Farm program considerations: Part 1

With low prices facing farmers as they harvest their 2016 crop, it is becoming clear that the counter-cyclical policies contained in the 2014 Farm Bill will not provide much protection for most producers. As a result, farm groups are beginning to look toward the next farm bill and the types of policies that might best protect farmers against low prices.

In last week's column, we argued against direct payments, subsidized revenue insurance when crop prices are above the cost of production, and loan deficiency payments. We promised future columns that would lay out some policy instruments we support. To start with, we want to identify a couple of principles that we keep uppermost in our minds as we identify program instruments that make sense to us.

We believe that farm policies ought to be designed so as to treat the cause of farm problems, not the symptoms. Our concern about the current array of crop programs is that they are designed to treat the symptoms, price variability while prices are at or above the cost of production, while ignoring the possibility of prices that are well below the cost of production and likely to remain there for extended periods of time.

There is the old saying: "an ounce of prevention is worth a pound of cure." That is certainly true of the cost of current farm programs which are slated to be higher than projected when the 2014 legislation was scored by the Congressional Budget Office.

The opposition to policies that could provide that "ounce of prevention" is based on two things. First, lulled into complacency by a decade of high prices that was brought on by annual increases in the amount of corn needed by the ethanol industry, they believed that crop prices were on a new plateau and would not drop below the cost of production for an extended period of time. With the assumption of prices that were, on average, profitable, they were more interested in providing shallow-loss revenue protection than providing support during long periods of low prices.

Second, and more importantly, they did not want to admit that aggregate food markets, in general, and agricultural commodity markets, in particular, do not behave like the neat supply and demand graphs they saw in their high school and college economics textbooks. Or more cynically, they know that, in the face of low prices neither quantities supplied nor quantities demanded respond sufficiently in the short-to-medium run to restore profitability, they just don't like the policy implications of such an admission.

We also believe that the loan rate for each crop ought to be set at a level, between the variable cost of production and the full cost of production, that will allow farmers to remain in production. This does not guarantee any but the most efficient to earn a profit while enabling most to put in a crop next year. To us it does not make sense to have a loan rate set at one level and a target price set at a higher price and thus two programs. We only need one program—one that works.

Another belief that we have is the idea that it does not make sense to design a program that requires the government to make a payment on every bushel or pound that is produced by US farmers. As economists, we believe that it makes sense to pay only for the bushels of supply that are in excess of those demanded by the market at acceptable prices, including normal pipeline supplies.

Our criteria for a credible farm program are:

- We ought to treat causes not symptoms of the farm price and income problem,

- We ought to establish reasonable loan rates that change over time, and
- We should not make payments on most every bushel and pound of production.

By now, most of our regular readers know what the program would look like.

Such a program would allow farmers to take out a short-term, nonrecourse loan on their crop or a portion of their crop. The loan would be made at the loan rate times the amount of production put under loan and the crop would be the collateral for the loan. Farmers would be able to pay off the loan plus interest at any time up to the term of the loan, say 9 months. If the price in the marketplace were to be lower than the loan rate, they could then forfeit the covered commodity as full payment of the loan. The government would have no recourse to collect the difference between the amount owed and the value of the crop at the settlement of the loan.

When we have done this in the past, the season average price paid to farmers has remained above the loan rate and only a small portion of the crop has been forfeited.

In the coming weeks we will flesh out the details of our vision for such a program.

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