

Policy Pennings by Dr. Daryll E. Ray

Policy shifts can be penny wise but dollar foolish

Secretary of Agriculture Vilsack has indicated some skepticism about the creation of a grain reserve, although it is difficult to know just what he was referring to when, at the G-8 meeting in Italy, he told Reuters writer Jeremy Smith, "Our recent experience with that concept was that in theory, [a grain reserve] sounds like a terrific idea but in practice it was very difficult. What we saw was that it really didn't create the kind of stability in pricing that people thought it would" (<http://af.reuters.com/article/investingNews/idAFJOE53I02N20090419?sp=true>).

In this column we want to take a look at the liabilities and benefits of a properly managed stockholding program from the perspective of the US taxpayer. In the absence of any clarification by the Secretary and assuming the administration would manage such a program in good faith, let us look at some of the most common criticisms that have been made of grain storage programs and the implications for taxpayers.

During the debate over the 1996 Farm Bill, the proponents for eliminating a government stock program argued that the traditional set of programs resulted in unpredictable government costs. It was further argued that a combination of decreasing decoupled payments and the subsidization of elements of crop insurance would make federal budgeting for agriculture more predictable.

The unpredictability of government program costs is the result of the nature of crop agriculture and the variability of weather, disease, and crop yields. For example, in years of bountiful production, more grain would be forfeited to the government storage program resulting in increased grain storage and acquisition costs.

The opposite would be true for those years when production is not adequate to meet domestic and export demand at a "reasonable" price. If the production shortfall were sufficient to drive prices above a predetermined release price, some portion of government stocks would be sold, providing repayment of the acquisition costs and a reduction in government grain storage costs.

It turns out that rather than making taxpayer costs more stable following the elimination of storage programs, the post-1996 regimen of government payments-especially countercyclical-type payments-and subsidized crop insurance made government outlays more costly and more unstable. Government payments to farmers, which averaged \$10.9 billion per calendar year from 1986 to 1995, jumped to an average of \$16.6

billion between 1996 and 2005.

The 1996 Farm Bill's elimination of the grain storage program, coupled with the elimination of an acreage management program, increased the cost to taxpayers for farm programs by an average of \$5.7 billion a year, more than a 50 percent increase over the prior ten years.

Not only that, but on a fiscal year basis-the federal budgeting year that Congress was trying to stabilize-the annual costs ranged from \$4.6 billion to \$32.3 billion. Congress' attempt to make government costs more stable by, among other things, eliminating the commodity storage program actually did just the opposite.

Another argument made for the elimination of farm commodity storage programs asserted that government stocks substituted for commercial stocks and that in the absence of a government storage program, the commercials would hold stocks sufficient to meet shifts in supply and demand, saving taxpayers the cost of storage payments.

As Dr. Phil would say, "How's that been working for you?"

One look at the sharp rise and rapid decline in crop prices over the last three years would suggest that it is not working very well.

Pilgrim's Pride and Verasun have gone bankrupt. Hog operators have been losing \$10-\$50 a head since 2007, and cattle finishing operations have been in negative territory since 2006.

As Richard Brock reports in his June 12, 2009 newsletter, 3,000 head dairy operations in California are burning through over \$300,000 a month at current feed prices.

With this in mind, let's carefully look at the argument. When it is said that government stocks substitute for commercial stocks, who is the "commercial" they are talking about? The first group that comes to mind includes ConAgra, ADM, General Mills, Kellogg's, Cargill, Bunge and other processors and marketers of grains and oilseeds.

Indeed, it would be nice if these firms did hold stocks in a meaningful reserve, but they don't. Any grains the processors purchase in advance of use, they hold for their own needs. They have no financial incentive to hold speculative stocks, hoping that demand will increase or that there will be a price-raising crop failure somewhere. The Chicago Board of Trade and other commodity exchanges are available to speculate on such price-raising events.

Cont. on p. 2

Originally published in *MidAmerica Farmer Grower*, Vol. 29, No. 25, June 19, 2009
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

Policy shifts can be penny wise but dollar foolish

Cont. from p. 1

If the processors have no financial incentive to hold reserves, then what about the marketers? Marketers make their money by matching agricultural commodity buyers and sellers and shipping the commodity from one to the other. Their income depends upon the volume they handle. Again, like the processors, the marketers have no incentive to hold physical stocks in anticipation of potential price increases; they too can use their superior knowledge to take positions on various commodity exchanges if that is what they want to do.

So who is it among the commercials that end up holding stocks from one year to the next? In a word: "farmers."

That means that government reserve stocks substitute for farmer-held stocks. That is no surprise; it's what a reserve program is supposed to do. It takes surplus grain off the hands of farmers and holds that grain for times of need.

By not taking that surplus off the market when prices were low, taxpayers wound up footing the bill

to the tune of an average of \$16 billion a year over the last ten years. A few hundred million dollars for storage payments would have been much cheaper for the taxpayer.

Because there were no reserve stocks at the time of greatest need, food prices increased, companies went bankrupt, and those who have survived so far have seen lower incomes. Again taxpayers were hit as all of these operations have not paid the level of taxes that otherwise would have been paid.

It is easy to complain about the cost of farm programs. But not having a grain reserve over the last dozen years may be a classic example of being penny wise and dollar foolish.

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.