Impacts Of A Farm Policy Do-Over For Historical 1998 To 2010

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Over the last 13 years, 1998-2010, government payments for crops totaled $152.2 billion for an average of $11.7 billion per year. Keep in mind that these numbers do not include government subsidies to crop and revenue insurance products and other products that have been promoted as a substitute for ad hoc disaster payments.

In the present political climate with the focus on debt reduction, most observers are expecting that the House and Senate ag committees will have less money to work with even though there are a significant number of current farm programs whose funding will end with the end of the current farm legislation.

In this policy climate, are there a set of policies that would cost less, but maintain farm income under a wide range of price and production conditions?

To answer that question, we examined the 13 years from 1998 through 2010. During that period, local elevator corn prices were as low as $1.50 a bushel for an extended period of time (well below the cost of production) and as high as $7.00 a bushel – other crops saw similar numbers. For us this seemed like the perfect period over which to identify a set of policies that would reduce government payments, allow farmers to earn most of their income from the market, and maintain the value of production adjusted by government payments and variable costs.

While in the real world there are no do-overs, we decided to use our POLYSYS model to conduct a do-over of the 1998-2010 period to see if we could identify policies that would meet our objectives of reducing government payments while maintaining farm income.

The policies that we looked at are a modification of the ones that were thrown out with the 1996 Farm Bill – a bill that resulted in farm payments in the 1998-2001 period that were as large as $20 billion in a year. It was during that time period that government payments to farmers exceeded net farm income in a number of grain producing states.

Under a contract with the National Farmers Union, we looked at the use of a farmer-owned reserve where the initial loan rate was set by the 3-year running average of the difference between the variable and full cost of production for corn. For subsequent years, the rate was modified by the change in a farmer purchased production-input price index. For corn the loan rate went from $2.27 in 1998 to $2.60 in 2010.

To provide a wide band in which the market could work to signal production needs and allocate crop supplies, the release price was set at 160 percent of the loan rate. For corn, the release price ranges from $3.63 in 1998 to $4.16 in 2010. The loan rate and release prices for other crops were set in terms of their historic ratio to the price of corn.

In addition, direct payments, loan deficiency payments/marketing loan gains (LDP/MLG), and the use of generic certificates were eliminated for most crops. For technical modeling reasons, these instruments were maintained for cotton and rice.

Over the 13 year period, corn prices averaged 26 cents a bushel higher under the farmer-owned reserve policies than the prices farmers saw historically during that period. For wheat the price differential was 48 cents a bushel and for soybeans it was $1.09 per bushel. These higher prices allowed farmers to earn their income from the marketplace and be less dependent upon government payments.

One of the criticisms of reserve programs in the past was that these programs are too costly. In our study we found that the policies that were implemented to replace reserves were much more expensive than maintaining reserves themselves. This is true in large part because the cost of the reserves is paid on only a portion of production while LDP/MLGs are paid on every bushel of production.

In the end, the reserve policies were projected to cost an average of $4.3 billion a year for a total of $56.4 billion over the 13-year period, $95.8 billion less than what the government actually spent in those years, in part to avoid the holding of reserves.

A second criticism of reserves and the loan rates that function to set a floor price, is that these prices will reduce exports. And indeed we found that exports of corn, wheat, and soybeans were slightly lower than the historical export levels. But, with higher prices, the value of exports over the 13-year period were higher with reserves than without reserves.

Our "do-over" suggests that Congress would do well to consider the reinstitute a reserve program if they want to cut costs while protecting farmers under a wide range of price and production levels. Δ

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