August 2015

A Farm Policy Objective: The Search Goes On

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Next year the new Congress will again debate what to do about farm policy. Farm-state representatives and senators will offer various proposals to remedy the ills of agriculture. In turn, farm organizations, environmental groups, and other concerned parties will try to determine how the various proposals best serve their own interests. There is, however, a recurring, fundamental question that has yet to be addressed satisfactorily: What do we actually want farm policy to do?

Some would argue for payments to maintain rural vitality. Others propose programs that would link farm income support with enhanced environmental stewardship. And still others suggest maintaining a minimum level of farm income through counter-cyclical payments.

In our governmental system, all proposed policy objectives need to be scrutinized by the public to determine 1) if those objectives are truly of broad public concern and 2) if they are achievable using means that are consistent with the way that most Americans want their economy to run: namely, that market forces ought to be the primary determinant of production and consumption decisions.

But in agriculture, even without such scrutiny the aid keeps flowing. Notwithstanding earlier statements that $8 billion in emergency payments was all that agriculture could count on this year, Congress is poised to spend an additional $2.0 billion in disaster assistance this fall. Direct payments for the 1998, 1999, and 2000 crop years are expected to total almost $60 billion. And, much of this $60 billion in support has flowed to agriculture either as “emergency aid” or aid automatically triggered by low prices.

The emergency label has enabled proponents to skirt the issue of what broad public policy objective is being met through the support of agriculture. The claim of an agricultural emergency seems sufficient to garner additional funds. However, if support is to be maintained at the high levels seen in recent years, proponents will be much harder pressed in each coming year to justify the aid in terms of meeting a broad policy objective. And, presumably, increasing agriculture’s baseline budget will come at a cost to one or more other important policy objectives, including modernizing the military, enhancing environmental quality, and improving our educational system.

**INCREASE RURAL VITALITY?**

There are few in Congress who are as forthright as North Dakota Senator Kent Conrad in specifying what they want farm policy to do. In introducing new federal farm legislation last year, Senator Conrad stated, “The goal is a national farm policy that keeps America’s farm communities strong and allows U.S. farmers to compete in world markets.”

For Senator Conrad, the first objective of farm policy is to keep rural communities strong. The way to accomplish this is to maintain rural populations by keeping farm families on the land so that they can support local farm-connected businesses. This support, in turn, results in viable schools and rural Main Street businesses.

But can maintenance of rural vitality be the objective of a national farm policy? Luther Tweeten writing in Choices (second quarter, 1995) suggests that it can not. He notes that “...fewer than one-third of the nation’s 2,400 rural counties are farm dependent, that is, receiving over 20 percent of their income from farm-related earnings.” Of course, most of these farm-dependent counties are in the Great Plains, which makes Senator Conrad’s position understandable.

Another factor, perhaps posing an even greater political difficulty in using rural vitality as the primary farm policy objective, is the large and increasing number of rural residents who have little connection with agriculture. And in many rural areas, new rural residents actually would prefer a reduction in land devoted to farming if that were to mean declines in livestock production, the burning of crop residue, and the application of pesticides.

A further difficulty is convincing urban residents that they have a stake in maintaining the rural economies of the Great Plains states. Most Americans live in concentrated urban areas on the East and West Coasts...
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Iowa Ag Review is published by the Center for Agricultural and Rural Development (CARD).
This publication presents summarized results that emphasize the implications of ongoing agricultural policy analysis, analysis of the near-term agricultural situation, and discussion of agricultural policies currently under consideration.

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and in the South. And those who live close to the Great Plains and Corn Belt states live in medium sized to large cities that have their own set of problems. Although urban residents may be able to make a general connection between federal farm policy and food, it may be difficult to convince them of the importance of specific agricultural support, such as the need to support farmers to decrease the out-migration from rural North Dakota.

A new trend that started in Western Europe and is spreading to the United States is the idea that urban residents may want to maintain and manage the rural landscape for their recreation pleasure. In that regard, most people probably would prefer that part of the rural landscape should include farms that are “visually appealing.” And to many people, visual appeal means traditional buildings, crops and livestock in the fields, and farm families living on the land. However, the number of these traditional farms that would be required to meet the demands of urban residents is not likely to account for the 210 million acres of corn, soybeans, and wheat that will be planted in 2001.

Using Proposals to Find Policy Objectives
Most legislators are not as candid as Senator Conrad in that they do not state explicitly what they want farm policy to accomplish. But they are not reticent about proposing new policies, and these policy proposals can reveal unstated objectives.

Counter-cyclical Payments
Another policy objective revealed through proposals is that of maintaining farm income at some minimum level. Proponents of payments that are counter-cyclical with respect to price, yield, or farm revenue must have this objective in mind. For example, Agricultural Market Transition Act (AMTA) emergency payments have been largely counter-cyclical with respect to price in the last three years, in that low prices have resulted in higher payments. Loan deficiency payments also are counter-cyclical with respect to price. In addition, crop insurance makes payments when yield is low, and revenue
insurance makes payments when revenue is low.

The initial reaction of many to a policy objective of guaranteeing a minimum income level for farmers is positive. The thought of a hardworking farmer putting food on our table, yet not being able to afford the modern amenities taken for granted by most of us, is a powerful image—emotionally and politically. An economic system in which a farmer cannot receive enough from the marketplace to cover production costs seems inherently unfair.

But our economic system is based on the underlying premise that if a company or individual cannot cover their costs of production from the sale of a product, then they should not be producing that it. Economists are quick to point out that the risk of not recovering costs from a venture is the reason why those who are willing to undertake the risk should, on average, be rewarded. That is, there is a basic tradeoff between risk and return in capitalism: the higher the risk of not covering costs, the higher the expected return. If there were no risk from producing a particular product, then everybody would immediately supply the product, which would guarantee that nobody made any money. This economic law must be kept in mind when designing a counter-cyclical policy.

Cost of Production Insurance. To see how a seemingly good idea can be extremely difficult to implement, consider cost of production insurance, a policy proposal included in this year’s Agricultural Risk Protection Act. This type of insurance would make up the difference if farm revenue fell below the cost of production. This seems like a policy that we all could support. But how could it be implemented?

The first issue that arises for such a policy is to determine what costs to include. Clearly, variable production expenses such as seed, chemicals, fuel, labor, and fertilizer should be included. According to ISU Extension, these costs total $164/acre on 135-bushel corn land in Iowa. If the goal is to make sure that all of a farmer’s expenses are met, then land ($120/acre) and other machinery expenses ($44/acre) also should be included, which makes total cost equal to $328/acre.

If there were no risk from producing a particular product, then everybody would immediately supply the product, which would guarantee that nobody made any money.

This “break-even” amount would need to serve as the basis for the cost of production insurance policy if we wanted to make sure that farmers at least cover their costs, without even considering the need for family living expenses. How much would such an insurance policy cost? The cost depends on the expected level of revenue that could be obtained from the marketplace. The higher the expected market revenue, the lower the cost of the insurance. As of this writing, the price for 2001 corn was approximately $2.40/bushel on the Chicago Board of Trade. With a 40-cent basis, this translates to a $2.00 local price. At an average yield of 135 bu/acre, this farmer can expect to receive $270/acre for next year’s crop, or $58/acre below the farmer’s cost of production.

The insurance premium of providing a revenue guarantee equal to $328/acre for this farmer would be $72/acre. This large premium reflects the fact that expected market revenue is below the guarantee. If the revenue guarantee were lowered to $270/acre, then the cost would fall to $32/acre. Currently, the highest revenue guarantee that the farmer could obtain (on a local basis) is $230/acre (85% of 270), which would cost a relatively modest $18/acre.

Of course, if 100% cost of production insurance were made available to this farmer, total production costs would increase by the amount of the premium, raising the total cost to $400/acre, which would raise the insurance premium to $136/acre. Implementation of this policy also would increase the value of land, because the risk of low revenue would be eliminated. The higher land cost would, in turn, increase the cost of production in a never-ending upward spiral.

But what if the government simply gave Iowa corn farmers this level of coverage, instead of charging the producer? Then the cost of production would not be inflated by the insurance premium. But land prices would immediately reflect the value of the government gift, which in turn would increase the cost of production.

This discussion shows the difficulty of trying to meet an objective of maintaining a minimum income level for farmers through counter-cyclical payments. Some might argue that Congress would never have this objective, at least not at such a high guaranteed income level. But Congress did implement a policy for the 1999 crop year whereby Iowa corn farmers were paid an average of between $90 and $100/acre through a combination of AMTA payments, supplemental AMTA payments, and corn loan deficiency payments. Such payments are consistent with the objective of making sure that Iowa farmers cover the cost of producing corn. Indeed replacing the existing policy tools with giving farmers a high revenue guarantee might, at least in the short run, have cost the government less than the existing policy.

Farm Policy in 2001 and Beyond
In an ideal world, clear policy objectives and a good understanding of the impacts of alternative policy tools

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The proximity of growing areas for corn and soybeans to the Mississippi and its tributaries make the system imperative for low cost exporting. The ability to quickly and efficiently access port facilities located at the mouth of the Mississippi River in Louisiana has proven critical to the export success of these U.S. crops.

If the United States wants to maintain the comparative advantage that it has long enjoyed with inland navigation, it will need to make a significant investment in its aging lock and dam system. This holds particularly true given the aggressive advances South American shippers are making to their own river system.

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would guide the actions of legislators. Those policy tools that achieved the desired objective at least cost to society would be selected. In theory, if policy were made in this manner, the greatest good for the greatest number of people would result, and taxes would be used efficiently.

But to suggest that policy is made with an eye towards only the efficient use of taxpayer's money is an oversimplification. Every policy involves winners and losers. Rather than passively accepting their fate in the name of policy efficiency, prospective losers often join together and lobby legislators for a policy that cuts or eliminates their losses. Their success in changing policy depends on the political pressure that they can generate relative to 1) the pressure that prospective winners from a policy can generate, and 2) the public pressure on legislators to adopt policies that meet broad public policy objectives.

As the search for farm policy objectives continues, agriculture needs to address head-on the question of what broad public policy objectives are being met through the federal support of agriculture. These objectives can be stated in either regional terms (such as enhanced water quality in a watershed) or in national terms (such as income support for food producers). But if agriculture is to compete successfully for expanded federal dollars in the next farm bill, urban legislators will need to be convinced why more federal support is needed and what is the ultimate objective of such support. An annual declaration of agricultural emergencies can go on only for so long before the emergency situation is recognized for what it is: the normal course of events.

Table 1. Comparative Geography and Infrastructure

<table>
<thead>
<tr>
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<th>Argentina</th>
<th>United States</th>
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</thead>
<tbody>
<tr>
<td>Landmass (sq. km)</td>
<td>2.8 million</td>
<td>9.3 million</td>
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<tr>
<td>Paved highways (km)</td>
<td>57,000</td>
<td>255,650</td>
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<tr>
<td>Total rail trackage (km)</td>
<td>34,572</td>
<td>236,035</td>
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<tr>
<td>Navigable waterways (km)</td>
<td>11,000</td>
<td>41,935</td>
</tr>
<tr>
<td>Total grain storage (mt)</td>
<td>53.9</td>
<td>264</td>
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