AGRICULTURAL POLICY: A NEW APPROACH

by

Carl R. Zulauf
Assistant Professor
Department of Agricultural Economics and Rural Sociology
The Ohio State University

October 15, 1986
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The farm policy debate rages on. The reasons are many, but two seem preeminent. First, there is an assumption in much of the debate that the "right" price and income support policy can solve agriculture's problems. Some argue lower prices will stimulate demand and reduce surplus supply. This effect, however, may be offset by other factors, such as increased production at home and abroad. Others argue that price and income support programs should solve the financial stress problem. But, while net cash farm income has declined for some farmers, it has increased for the sector from $37 to a forecasted $44 billion between 1980 and 1985. In contrast, farm debt, which was estimated at $212 billion on December 31, 1984, increased by $51 billion between 1979 and 1982. Debt is the main culprit, and price and income support programs cannot solve a debt problem. However, substantial reductions in these programs can make the problem worse. A second reason for the on-going debate is that specific price and income support levels are established by Congress through legislation and by the Secretary of Agriculture through discretionary authority. Determination is therefore left to the forces of political influence. This translates into continuous jockeying among competing parties. Much of the current debate would stop if an appropriate mechanism, agreeable to all parties, could be developed for setting specific price and income support levels. Furthermore, solutions to agriculture's problems require a full range of complementary credit, disaster assistance, public stocks, and research programs (conservation and export programs in the 1985 Farm Bill are already complementary).
Price and Income Programs: Parity, cost of production, and inflation indexation have been used to set price and income supports, but parity is the only method used for any period of time. Parity, which is based on the concept of maintaining purchasing power of farm products with a period of prosperity (1910-14), was eventually discarded because it came to yield what most policy participants considered unreasonable support levels. Current parity prices for corn, soybeans, wheat, and milk are $5.10, $12.70, $6.99, and $23.30 respectively. Parity, however, remains a much discussed and, more importantly, understandable objective. Therefore, it is proposed that a modified and updated version of parity be used to establish income supports. The base period would be 1975-79 instead of 1910-14. The 1975-79 period was one of prosperity with little government intervention. During 1975-79, net farm income, in 1982 dollars, averaged $13 billion per year compared with $8 billion during the 1980s.

The proposed formula: New Parity = commodity price '75-79 \times \frac{\text{prices paid last 5 years}}{\text{prices paid '75-79}} \times \frac{\text{Productivity '75-79}}{\text{Productivity last 5 years}}

where Commodity price is average price received for 1975-79 marketing years

Prices Paid is the average USDA index for prices paid for production inputs, interest, taxes, and wage rates.
Productivity is average USDA index of total farm sector productivity.

As in the original parity formula, income supports increase as national cost of production increases relative to the base period. But, in contrast to the original formula, supports decline as productivity increases relative to the base period. It was failure to capture the increase in farm production efficiency which primarily resulted in parity prices becoming unacceptable. This formula yields the following income support prices, which are compared with the 1985 Farm Bill. (The soybean loan rate has basically been used to provide a minimum level of price support, not to support income.)
The proposed formula for loan rates: Loan Rate =

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\text{income} \times \left( \frac{\text{proportion of latest cost}}{\text{base set-aside} \times \text{yield last 5 years}} \right) \times \left( \frac{\text{proportion of national average}}{\text{base planted}} \right)
\]

where Base equals program commodity acreage.

Cost of production is based on the latest USDA data and equals fixed cost plus a management charge plus the cost of maintaining the set-aside minus any returns earned from the set-aside.

Price support for soybeans would be set at the corn loan rate times the average of soybean-corn price ratio for the five previous years.

The above formula would work as follows. USDA determines the proportion of land to be set-aside to balance supply with demand. For a farmer to be as well off in a set-aside program as at full production with supply and demand in equilibrium, the per acre set-aside payment must equal the fixed cost of production (including a return to labor and management) plus cost of maintaining the set-aside minus any returns from the set-aside. This formula translates this amount into a reduction in the loan rate relative to the income support. This reduction becomes a payment for each program bushel produced by the farmer, and the payment is guaranteed at sign-up. The loan rate formula in essence ties the income support rate, loan rate, and set-asides together and makes what is now called the deficiency payment a paid land diversion. Note, the larger
the set-aside, the greater the difference between the income support and loan rate, and therefore the guaranteed paid diversion.

This formula yields 1987 loan rates of $2.45, $5.54, and $2.93 for corn, soybeans, and wheat, respectively, with a 30% set-aside and $2.26, $5.11, and $2.59 for corn, soybeans and wheat, respectively, with a 35% set-aside. The formula can be modified for milk, and preliminary calculations yield 1987 loan levels of $11.94 for a 10% set-aside and $11.50 for a 15% set-aside.

These formulas have many advantages: (1) they establish a mechanism for determining income and price supports which are consistent across all commodities and independent of political influences, (2) they yield results similar to the 1985 Farm Bill and thus should satisfy political considerations, (3) they tie future declines in support to increases in productivity and decreases in input costs, (4) they base loan rates on supply/demand balance of each commodity in a way that encourages set-asides where appropriate, and (5) while some new costs are added, higher income supports and loan rates and paid set-asides (deficiency payments) for commodities not previously covered (dairy, peanuts, sugar, and tobacco), these are more than offset by eliminating the need for paid set-aside programs as well as deficiency payments and by lowering deficiency payments for corn, wheat, cotton, and rice (assuming five billion bushels of eligible corn a $.20 reduction in deficiency payments saves $1 billion).

FINANCIAL STRESS PROGRAMS: To address farmer-debt problems, a Farm Debt Retirement Program (FDR) is proposed. FDR funds would come from savings generated by the above revisions in price and income programs. Funds would be given to lenders which reduce the debt of qualified farmers by an equivalent amount. Preference would go to farmers in states which join the matching program.

DISASTER ASSISTANCE: Limited participation in federal crop insurance and high delinquency rates on FmHA disaster loans suggest current programs are not
meeting the needs of farmers. They should be replaced by individual tax-deferred disaster accounts. These accounts, similar to individual retirement accounts, could be funded to a maximum of the farm's variable cost of production. Funds could be withdrawn when a verified natural disaster reduced production by more than a specified amount.

**FARM STORAGE:** Release prices on Farmer-Owned Reserve grain (§3.15 or above for corn) substantially exceed likely prices. Storage programs should be made more market oriented by making the release price on all producer stored grain equal to the announced loan rate for a crop year plus previously accumulated interest. The producer would repay the loan at the lesser of the announced or original loan rate and would continue to receive storage payments. Commodity Credit Corporation (CCC) could not sell commodities until market price exceeded highest farmer release price by 5%.

**RESEARCH:** Current research is tilted toward supply increasing. However, surplus production is the current (historical) problem. Redirecting supply research toward demand would only reduce the competitiveness of U.S. farmers. Therefore, a trust fund is proposed with its annual annuity used to fund demand oriented research. It would be funded through the sale of CCC commodities in conjunction with current export subsidy programs and by royalties collected on new uses resulting from this program.

In **CONCLUSION**, these proposals are a unified set of programs. They protect farmers' income, use budgetary savings to address the debt problem, encourage self-insurance through tax-deferred disaster accounts, and encourage demand by stabilizing prices through a restructured storage program and developing new uses. Undoubtedly, there are problems, some maybe fatal, with these proposals. However, if they cause debate to focus on all agricultural programs with an eye toward making them consistent, they have achieved their goals.