Fixing the FAIR Act to Reduce Budget Costs

John A. Schnittker

U.S. farm policy is on a collision course. The reform farm bill of 1996, enacted with vague intimations of a transition to free markets and smaller subsidies, and with high hopes based on bad advice that the export market would take all we can produce, has a fatal flaw. The new policy, technology, the farmers’ instinct to plant no matter how low prices fall, or whether subsidy payments permissible under our trade agreements are green, amber, or blue, and fair weather, have programmed the farm sector to generate crop surpluses, low prices, and high subsidies, year after year, except for the occasional drought.

There are compelling reasons to expect that this is the probable outcome for the years ahead, based on USDA’s new projections and others, which offer little hope of reduced production, increased exports, or rising prices and declining farm subsidies. Export expansion, the Holy Grail of agricultural politics and the “fail-safe” of the current full production farm policy, has not kept up and is not likely to keep up with grain harvests in a world where technologies travel fast, raising yields everywhere and limiting export demand.

The Demand/Supply Situation

Rose-colored projections and general euphoria were instrumental, in 1996, in creating the fiction that an export explosion was just around the corner. This has led us into the present surplus and subsidy trap, in which farm income is about as dependent on the federal budget as on returns from markets. The flawed conclusion, spelled out in a 1995 study for the Grain and Feed Association, that export markets would absorb all our increased production without any decline in prices, became virtually the law of the land.

Grain and soybean surpluses produced since 1996 have driven farm prices to depression-era levels. Federal spending for subsidies, to keep farm income near record high levels and to maintain the value of agricultural resources at peak levels, reached $32 billion in 2000, or around four times the level generally projected when the 1996 farm bill was adopted. Farm subsidies seem likely to increase year after year, as surpluses rise and prices fall further, until either drought here or abroad, a budget crisis, or revised legislation intervene.

Bruce Gardner referred to the possibility of short crops in a statement to the House Agricultural Appropriations Sub-Committee on March 14, saying essentially that, based on past experience, “something will come along to bail us out” if we wait long enough.

The situation in 2001 is similar to 1983 and 1987. Surplus stocks are not as large as then, but crop prices are lower and budget costs higher. Good crops in 1987 had increased corn ending stocks to 4.9 billion bushels, and wheat to 1.9 billion, around three to four times the levels needed to assure plentiful food supplies and stable, yet remunerative, crop prices. With big

* John A. Schnittker is with Schittker and Associates, Santa Ynez, California.
harvests expected, the Reagan-appointed Secretaries of Agriculture were driven, reluctantly and against their will, to launch massive acreage reduction programs, paying for them with surplus stocks accumulated by the Commodity Credit Corporation (CCC) in preceding years. These actions gave acreage reduction programs, already seen as relatively inefficient (to reduce output by less than the percentage reduction in acreage), a really bad name. They were necessary, or were justified at the time, because of good harvests, disappointing exports following optimistic projections, and acreage reduction programs in prior years inadequate to stem the surplus tide.

Corn acreage was cut from 77 million in 1986 to 66 million in 1987 and to 68 million in 1988. The wheat area under production fell from 72 to 66 million acres. Corn and wheat production declined sharply, with the help of a Cornbelt drought in 1988. By 1989, corn stocks were only 1.3 billion bushels, and wheat stocks 536 million bushels. Corn prices at the farm averaged $2.24 per bushel in 1987 and 1988, 50 percent above average prices in 1986; wheat prices rose 30 percent, from $2.42 in 1986 to $3.15 in 1987-88. Corn exports increased in both years in the face of reduced production and higher prices, confounding the conventional wisdom that acreage reduction inherently, and almost inevitably, reduces exports.

With rising surpluses virtually assured except for bad weather years, farm prices will go lower and farm subsidies higher, if Congress essentially extends the FAIR Act as it is, and acts to maintain current farm income levels. While surpluses are not as large as in the 1980s, farm prices are lower because all the excess grain is now privately owned, while back then government ownership of part of the surplus, and a farmer-owned reserve program shielded surpluses from the market. Farm subsidy costs are not only higher now that in 1987, but under present USDA procedures, the money is gone—paid out to farmers. In the 1980s, it bought crop surpluses (assets) which later paid for acreage reduction under the Payment-in-Kind (PIK) program. Roughly half of what appeared to be record farm program costs in 1986 actually built valuable inventory, which reduced federal expenditures for acreage reduction in 1987 and 1988.

Perhaps drought will rescue the farm policy in 2001 or 2002, but it will not do so year after year. If we wait a few years for “something to come along”, crop surpluses may be far larger, prices lower, and either subsidies higher or farm income lower. No one, least of all Congress and farmers, really wants to return to voluntary, paid acreage reductions. Chances are good, however, that this President and this Secretary of Agriculture will have to ask Congress for authority to do that in a few years, as surpluses and subsidies rise, as tax cuts reduce revenues, and as increased spending on truly high priority programs raises questions about open-ended spending on farm programs, where most of the money goes to a few hundred thousand big and well-off farmers.

Basic Options

In this situation, Congress has three distinct choices:

1. **Continue the FAIR Act more or less as it is**, possibly adding an income assurance program in place of emergency aid. Except for drought years, this approach will institutionalize annual farm subsidy costs in the range of $20-30 billion.
2. **Congress could pull the plug**: Recognize that most of the growers who now receive the big subsidies have very low production costs (as J.B. Penn has demonstrated) and will continue to produce without emergency aid. This would be “FAIR light,” letting the market work to set prices, land values and farm incomes.

3. Congress could act to limit crop production moderately; establish a reserve, align loan levels by reducing the soybean loan to around $4.50, and eventually cut annual farm program payments to around 1/3 recent levels.

**An Action Program**

Three key amendments to the FAIR Act would reduce farm program costs and surplus stocks, while raising farm prices by enough that net farm income would come principally from market transactions, instead of from crop subsidies. The principal by-product of reducing farm program spending would be roughly $15 billion a year or more for aid to small and low-income farmers, Social Security, Medicare, health insurance for the needy, education, pollution control and debt and tax reduction.

**End AMTAs.** The first amendment I suggest is to terminate the so-called Agricultural Market Transition Act payments (AMTAs, enacted in 1996). If this were done over a four to five-year transition, it would fulfill the original theory, or at least the original folklore, on which these payments were based. That was the idea that farm subsidies could be reduced gradually over time. If AMTA payments were reduced to or near zero by (say) 2005, to fulfill the forgotten promise of a “transition” to a situation in which net farm income comes mostly from the market, federal aid for farm income support would be principally countercyclical, operating only when big crops or huge disappointments in exports, reduced prices. Loan deficiency payments and perhaps an income support program, as suggested by Cong. Stenholm and others, would then represent the main safety net.

Expenditures for crop insurance (risk management) would continue, of course. The Conservation Reserve Program (CRP) and other conservation programs, which represent principally public investment in resource protection by farmers, but have some effect in limiting crop production (in the case of CRP) would also continue. Farm program spending might be sizable in some years, but it would be low by current standards.

AMTA payments have had an important adverse effect on farm policy and on federal spending. They sweetened the FAIR Act in 1996, when farm prices were so strong that price and income goals were being met and surpassed without AMTAs. The $7 billion in AMTA payments in 1996 helped set a new and high standard for aggregate net farm income. Since then, the farm lobbies and Congress have insisted that the farm income threshold established in 1996 and 1997 must be matched year after year, whatever the cost, following the decline in market prices generated by the FAIR Act. This cycle may well be repeated in future years; when drought again brings strong prices, AMTA payments will leverage net farm income to a new level, to be reached, after farm prices fall, by new levels of federal subsidies.

**Re-establish the Farmer-Owned Reserve (FOR).** A second major amendment proposed is to reestablish the Farmer-Owned Reserve program, more or less as it operated from 1977 to 1996,
with improvements based on experience. Crop prices now are low, not simply because total carryover stocks of wheat, corn and soybeans are large, but because nearly all our reserve stocks are “free stocks”, available to the market every day.

If free stocks of wheat readily available to the market this year were only 400 million bushels, instead of around 850 million bushels, while the balance of the wheat carryover was in the FOR; if free stocks of corn were only 800 million bushels instead of 1.9 billion; and if free stocks of soybeans were 150 million bushels instead of 350 million, crop prices would be higher. Subsidies needed to meet political farm income targets would be lower.

The FOR can be operated cost-effectively, and without raising crop prices unreasonably. Reductions in loan deficiency payments (LDPs)—the result of higher prices--could be in the area of $5 billion a year, down two-thirds from recent years, while annual storage and handling costs ($685 million) and interest on the inventory of grain “under loan” ($385 million) in the reserve would be about $1 billion per year. That leaves $4 billion a year in savings on farm programs to spend on high priority programs, possibly including aid to low income farm families instead of FAIR Act welfare payments for mostly well-off farmers.

Congress and the USDA have over 20 years of experience to guide the design of this program revival. Rules could be set to admit grain and oilseeds to the reserve when key crop price are unusually low or carryovers “too high”. For example, at the start, admit as much corn to the reserve over a few months as would be likely to keep corn prices near or just above the level of the marketing loan ($1.89/bu.), thus eliminating or reducing LDPs. After that, open the reserve to additional grain following the same general rule. Producers should have the option of selling the grain out of the reserve at any time, and government should be prepared to stop the storage payment incentives when prices rise above the marketing loan level, thereby encouraging delivery of grain to market and limiting price increases so long as there is grain to be removed from the reserve.

A Standby Acreage Reduction Program. A third essential amendment to the FAIR Act is a “Standby Acreage Reduction Program”, as was proposed by Secretary Glickman in the Clinton Administration’s belated recommendations to Congress in 1996. When carryover stocks reach, or are expected in the next crop year, to reach levels which would keep prices below marketing loan levels with an average crop, despite operation of the FOR, or when carryover stocks reach some absurdly high level to be determined, the Secretary could (or would be required) to operate a marginal acreage reduction program for the crops in question.

We have had a lot of experience with acreage reduction programs. They have ranged from (1) a requirement that farmers idle (not plant) X percent of their crop acreage to be eligible for federal farm payments of any kind (euphemistically called “unpaid diversion” by farm groups, which now consider subsidy payments a matter of right not to be encumbered by any acreage or conservation requirement): (2) “paid diversion”, in which USDA offers the producer slightly more per acre in cash than the producer’s expected to net from crop production, to idle (perhaps) 10-15 percent of the producer’s crop acres. This would provide producers with another market-based option—to grow corn, soybeans, wheat, or nothing at all on a small part of
the land on any farm. This is truly market-oriented, providing producers an additional choice, a conserving use, in addition to the crops adapted to the area.

Some argue, or fear, that acreage reduction would interfere with the production flexibility provided by the FAIR Act. This is simply false. Farmers could retain the same options as now, to plant whatever they want to plant, with one more option provided by the program. I am old enough to remember that my father was eligible to receive “conservation” payments while planting any crops he chose on his “soil-depleting base” under the Soil Conservation and Domestic Allotment Act of 1935, so long as he maintained the prescribed acreage in a “soil-conserving” manner.

Another acreage reduction idea which has gained some support this year is the “Flexible Fallow Program”, under which growers would be awarded higher marketing loan payments, based on the percentage of their cropland idled. Some analysts see material advantages to this approach, compared with past programs. I have heard that some members of Congress may oppose “voluntary land retirement”, but might support “Flexible Fallow”. There is a risk, as the program was first advanced, that participants would receive no payments at all in years when reduced production from either drought or acreage reduction kept prices above marketing loan levels, thereby eliminating or severely reducing payments. If corn prices rose to $2.75 a bushel, for example (the highest level suggested in the plan), payments would be suspended. Participants and non-participants would receive essentially the same returns on their crop, but participants would have smaller crops and lower receipts. If this program is considered seriously, USDA needs to do some careful arithmetic to adjust the incentive levels now listed in the proposal, to foster participation at intended levels.

It is not my intention, however, to recommend a specific acreage reduction program. Rather, I argue that if/when corn the carryover approaches 2.5 billion bushels, soybeans perhaps 500 million, and wheat 1 billion bushels, prices will be lower than now and subsidy costs higher, to reach present farm income targets. That’s when a “Standby Acreage Reduction Program” might be welcomed, even by those who now oppose it, just as Secretary Block and Secretary Lyng used available authority in the 1980s to stop unreasonable surplus accumulations.

Some argue that to idle agricultural resources leads to a “dead-weight loss” to the economy. It is a puzzle to me that even the most conservative among us cheered when the Federal Reserve intervened in 1999 and 2000 to raise interest rates to idle plants and workers because the economy seemed to be growing at “an unsustainable rate.” The Fed was not charged with generating a “dead weight loss”, arising from intentional development of idle plants and idle workers. When the Fed intervenes openly to reduce interest rates to speed the recovery after production and profits lag, as in 2001, everyone cheers except stock market bears. Meanwhile, agricultural analysts argue that it is virtually immoral for government to act to idle farm resources in order to reduce crop production, increase its value and the value of exports, and cut federal farm subsidies by raising crop prices moderately.

I am puzzled at how we can call it a loss (when producing [say] 5 percent less corn (500 million bushels) in some year by idling 10 percent of our corn acreage (8 million acres) and raising prices by [say] 15 percent or $0.30 per bushel on 9.5 billion bushels produced could raise the
value of the crop by $2.9 billion, and the value of exports by $600 million, compared with continuing the status quo). Where is the loss in that program?

It must be granted that even moderately higher grain and oilseed prices would, over time, cause food prices to be slightly higher than with lower commodity prices and higher subsidies. This is virtually inevitable, even though food prices did not decline as FAIR Act repercussions drove commodity prices down. Commodity costs, however, are now only about 20 percent of retail prices, so the impact of either policy-driven, or drought-driven higher prices for raw materials will be small. Concern about rising food prices does not provide a material basis for opposing some of the actions suggested above.

John Maynard Keynes, speaking in the 1930s in support of government intervention to increase spending and economic activity, and against the opposition of orthodox economists, said “It would be better if they (individuals) did it for themselves, but that is not an argument for not doing it at all”. In the present case, it would be better if farmers would reduce crop production to raise prices a bit, to generate more of their income from markets. But that is not how farmers operate, and besides, Congress keeps pouring money into the sector, encouraging both farm consolidation and rapid technological gains, feeding the fires of overproduction and guaranteeing continuing political demands for increased and permanent subsidies. Institutionalization of a subsidy-dependent agriculture will be the inevitable result.