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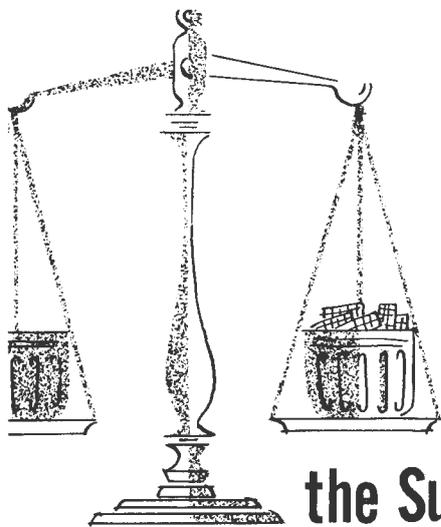
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# Can “Payments-in-Kind” Solve the Surplus Problem?

by Arnold Paulsen and Earl O. Heady

**F**ARM PRODUCTION has outpaced demand for some time. As a result, we've accumulated extensive surpluses under government loan and storage. These surplus stocks and their costs are the symptoms of an important national problem. The public is becoming more and more concerned about the size of the stocks and the cost of carrying them. Pressure is increasing to do something about both.

Some people believe that the stocks themselves are depressing farm prices and are the heart of the farm problem. In other words, why not get rid of the stocks and solve the problem?

“Payments-in-kind” are being discussed as one method of doing this. Generally payments-in-kind refer to paying farmers in bushels of corn or wheat, rather than money, for taking land out of production or for complying with other possible government farm programs. “Use the surplus to eliminate the surplus,” or, “Pay the farmers in unneeded grain instead of cash.”

**What Purpose?** Why are payments-in-kind so appealing? Probably because they appear to offer a way to accomplish several goals that might be attained with a change in farm programs. (1) Stop building up surpluses. (2)

Reduce stocks by using them for something. (3) Maintain farm prices at a “satisfactory” level. (4) Maintain food prices at a “satisfactory” level. (5) Accomplish these goals at a minimum treasury cost.

There are other goals, too—conservation of resources, economic growth, freedom for farmers, justice, equity and many others. It isn't possible to say what goals the public deems most important or how much of one the public is willing to give up to accomplish another.

Still, the attractiveness of the payments-in-kind approach probably has its base in the possibility of being able to accomplish several goals at the same time. To more accurately gauge the effectiveness of such an approach, let's consider first the surplus stocks and then how a payments-in-kind program might work.

**About the Stocks:** The stocks themselves have done very little to depress farm prices. From another study at Iowa State, Geoffrey Shepherd concluded, “For feed grains as a whole, the effect of withholding CCC stocks appears to be as great as if the CCC stocks were removed from the market.” The stocks are of little concern to the daily market so long as they aren't fed back into the market.

If we got rid of all surplus stocks and only all current production were to flow onto the market, price improvement wouldn't come about. The government

stocks—withdrawn and immobilized from the market—aren't the major depressing force on prices. The depressing force is the supply that's *still* free on the market. Even with the stocks gone, annual production can still give a market supply greater than the amount that has been free on the market in recent years.

**Reduce Supply?** Under some circumstances, payments-in-kind could *increase* the supply on the market and thus act to further depress market prices. That is, they could cut down surplus stocks *without depressing* market prices *only* if the supply-management or production-control parts of the program were effective enough to “make room” for the additional supply. There would be “room” for the additional supply at present market prices only if current production were cut as much as the amount released from storage in “grain payments” *plus* the amount that has recently been going *into* storage. Payments-in-kind could cut down surplus stocks and *improve* market prices only if production were cut *more* than the amount released from storage and *more* than the amount that has recently been going *into* storage.

Let's look at some examples. Say that normal-weather grain production expected for next year is 200 million tons with no production control. A payments-in-kind program might release 10 million tons of stored grain. If the counteracting production control were not successful and 200 million tons still were produced, then the net effect would be the same as if we produced 210 million tons and put them on the market. If current production were cut 5, 7 or even 9 million tons, the situation still would be similar.

Prices would be lower than with no controls, no supports and constant stocks whenever production wasn't reduced enough to counteract the amount released as payments-in-kind. Full average-weather production would clear the market *only* at prices below present levels. And with no production control but payments-in-kind, prices would be still lower.

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Say the control program reduced over-all production the full 10 million tons. Then 10 million tons could be released from storage without depressing market prices below the "no supports-no controls" level with constant stocks. Thus, payments-in-kind on a bushel-for-bushel basis—giving a farmer 1 bushel for each bushel he cut production below normal—would reduce stocks. But it would have no effect in *improving* prices above the "no supports-no controls" level.

Say the control program reduced *over-all* production more than 10 million tons. Then prices would be higher than the "no supports-no controls" level. How effective would the control programs have had to be to maintain the prices which existed in 1959 and 1960? An output-management program using 10 million tons of payments-in-kind would have had to reduce over-all grain production an average of 26 million tons each year in 1958 and 1959 to maintain 1959-60 grain and livestock prices.

Probably, no supply-control program would be designed to get less than 1 bushel of control for each bushel paid in kind. Could it be designed and administered to get as much as 26 bushels of production control for each 10 bushels paid in kind? Perhaps, but supply-control programs often fall short of their goals. While corn production, for instance, is being reduced, grain sorghum may be increasing. Or, production may drop in one state and increase in another. One farmer may cut his output while his neighbor increases. Acreage may be reduced, but yield per acre may increase. Favorable weather may result in production exceeding normal expectations. Any of these would mean no room on the market for grain released as payments-in-kind without depressing prices beyond goals.

**How Effective?** How much theoretical production control might a bushel of grain buy? Theoretically it might buy more than a bushel. It shouldn't be necessary to pay a producer the full anticipated value of his crop to

induce him not to grow it. This is because growing the crop involves direct out-of-pocket costs.

If the crop isn't grown, these costs can be saved. Most farmers would be induced to cut production if the payment for not growing a crop were equal to normal yield times price, less out-of-pocket costs.

It might be possible on this basis, say, for 1 bushel of payment-in-kind to buy 10 bushels of production control. This might be the case on marginal land, if hired help and custom machinery were used. There the expected value of the crop would be low and uncertain, and almost all costs could be saved if the crop weren't grown. On a typical family farm in the Corn Belt, on the other hand, direct out-of-pocket costs are a small proportion of the total value of the crop. If we consider investment, machinery and family labor as fixed costs, few savings could be made even if the crop weren't grown. In this case, 1 bushel of payment-in-kind might "buy" something nearer 1¼-2 bushels of expected production.

How efficient is grain, compared with cash, as a way of paying for voluntary participation in a supply-control program? Probably not as efficient. Given a choice between a check and an amount of grain of the same value, most people would choose cash. Then they wouldn't have to convert part or all of the grain to cash to buy the things they need. Offered an amount of grain of more value than the check, they might more readily accept the grain and take the trouble of converting it into cash. But it could certainly require at least as much, if not more, value in grain as cash to buy a given volume of production control.

We can't ignore the fact that grain is more expensive to transport and deliver than a check if the grain is to be delivered as a check would be. And the volume of grain, presumably, would have to be measured exactly. A certificate might be given—perhaps redeemable in cash or grain. This would be a form of check but would introduce another means of exchange and more bookkeeping.

So payments-in-kind might not be the least-cost way of liquidating government stocks. It might be cheaper for the government to sell the stocks on the market and use the proceeds to make money payments to farmers.

**Stabilize Prices?** It was possible to stabilize grain prices from years of small crops to years of large crops by varying the rate at which stocks were built up. Releasing stocks at a variable rate in an optional payments-in-kind program could be used to stabilize prices under a supply-control program. That is, the rate at which stocks were released could be varied to offset variations in production or demand and thus stabilize prices.

The government currently releases some grain from stocks each year. In the last 8 years, however, this has been more than offset by additions to stocks. The amount released each year is converted into money in the market. Payments-in-kind would use the grain directly for payments rather than use cash for distributing the value to farmers. But the effect on the supply and the price of grain would be the same whether the grain is converted to money in the market and the money sent to farmers or the grain distributed to farmers directly.

**Summing up:** We could *dispose* of all our surpluses with payments-in-kind. Optional payments-in-kind could be used to *stabilize* prices under a supply-management program. However, liquidation of the stocks wouldn't necessarily *raise* prices.

To *improve* market prices, any payments-in-kind programs must be coupled with an output-management program effective enough to accomplish at least three things: (1) a sufficient reduction in current output to offset the stocks released by payments-in-kind, (2) an additional reduction in current output the size of the past annual additions to stocks, (3) still another cut in current output which would reduce the total supply per person below what it has been in the last few years.