

Policy Pennings by Dr. Daryll E. Ray

Farmer-oriented blueprint increases corn prices 37%

As we saw in the previous column, although touted widely as “the” solution to the current international agricultural crisis, eliminating agricultural subsidies in the U.S. or even in all developed countries will not result in timely price increases of a magnitude that could help the world’s large population of small farmers who live primarily in less developed countries. Subsidy elimination would cause a shift in the mix of crops produced and, therefore, some relative changes in prices, meaning that some farmers and countries will be helped and others harmed. But the overall price impacts are negligible.

Getting rid of subsidies certainly will not result in the levels of agricultural prosperity internationally that is claimed by its advocates. In the U.S. agriculture would be thrown into a depression. Total U.S. net farm income would decline by one-third, and on crop farms net income would drop by well over one-half. Land prices would collapse and rural communities would deteriorate at an even faster pace than during recent decades.

Well, if phasing out subsidies will not solve the problem, what will raise prices and improve the lives of farmers? One compelling option is to redirect the goal of U.S. farm policy away from low market prices and high subsidies and toward managing productive capacity. Managing the excess is an explicit recognition that the farming community is not capable of a timely response to changes in supply and demand.

Carefully crafted and implemented policies, however, can provide a reasonable and sustainable level of farm prices and income, a higher level of stability, increased dependence on market revenues and less reliance on government payments. An appropriate cluster of policies could improve the position of American farmers and provide relief to farmers around the world.

The idea is to increase market prices to a reasonable and sustainable band and then manage the excess. Several combinations of policy tools show promise as paths to achieving this objective. This study identifies and analyzes one such combination based on the idea that no single policy instrument is powerful enough to address the complicated issues presented by the current crisis. It includes: (1) acreage diversion through short-term acreage set-asides and longer-term acreage reserves; (2) a farmer-owned food security reserve; and (3) price supports through government commodity purchases. We have called this policy set a farmer-oriented policy blueprint.

The diverted-acreage component includes a short-term annual set-aside program and a long-term land retirement program. Acreage retirement would reduce excess production and improve environmental performance. Farmers would be encouraged to retire environmentally sensitive cropland for ten or more years and institute conservation or restoration practices on the retired land. Short-term set-asides would avoid the occurrence of very low prices by inducing farmers to idle a portion of their working cropland.

The second element of the blueprint is a food stock or inventory management reserve program. Stock reserves provide a measure of supply-dependability to domestic commodity users and our major export customers. Also, historically, it has been the large price spikes that have pulled idle or new cropland into production. Once that land is put into production it tends to remain in production even as prices fall.

When prices are below a defined threshold level, producers would enroll a share of their production in an on-farm storage program. The farmer holds the commodity in reserve, isolating it from the market, in exchange for a storage payment from the government. The farmer maintains full ownership. When the price increases beyond a threshold

price - called the “release price” - producers are given strong incentives to sell reserves until the price drops.

The third element - a price support mechanism - would trigger government purchases of commodities from the market when the price falls below the threshold. The price support comes into play only when set-asides “miss” a low price event. Since the purchased stocks would be owned by the government, they would be the first to return to the market when the price increases beyond the release price. The purchased stocks provide an added margin to meet essential domestic and export needs in times of weather or other nature-based catastrophes. Supply management instruments would need to kick in once stocks grew to desired levels.

While a non-recourse loan is technically operational in the current farm policy legislation, it does not function as a price floor because of the availability of the loan deficiency payment (LDP) and marketing loan gain (MLG) options. With LDP/MLGs, government payments make up the difference between the “support price” and a lower market price. By eliminating the LDP and MLG options, this policy blueprint restores the function of the non-recourse loan rate as a price floor.

Using the POLYSYS modeling system that we have developed at the Agricultural Policy Analysis Center, University of Tennessee, we examined the impacts of the policy we have just been describing. One of the most dramatic results was the increase in crop prices. Under the farmer-oriented policy blueprint, the price of corn in 2011 was \$3.13/bu., 37% above what would be expected under a continuation of the current set of policies. Similarly, wheat would see a 34% increase, soybeans a 24% increase, cotton a 16% increase, and rice a 24% increase. Because the policies were designed to enable farmers to get their income from the marketplace, government payments declined by 57% from what would have been expected under a continuation of current policies while net farm income increased by 5% to \$50.4 billion.

Because the U.S. is the price leader for major crops, the increase in the price of these commodities will be enjoyed by farmers around the world, raising their income far more than it would be raised by the elimination of all subsidies. In the future, should the U.S. lose its price leader status - realistically soybeans and Brazil seem to be the commodity and country that may be a threat in that regard - more comprehensive supply management possibilities may need to be considered. We will say more about that next week.

It turns out that the problem farmers face is not U.S. subsidies, but rather the mix of instruments used to implement U.S. agricultural policy. With a policy mix that takes into account the unique characteristics of the crop agricultural sector, all farmers reap the benefits. Under this policy mix, with \$3.14 corn and 64 cent cotton, the accusations of dumping will decline significantly.

Reviewing this blueprint, one might be tempted to ask, “Aren’t these the failed policies of the past - the ones that we dumped in 1996?” The answer is that they are some of the policy instruments that were in place at that time. However, with the experience of the last ten years, we have discovered that they worked far better than we thought. For the same year ending stocks-to-use ratio, farmers received prices that were some 20% higher than they do under current policies. A fuller treatment of the criticisms that were made of these blueprint policies and why these policies still make sense can be found on the internet at <http://www.agpolicy.org/pesek.html>.

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.

Originally published in *MidAmerica Farmer Grower*, Vol. 22, No. 34 August 26, 2005
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, 310 Morgan Hall, Knoxville, TN 37996-4519