

The problem that Henry A. identified was the one that our readers hear us talk about all of the time—the lack of timely self-correction on both the supply and the demand side for aggregate agriculture. In the absence of timely self-correction the invisible hand of the market does not work to quickly adjust supply and demand to return commodity prices to an equilibrium in which the price approximates the marginal cost of producing an extra bushel or pound of a commodity.

Faced with lower prices, as price takers farmers do not reduce production because to do so would leave them with little to sell and even less income. Instead they attempt to cut costs to a minimum while producing as much as possible. As production increases, prices fall even further.

On the consumer side, the story is similar. Once diets are adequate, consumers do not respond to lower prices by increasing their food consumption by adding a fourth or fifth meal a day.

This minimal measure of price responsiveness on both the supply and demand sides resulted in the low corn price pattern seen during 1867-1932 period. There were occasional price peaks that resulted from production shortfalls caused by weather or pests, or from short-term spurts in demand like WWI, but these temporary price spurts only masked the long-term fundamental farm problem that became evident to policy makers in the 1930s.

Henry A. Wallace introduced supply management programs into federal policy to do for farmers what they could not do for themselves, gauge production to demand. He knew that without engaging in supply management most other farm policies are doomed to failure.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; <http://www.agpolicy.org>. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.

Originally published in *MidAmerica Farmer Grower*, Vol. 23, No. 43, October 27, 2006
Reproduction Permission Granted with 1) full attribution to Daryll E. Ray and the Agricultural Policy Analysis Center, University of Tennessee, Knoxville, TN; 2) Copy of reproduction sent to Information Specialist, Agricultural Policy Analysis Center, 309 Morgan Hall, Knoxville, TN 37996-4519