

## PolicyPennings by Daryll E. Ray & Harwood D. Schaffer Next Farm Bill under discussion in DC; Down on the farm producers face uncertainty

We are barely two years into the 2014 Farm Bill and Congressional hearings have already started on the 2019 Farm Bill. In no small part, the hearings are triggered by the precipitous decline in net farm income from \$123.3 billion for the 2013 calendar year to an estimated \$54.8 billion for 2016, a drop of 56 percent. Needless to say the drop in income is the result of commodity prices well below the level that, at the time the farm bill was being designed, all but a few thought was impossible.

On that issue, we were in a distinct minority as we called for counter-cyclical programs to protect farmers against the kind of prices we are seeing today. Most farm leaders and agricultural economists seemed to focus on developing policies in the 2014 farm legislation that farmers could use to maximize short-term program payments rather than provide farmers with adequate longer-term protection against low prices and farm incomes.

Some of this behavior is understandable given the premises that many use in their analytical model. The prevailing premise/theory is that on average agricultural commodity prices are OK, and the role of policy is to smooth out some of the bumps along the way. In this model, the free hand of the marketplace works well and for the most part the role of government is to stay out of the way.

When we hear legislators cutting the cost of future farm programs from the reduced levels of the 2014 Farm Bill in order to allow the market to use its magic, it is clear to us that there is a misunderstanding of the economics of the crop sector.

We wish that others were correct about the way economics works in the farm sector, for if that were true there would be no need for farm policy or even a separate discipline called agricultural economics. For example there is not a separate discipline called “printing and publishing economics.” There are people who study the economics of the printing and publishing industry, but they are a part of general economics.

That brings us to the economic view that we use in our analytical model. A fundamental reason agricultural economics developed as a separate discipline was because agricultural markets experience market failure—in the face of low prices neither supply nor demand respond sufficiently, in the short- to medium-run, to return prices to a break-even level (see our discussion of why this is true at <http://agpolicy.org/articles16.html> in columns 808 through 811).

Ideally, farm programs should be designed not as a way to show undue preference to agriculture over other sectors but to provide minimally invasive tools to overcome the market failure while still allowing the

market to provide price signals between consumers and producers to the greatest extent possible.

The situation farmers face this spring as they decide what and how much to plant exemplifies the need for farm programs and the limits on information farmers have in this decision-making process.

As farmers prepare to plant—or in the case of Southern farmers who have completed much of their spring work—the price they are going to receive for their harvested crop is anyone’s guess. Some analysts look to signs that the Chinese economy is in the process of stabilizing and that will result in increased demand for agricultural imports. Others look at the recent decision of the Chinese government to modify their grain storage programs, especially with regard to corn, and expect that the Chinese will be reducing their imports of feed grains. If the past is any indicator they could even export corn to reduce their stocks.

Certainly the production decisions of farmers in our major export competitor countries, will have an impact on US exports over time. At the present time the dollar is strong against most other currencies, giving producers in those countries a price advantage over US farmers. Note that our focus is on the impact of currency valuation on the quantity producers supply in future production periods, not the quantity demanded in the current marketing year.

Our grain export competitors tend to hold little stock, which means output above their domestic needs—that is their exportable surplus—is exported.

Once the commodity is produced, changes in currency values may influence the speed at which the year’s exportable surplus is sold (and daily futures volatility), but have very little impact on the size of the competitor country’s exportable surplus itself. Thus the strong US dollar primarily affects US grain markets from the supply side.

And then there is the issue of weather in the US and around the world. Those predicting a quick shift from an El Niño weather pattern that provides a reasonable amount of rainfall across the US crop region, to a La Niña weather pattern see a distinct possibility of dry weather and reduced yields in the US.

At the same time we see speculators and some funds buying grain futures in the expectation that prices will be higher in coming months. They are trying to use the old “buy low, sell high” strategy. Whether they are correct or not is still to be determined.

Meanwhile, crop farmers have to make a decision on how much to plant and what to plant in spite of all this imperfect information. It’s a pretty good bet that they will decide to use every acre possible to minimize potential losses and maximize potential gains if there

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is a crop failure in some other part of the country or an unexpected spurt in demand.

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