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PolicyPennings by Dr. Daryll E. Ray

# Harkin raises issue of shifting direct payment money to other ag uses

As long as corn prices remained near or below the counter-cyclical payment rate ($2.60 for 2002 and 2003 crop years and $2.63 for subsequent years) direct payments received little attention. Given trade negotiation considerations, direct payments were seen as being less subject to challenge than the combination of loan deficiency payments/marketing loan gains and counter-cyclical payments.

As a result, until the increase in corn prices that began at harvest-time 2006, it was almost a foregone conclusion that direct payments would be a part of the 2007 Farm Bill. The current high prices have made direct payments seem less attractive.

As DTN reports, at a recent field hearing with farmers "[Sen. Tom] Harkin questioned annual direct payments, saying they have generated 'notoriety' lately, given that direct payments are decoupled from production and tied to base acres that might not even be planted to the commodity for which they were established. Farmers are receiving payments even if they are getting strong prices and good yields."

Harkin asked whether or not it is '"wise to continue this policy of direct payments when you get a government check no matter what you make…can we still afford to do that?"'

Eliminating direct payments would free up about $26 billion over the next five years. Given the need to reduce the federal budget deficit and the lower baseline expenditures for the farm program budget, $26 billion is a huge sum of money that could be spent in other ways.

Conservation spending and rural development were two of the possibilities suggested by Harkin. Other suggested uses for the money included crop insurance, incentives for cellulosic crops that could be used for energy production, or the Conservation Security Program.

At the same time, some in the audience suggested that not all crops are in the same situation as corn and producers of those crops might be less enthusiastic to see the direct payments eliminated.

Still, the fact remains that direct payments are difficult to defend whenever crop prices are "high" and market-generated incomes are substantial. This is especially true, if the objective of commodity programs is to provide a safety-net for major-crop agriculture. Paying out billions of dollars when farmers are doing just fine seems contrary to the safety-net concept.

Moving the direct payment money to other "decoupled" agricultural uses works especially well when farmers' incomes are such that no government payments are needed anyway. All the suggested uses for direct payment money are indeed worthy of government investment. The question is what about when commodity prices and incomes fall, as they inevitably do.

One obvious approach would be to use the direct payment money, which is not truly a safety-net program, as the basis for re-computing commodity loan rates and target prices, which are part of safety-net programs. That way, the money that otherwise would have been assigned to direct payments would only be spent when crop prices or revenue fall below specified thresholds.

Certainly any time some budget resources can be freed up, one will see a slew of suggestions as to how to spend that money. We caution readers to remember that not all alternatives are equal and some may leave a large number of farmers worse off than they are under the current program.

This is particularly true if the current high corn and other crop prices are not sustained over the long haul. For example, a record corn harvest in the US, low crude oil prices in the short- to medium-run, and increased corn production in the southern hemisphere could send corn prices tumbling into the basement.

As legislators tinker around with farm programs, we need to be mindful that well designed programs should work as well when prices are low as they do when prices are high. Any shift in farm program expenditures should be greeted with the question, "how will this program proposal function if prices drop to the loan rate."

Given the problem we have with paying out a direct payment during a time of high prices we also need to ask "how will this program function when prices are double the loan rate?" Answering both questions ahead of time forces policy advocates as well as policy makers to be sure that a given policy proposal will function well over a wide range of prices.

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