policy pennings

Δ **Contact Dr. Daryll E. Ray** at the UT's Agricultural Policy Analysis Center by calling (865) 974-7407, faxing (865) 974-7298, or emailing dray@utk.edu.
For more info, visit: www.agpolicy.org

Conventional Wisdom Versus Learning From History

DR. DARYLL E. RAY
Agricultural Economist
University of Tennessee

With the passage of the 1996 Farm Bill it was argued that farmers needed to plant for the market instead of the farm program and so many of the traditional farm program mechanisms were made ineffective.

By the 1998 crop year, corn prices had dropped from a 1995 crop year season average price paid to farmers of \$3.24 to \$1.94. The next year the price fell to \$1.82.

The year ending US stock levels for corn had increased from 426 million bushels (5 percent of usage) in 1995 to 1.7 billion bushels (18 percent of usage) in 1999.

The conventional wisdom during the 1998-2001 crop years suggested that the low prices were the result of over production on the part of US farmers. Even with government payments factored in, the value that farmers received was still below the full cost of production and, in many grain growing areas, government payments were more than 100 percent of net farm income. Farmers were using government payments to help pay production costs.

In that atmosphere, farmers were left with two choices. First, they could have reduced production. But, with land rents, land mortgage payments, and taxes, not to mention ongoing machinery costs, planting seemed like the best course of action as long as the price was above the variable cost of production. That way if there were a crop failure somewhere else in the world they would have something to sell.

Second, instead of reducing supply, farmers could work to increase the demand for their product – cheap corn. Some promoted the direct burning of corn in corn furnaces as a means of heating homes. Others worked on the extraction of chemical chains from the corn kernel that could be used in the spinning of fibers that could be used to make shirts and other clothing items.

By far, the most popular way of increasing demand for corn involved the establishment of farmer-owned ethanol cooperatives. Farmers promoted ethanol with state and federal legislators as a means of achieving three goals. First, using corn to make ethanol would reduce the corn "surplus" and increase corn prices. Second, the production of ethanol would reduce the US's dependence on imported crude oil. And, third, the ethanol plants would fit in with a larger rural development strategy by providing industrial-type jobs in a rural setting.

It should be noted that in 2000 and 2001, the world consumption of grains was greater than the production of grains by the farmers of the world. While some analysts made note of that fact, the conventional wisdom still asserted that farmers were producing too much and the blame for overproduction was placed squarely on the shoulders of the US farm program.

During this period, with world production levels falling below consumption and with US government stocks of corn sitting at one-tenth of one percent of annual utilization, farmers were being told they were overproducing.

Only now when prices are high, does conventional wisdom recognize that grain demand has exceeded production in 7 of the last 9 years.

If, instead of instituting direct payments and strengthening the marketing loan program, US policy had continued the effective use of the CCC (Commodity Credit Corporation) and FOR (Farmer Owned Reserve) storage programs, some grain would have been put into storage.

That would have forced prices above the loan rate. The savings from not paying LDPs on 100 percent of crop production during most of those years would likely have more than offset CCC interest and storage expenses for all the years since 1996 for the fraction of total crop production that would have been put into storage for the proverbial rainy day.

And, of course, that grain would have gold-like value in times like these.

Benefits all around. Consider the list of current miseries: shattered livestock incomes, increased commercial ingredient costs, impacts on food prices later on from decreased meat production, developing country food riots, actual food shortages, increased malnutrition, starvation and increased susceptibility to disease.

For decades, we had a reserve system and then "conventional wisdom" convinced us that it was not needed.

The last period of time in which a "reserve" system was dismantled was the years before the 1970s, a time when reserves were needed the most. Because of that experience the Farmer-Owned-Reserve was put into place to supplement the Commodity Credit Corporation's government operated reserve.

It took a quarter century to do it, but again just a few years before a reserve was needed, the mechanisms to establish and maintain reserves were abolished in case of the Farmer-Owned-Reserves and made ineffective is the case of CCC government reserves.

It seems the adage about not learning from history has been proven true once again. Δ