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Whither Farm Policy?

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Whither Farm Policy?

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As the U.S. Congress prepares to pump at least $8.7 billion in supplemental aid to farmers (on top of the $10.5 billion that has already been earmarked), many people—both in and out of agriculture—are openly wondering if there isn’t a better way to run farm programs. To many, it seems that we have no coherent farm policy in the sense that tax dollars are being committed with no clear objective in mind. After two straight years of supplemental appropriations, it is clear that the current farm program (the FAIR Act of 1996, commonly known as Freedom to Farm) is not a politically sustainable policy. And, the policy objective of the ad-hoc aid is clouded by the apparent inability of Congress to pass aid packages targeting assistance to the most at-risk farmers.

In fact, because federal price support payments depend on harvested production, the largest amount of aid will go to crop producers who harvest the biggest yields. Thus, Iowa corn farmers who expect bumper crops this fall will receive higher federal payments than will drought-stricken corn farmers in the eastern United States. (It should be noted that the farmers affected by the drought will receive crop insurance indemnities—if they had the foresight to purchase crop insurance—in addition to some emergency drought aid.) Furthermore, the group suffering more financial stress than any other—hog producers—will be receiving little federal assistance.

Many critics are calling for an end to Freedom to Farm. Some see solutions in further reform of the crop insurance program, while others are calling for adoption of a new policy made up of remnants of the former farm bills. But, before any new reform proposal can be seriously evaluated, we need to ask—and answer—“What do we want farm policy to accomplish?”

**Farm Program Proposals: A Crowded Menu**

It is naive to think that achieving agreement on farm policy objectives will be an easy task, especially when we consider the crowded menu of interest-group proposals.

- Environmental groups want farm payments to be used to entice farmers to adopt environmentally-friendly production practices.
- Many rural advocacy groups want farm program payments targeted to small producers, believing that many small farmers increase rural vitality more than fewer large ones.
- Input suppliers prefer payment schemes that do not require a reduction in planted acreage.
- Non-farming landlords prefer payment schemes that are predictable so that land values and cash rents will be enhanced.
- Farm operators who rent land should prefer payments that are not automatically bid into land rental rates.
- Livestock producers—a group that has never been eligible for federal aid—simply hope that federal policy does not increase the price they must pay for their feed.
- Processors and exporters prefer a policy that encourages expanded production.

- True believers in the free market point out that the producer price floors in the FAIR Act (the loan rates) limit agriculture’s flexibility. Land that should go out of production in response to low market prices stays in production because the government-guaranteed price is higher than the market price.
- Some point to the government’s responsibility to maintain national food security and an affordable food supply as reasons to subsidize crop production.
- And Congress, it seems, just wants to be viewed as doing something for agriculture.

The wide reach and diversity of these collective policy preferences (the list is not exhaustive) indicate that we need to step back, gain a more unified perspective, and then discuss what the role of government in agriculture should be, and why.

**Correcting Market Failures**

The first, and perhaps most frequently cited, reason for government intervention is to correct market failures. Economists deem a market to have failed when the price consumers pay for a product is significantly different from the cost of production. Agriculture faces two potential market failures: (1) agricultural pollution, and (2) the exercise of market power in input supply and output processing.

Free-market prices generally do not account for the cost of pollution because pollution damages are not borne by producers of goods and services. Thus, agricultural prices will underestimate the full cost of production when agricultural production leads to substantial pollution. Steps
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in the Party targeted farm programs from day one because they were seen as a prime example of government interference with free markets and the management of farm operations.

• Then, in the fall and winter of 1995, crop prices increased to levels such that traditional farm program payments would essentially disappear.

• Meanwhile, in Congress, Senator Lugar, chair of the Agricultural, Nutrition, and Forestry Committee, and others saw the need to continue down the path of incremental reform of farm programs toward greater market orientation and lower government costs that had been initiated with the previous farm bills.

• Responding to the strength in commodity prices, mainstream producer groups rallied behind Freedom to Farm with its fixed program payments, and it passed.

Given this history, it is not surprising that many former advocates of FAIR are calling for a return to the old farm policy now that crop prices have fallen to levels where payments would be higher under the old supply-control programs.

But wouldn’t an abandonment of Freedom to Farm reduce the flexibility and competitiveness of the agricultural sector? After all, many advocates of the current policy say that by getting government out of agriculture, Freedom to Farm has forced farmers to look to the marketplace for signals about what and how much to produce, rather than to government. But this is far from an accurate assessment.

Acreage was planted in 1999 solely because the government floor prices were in place. Thus, the large supply of crops in 1999 and the resulting low market prices were actually enhanced by the FAIR Act’s floor prices. The supply expansion was especially significant for soybeans because the government floor price of soybeans was set high relative to the floor prices of corn and wheat in the FAIR Act.

In addition, the 1999 increase in crop insurance subsidies also increased production. There is an old adage that you always get more of what you subsidize. Thus, crop insurance subsidies tend to increase risky behavior. The subsidies increase the viability of continuous wheat production in the arid Great Plains on land more suitable for wheat grown in a wheat-fallow rotation. The subsidies also increase the production of corn and soybeans on land that is more suited for crops that can better withstand drought and high heat.

A FLEXIBLE AND COMPETITIVE AGRICULTURAL SECTOR

There are few people, if any, who believe that the current farm policy should be maintained; and at times the clamor for a new farm policy has been deafening. The loudest voices are saying that the U.S. government should dramatically increase its involvement in agriculture. Given that the role of government in agriculture in 1999 is already pervasive, these fervent appeals bring us back to our original question: What exactly do we want farm policy to do?

If we want policy to move midwestern agriculture to a market-oriented system, with farmers producing the commodities consumers want, in the quantities that can be profitably produced, then we should eliminate all government-guaranteed prices (the loan rates) and crop insurance subsidies. Under this policy alternative, land in low-yielding fringe production areas would come out of production in 2000, the supply of crops would drop, and the prices of corn, soybeans, and wheat would increase. The low-cost producers would be able to weather this disruption in supply and may even come out of it in better shape than if the current policy is maintained. This policy objective, however, appears to be a “non-starter,” because the vast majority of opinion leaders and farm organizations are opposed to letting the market determine who should be producing crops in the Midwest.

If we want farm policy to supplement farmers’ incomes in a way that maintains the long-run benefits of production flexibility and a market-driven agricultural sector, then we should eliminate the loan rates and crop insurance subsidies, and simply write government checks to farmers. The size of the checks should have no relationship to the actual production decisions that farmers implement. If Congress needs to transfer
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more money to agriculture when widespread crop or revenue loss occurs, the size of the checks could depend inversely on the level of market prices or revenue levels in a region (state or county).

At the county level, such programs already exist. For example, the Group Risk Plan (GRP) and Group Risk Income Protection (GRIP) pay farmers indemnities if county average yield or county average revenue is below a certain level. Because the payments depend on county yield, a single farmer’s actions cannot affect the level of payment. The government could give every farmer a GRP or GRIP policy. If farmers want to add individualized risk management protection, then they could pay the full cost of a business-interruption insurance plan, much like other businesses do.

The key factor in a flexible and competitive agricultural sector is that farm-level production decisions need to be reflected in farm income. Only then will we see midwestern farmers producing the crops that consumers want, at prices that cover the cost of production.

Clearly, the debate about what to do about farm policy is very much alive. But what we need to focus on is the ultimate objective of farm policy and the costs of implementing policies to meet this objective. We should build on what we have learned from our experience with the old supply-control programs, the various environmental provisions, and with Freedom to Farm to design a policy that does not hinder agriculture’s ability to respond to current and future economic realities.

SELL OR STORE?

CARD’s Web-based decision aid is now available

The Center for Agricultural and Rural Development (CARD) recently launched an interactive Web site (www.card.iastate.edu) to help farmers understand the risks and rewards associated with alternative marketing strategies for corn and soybeans.

Producers in the contiguous 48 states can access the site, input their county name and crop information, and receive county and crop loan rates, posted county prices, and per-bushel loan deficiency payment (LDP) figures. In addition, the site provides information that can help producers decide whether it is better to store or sell their crops at harvest.

The Web site uses sophisticated numerical procedures to calculate average returns and the riskiness of returns for three different strategies that involve crop storage. The strategies are (1) take the LDP now and store until summer, (2) put the crop under loan and store until summer, and (3) take the LDP now, store until summer, and hedge on the futures market.

“Last year many farmers did not fully understand how to incorporate the LDP and the government’s loan program into their fall marketing strategies,” Bruce Babcock, director of CARD, says. “Many producers ended up taking the LDP in the fall and storing their crop, instead of selling it at harvest. These producers then watched the value of their stored crop decline as prices plummeted in the late spring and early summer. Our new Web-based decision aid is designed to inform producers of the potential risks and rewards associated with common marketing strategies that involve storage. They can then be in a better position to decide if the potential rewards from storing the crop are high enough to compensate them for the increased risk.”