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RATIONALE FOR FARM PROGRAMS

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Department of Agricultural Economics
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RATIONALE FOR
FARM PROGRAMS

by

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The debate surrounding the 1990 farm bill has raised a number of questions regarding the rationale, effects and beneficiaries of farm programs. The controversy results from potential misunderstandings concerning the evolution of farm programs, changes in the structure of agriculture, the increasing incidence of global forces affecting agriculture, and increasing public interest in farm program impacts. The purpose, therefore, of this issue paper is to discuss what is known regarding the alternative rationale for farm programs and their effects on producers, trade, taxpayers, and consumers. Since books have been written on these topics, this analysis will be of a summary nature.

Alternative Rationale for Farm Programs

The alternative justifications for farm programs can be grouped in three categories:

- Economics reasons,
- Food security reasons, and
- Social reasons.

Economic Reasons

The origin of contemporary farm programs lies in the depression conditions of the 1930s. However, over time, there has been substantial evolution of program components -- largely in response to economic impacts of those programs on various constituencies including farmers, consumers, taxpayers, and the overall economy.

Price Support. The original objective and/or effect of farm programs was to raise and directly support the level of farm prices. This policy provided *both* price and income support with three major program instruments -- the nonrecourse loan, production management, and direct government purchases. The vestiges of this support income through supporting price policy still exist in commodities such as sugar, tobacco and peanuts. While dairy continues to rely on price support programs, trigger mechanisms included in the 1985 farm bill which tie the level of price support to the level of government purchases provide assurance of support and market price movements toward competitive levels. Other major program commodities, wheat, feed grains, cotton, and rice, maintain supply management components but the use of Secretarial adjustments to the loan and/or marketing loan provisions have somewhat aborted the loan as a price support.

Income Support. The separation of income support from price support began in the late 1960s with the realization that price support levels had stifled the competitiveness of U.S. commodities in export markets. Lowering the level of price support was made politically feasible by substituting direct payments (later identified as deficiency payments) to farmers. In particular, the 1985 farm bill took decisive steps to lower the loan rate and/or remove its effectiveness as a price floor in order to provide assurance that U.S. commodities would be competitive in world markets. As a result, greater reliance is being placed on supporting income through target prices (deficiency payments), with less emphasis placed on price supports. This is the case for all but a very limited number of program commodities such as sugar, peanuts, tobacco and milk.

The separation of price support from income support has an interesting impact on farmer production decisions. Specifically, production decisions are made on the level of income support (target prices) rather than market prices. Because the target price is generally higher than the market price, the target price has the effect of stimulating production and lowering the level of the market price, thus making U.S. commodities more competitive in world markets.

Price Stability. In a free market context, farm prices are inherently unstable. This instability is due to the universal need for food -- regardless of price. Therefore, consumers do not change consumption materially when food prices rise. This is certainly the case in the aggregate, but also tends to be true of individual commodities. That is, while individual foods have substitutes in other foods, most have an inelastic demand. Since, in the short run, supply is also inelastic and is determined largely by weather, free market prices are highly volatile.

As a farm policy objective, price stability is designed to reduce risk and, therefore, reduce errors in farm production and marketing decisions. Price support and price stability are mutually compatible objectives because a floor is set on the level of price. The higher the level of price support, the more price stability. Sugar, tobacco and peanuts, therefore, have very stable domestic prices.

The substitution of income support for price support increased the amount of price instability. Instability gives an advantage to those farmers and agribusiness firms who are in the best position to defray risk through devices such as the futures market. In the absence of effective price supports, other programs such as those relating to stocks, may be relied upon to provide a degree of price stability.

Export Expansion. As indicated previously, export enhancement was a primary reason for the establishment of the target price program. Additional farm program provisions such as the Marketing Loan, "Findley" Loan Adjustment, Expanded Export Promotion Programs, and payment-in-kind certificates have been established to expand exports. Underlying reasons for export expansion involve preventing the accumulation of stocks in the hands of the government, improving the U.S. balance of trade, and expanding domestic economic activity.

Supply Management. One of the enduring characteristics of agriculture has been excess capacity. The only interludes of a relatively tight supply-demand balance were during wars and in the early 1970s' world food crisis period. Two major reasons have been postulated for this excess capacity:

- Continuous infusion of new technology shifts supply more rapidly than demand in the presence of relatively fixed resources.
- Farm price and/or income supports stimulate surpluses. In principle, this should happen if the price and/or income support rate is higher than the market equilibrium price without the support.

The existence of excess capacity (production in excess of commercial domestic and export utilization) has led to acreage reduction or set-aside provisions which are required as a condition for receiving program benefits. During the early eighties, annual acreage reduction programs were the primary supply management tool. Since 1985, the conservation reserve program has become the primary supply management tool with 34 million acres currently enrolled in the program.

Food Security Reasons

Since the world food crisis in the early 1970s, food security has become a considerably more important justification for farm programs relative to price and income support. Food security can be a justification for the government either holding stocks or maintaining policies which stimulate production.

Production Stimulation. In addition to supporting farm prices and/or incomes, farm programs provide food security by stimulating production. Production stimulation is a direct product of price support, income support, and the added stability (reduced price and income risk) provided by farm programs. In addition, the history of continuous support for research and extension has resulted in the continuous infusion of a new technology with the effect of expanding output, lowering costs of production, making the U.S. commodities more competitive in world markets, and lowering food costs.

Commodity Stocks. With periodic and unpredictable adverse weather, government stocks have been a key to food security. Farm programs have made the United States an important storehouse of grain for U.S. consumers and the rest of the world. This residual supplier status has been both a curse and a blessing. It has been a curse in that from a farmer perspective, prices are relatively low. It has been a blessing for domestic and foreign consumers as well as for exporters. While the private sector could theoretically be relied upon to hold stocks, price instability would be substantially greater. In addition, there is no assurance that the quantity of private sector stocks held would be consistent with public sector needs in the event of crop failure. The propensity of the private sector to sell despite low stocks was very apparent during the world food crisis in the early 1970s.

Social Reasons

Social reasons for farm programs refer to concepts directly related to the welfare of subsistence producers (unrelated to their production capacity), the welfare of consumers, and the preservation of the natural agricultural resource base.

Subsistence Producer Welfare. Due to their small scale of operation, many individuals classified as farmers do not receive significant benefits from farm programs because benefits are allocated on a per unit of production basis. Most of these smaller scale operations are operated by part-time farmers that do not depend primarily on agriculture for their livelihood. Some small farmers, however, are very poor and operate on a subsistence basis. These rural poor are essentially poverty cases. While they may be looked upon as part of the farm problem and can be reached through extension small-farmer programs, contemporary price and income programs are not designed to help these individuals. Farm programs could potentially be designed to help only the poor who are not of sufficient size or have the capability to generate a profit. However, from society's perspective, such programs would favor the highest cost farmers who produce a small share of the total output and would not achieve either the food security or stability objectives.

Low Food Costs. U.S. farm policy is often accused of being designed as a cheap food policy. There is merit in this position for grains and cotton which also generate low input prices for livestock production. Currently, the only notable exceptions to this cheap food policy include sugar, tobacco, peanuts, CRP (instituted partly for environmental reasons) and set-asides (designed to reduce CCC stocks accumulation). As a result, eliminating farm programs would likely raise food prices.

Resource Use. Agricultural resources and inputs related to agricultural production are sometimes used more intensely than desired by the public. A *part* of this excessive use of resources is due to government programs which support farm prices and income. However, exploitation of land resources and the accompanied problems of soil erosion occurred in a market environment long before farm programs existed.

Farm programs assist in dealing with the problems associated with excessive use of resources by removing the most erosive land from production on a long-term basis and by preserving wildlife habitat (Conservation Reserve or Wetlands Programs). In addition, conserving practices are contingent upon farmers recieving price and income support benefits. Removal or reorientation of the programs toward small farms would require alternative forms of regulations to accomplish resource use objectives.

Summary of Program Effects

The above discussion has explicitly, or implicitly, developed the major impacts of farm programs, including:

- Lower food expenditures by consumers,
- Increased food security,
- Increased exports,
- Unclear structural impacts with research indicating that if farm programs were eliminated, moderate size farms would be less likely to survive,
- More stable prices, and
- Less soil erosion.

This is not to imply that farm programs are perfect. However, adjustments have been made in farm programs since the 1930s to assist in achieving societal goals. Most of these policy changes not only affected the majority of the production but could not have been implemented if a majority of the production was not covered by the program.