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PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Policy distortions

While we see revenue insurance as an upside down safety net (http://agpolicy.org/weekcol/760.html), others see it as a part of an overall program "that lessen[s] the distortionary effects of US farm policy (Orden and Zulauf, http://tinyurl.com/nomcm78). This statement is made in reference to the programs that were in effect before the adoption of the 1996 Farm Bill, which was to be the farm bill to end all farm bills. Believing that high prices and growing corn exports to China were the future, the projected cost of the legislation was so low that Congress added a declining decoupled payment program—called Agricultural Market Transition Act (AMTA) payments—to capture funds that had been allocated for the legislation.

As Orden and Zulauf write, the payments were designed to "capture [Congressional budget] support that would have evaporated as market prices rose above target prices." Farm programs have been seen by some as, to use the language of economists, entrepreneurial rent seeking. In everyday language that means farmers were able to get a farm bill and payments not because they needed it, but because they could. They had the necessary political muscle in Washington.

We would even go so far as to argue that revenue insurance—as distinct from yield insurance—is another example of entrepreneurial rent seeking this time on the part of crop insurance companies and some farmers. Farmers did not need to be insured against a drop in market prices to a level that was still well above any measure of the cost of production. What they needed was a farm program that would protect them against low prices that could put them out of business and introduce uncertainty in the US food supply.

In their original design, farm programs were about such an event—a multi-year event. Following the end of WWI farmers experienced a decade of low prices before the 1929 market crash. With the advent of the Great Depression, the situation became even worse as prices fell to the point where farmers could get more heat out of a bushel of corn by burning it in their stoves rather than they could by selling the corn in town and buying coal.

Did these programs create distortions? They certainly did. African American tenant farmers in the south were put off the land so that the landlords could collect the program payments. Urban workers without a job did not receive the same level of support as farmers who were kept on the land. But agriculture was stabilized until WWII brought increased demand and higher prices.

It took until the War on Poverty for hunger to grab the attention of the public and lead to the development of programs that were more about feeding people than they were about the disbursement of surplus commodities. Black farmers are still trying to get a settlement to lawsuits that showed that they were systematically discriminated against in the administration of farm programs.

Though, when most people talk about farm program distortions, these aren't the distortions they are talking about. In the early 1980s, it was asserted that loan rates were keeping US prices above the world price, so people argued for policies to recapture "our export markets." Acreage setaside programs were giving acreage to our export competitors, we were told, and people were making planting decisions based on protecting base acres as some argued that farmers were farming the program. And one of the biggest arguments against price supports was the idea that some portion of the government payments gets capitalized into fixed resources like land.

Let's talk about those issues. If farm programs were responsible for losses in the US share of export markets, then we should have seen the US recapture these markets following the changes in the "export oriented" 1985 Farm Bill and ultimately in the adoption of the 1996 Farm Bill. US exports of corn peaked at 2.4 billion bushels in 1979 and 1980 and have been down to flat at approximately 80 percent of the peak with the exception of 1989, 1994, 1995 and 2007—4 years out of 34. Wheat exports peaked at 1.8 billion bushels in 1981 and have been down ever since. Soybean exports have increased dramatically since 1995, but that has little to do with US policy and almost everything to do to Chinese agricultural policy.

As a percent of world exports, corn peaked twice at 84 percent (1979 and 1994) and has been on a downward trend since with the 2014 share projected to be 29 percent. The high share of world exports of wheat for the US was 50 percent in 1973 and has been down ever since. The projected US share of world wheat exports for 2014 is 16 percent. For soybeans the story is no better with a 94 percent share in 1969 and 1970 and 40 percent for 2014—a 44 year slide.

Forces far more influential than US policy are at work when it comes to US farm commodity exports. That being said, the recent high prices will bring in more acres worldwide than the acreage reduction programs of the past ever did. And, as price fall, these acres will remain in production for a long time.

The argument that farmers were making planting decisions based on maintaining base acres has real validity and the planting flexibility that was introduced in the 1996 bill was a positive change that reduced distortion.

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There is no doubt that a portion of traditional payments were capitalized into land. But to make that argument stick, one would have to argue that the high prices we have seen and guaranteed with revenue insurance, especially the harvest time pricing feature, has nothing to do with the astronomical land prices we are seeing today.

With the land prices that we saw two decades ago, young farmers were having trouble getting enough land to get into farming. Today, almost nobody is talking about young farmers; land prices are all but out of reach.

So yes, farm policies, like all policies, “distort” the economy. That is by design after all; otherwise there would be no societal justification for implementing a policy. From society’s viewpoint, it works as intended when the “policy distortions” achieve objectives that cannot be achieved by free markets. But undesirable distortions can/do also tag along. The challenge is to design policies that have the desired outcomes with the fewest negative distortions.

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