Farm Policy Considerations: Introductory Comments

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The 1996 farm bill was touted as the legislation which would transition agriculture to a free market, reduce government outlays and boost farm exports. In the years since enactment, costs have risen to record levels (more than $28 billion in 2000), exports have fallen almost 20 percent and the level of economic trauma has risen. Clearly, the 1996 act, which introduced an adjustment model based on economic pain, was unacceptable to the Congress. It is a fundamental tenet of politics in a democratic system that constituency pain trumps ideology.

The problem, in short, is too much production of basic agricultural commodities. Better prices can be expected with (1) bad weather in major producing regions; (2) increased domestic demand; (3) increased exports; (4) shifts in land use patterns; or (5) a change in policy. At this juncture, it would be difficult to attach a very high probability to any of the five possibilities. Of the five factors, only change in policy can be accomplished in the near term by Congressional action.

Choices in Farm Policy

With the convening of the 107th Congress in January, 2001, the focus of at least the House and Senate Agriculture Committee has been on farm policy. News that more than $28 billion was spent in fiscal year 2000 (and yet economic trauma persists) has provided an unsettling start to the new Congress. Although the 1996 farm bill runs through 2002, debate is beginning in 2001 on the contours of the new farm bill with some chance for change in 2001.

Three choices. Congress faces three choices on how to proceed in the face of low commodity prices, high levels of budget outlays at the federal level and continuing economic problems on the part of producers.

• One possibility is to continue the heavy subsidization that has become the hallmark of the 1996 farm bill for the “program” crops. While the $28 billion plus for the 1999-2000 federal fiscal year is a modest fraction of the country’s food bill, it is large enough to be a visible budgetary target.

If the country is in the early stages of an economic downturn, as seems entirely possible, that level of expenditure may loom even larger this coming year. With the budget surplus narrowing, or even disappearing, less money will be sloshing around Washington and additional appropriations for agriculture may be more difficult to obtain.

Another hazard is a change in priorities in the budgetary process with a majority in Congress concluding that other programs merit more funding and agriculture less in support.

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A second possibility would be to reduce—or eliminate—federal subsidies for agriculture. That would likely result in a reduction in land values. Much of the subsidies is being bid into cash rents and capitalized into land values. One cannot justify present land values on the basis of existing commodity prices. If investors were to develop an expectation of less federal funding—or none at all—land values would likely decline. The drop would be severe if withdrawal of subsidies is abrupt. After all, land values are based heavily on expected profitability of the dominant crops in the area plus expected government payments.

Some have argued for a withdrawal of all subsidies with land values falling to a new lower level. Equilibrium would eventually be re-established for returns to labor and capital near present levels. But returns to land would almost certainly be re-established at lower levels on a more or less permanent basis. While that might be appealing to some, the ride down would be rough—possibly a greater decline in some areas than experienced from 1981 to 1986.

Yet, the awesome part of this is the growing vulnerability of the sector to just such an adjustment.

Even with the sharp declines in land values, pressure on prices would continue as supply fluctuates but with technology likely pushing the supply curve to the right faster than demand is likely to increase.

Those who point to high land values as a factor in international competitiveness are wide of the mark, however. It’s been clear since repeal of the corn laws in Britain more than a century ago that land values are price determined, not price determining. Land values are not properly viewed as a cost of production but as the result of expected profitability. Thus, higher land values in the United States than in Brazil should not be viewed as a problem. What will drive down land values is a decline in expected profitability.

The third possibility is to return to the Secretary of Agriculture some of the authorities swept away in the brief period of economic euphoria in 1995-1996. That would enable the Secretary to act as the surrogate CEO of agriculture and to manage inventories as other CEOs do. Many companies occasionally experience excess inventories—Deere, Intel, Boeing, General Motors, indeed virtually every firm in the world. The time honored solution is to idle people and idle productive capacity.

If that is the direction the country takes in its farm policy, the programs should be designed to encourage resource idling at the periphery and to do so in a market-oriented manner. Programs should take into account the clear trend for technology to boost supply faster than demand is likely to increase.

*The second best solution.* Most farmers and landowners would prefer to make their own production decisions and to produce flat out. That is the first best solution for many.

But the first best solution may produce such budgetary consequences that it may not be attainable. If that is the case, what is the second best solution? Let land values fall? Or to try managing inventories for a change?
It's time to begin serious consideration of a second best solution.

**Evaluating Policy Alternatives**

One apparent reason for the great divergence in policy recommendations is the lack of agreement on how to evaluate alternative proposals. Some argue that the cost of commodities at the farm gate is all that matters. However, a compelling case can be made that, to the extent public funds are employed, farm policy proposals should be subjected to benefit/cost analysis with appropriate attention to—(1) the cost of food to the consumer; (2) the impact on the environment; (3) the effect on producers; (4) the consequences for rural communities; and (5) the cost to taxpayers.

This policy issue deserves attention in farm bill debate.

**A Global Food and Agriculture Policy**

The globalization of food supply and demand and the position of the United States suggest that food and agriculture policy analysis should shift to a new level to encompass global food and agriculture issues. Such a policy would likely take years to accomplish and would require skilled diplomatic efforts, but the logic behind such an approach to policy is obvious.

A global food and agriculture policy should have several components—

- First, and probably foremost, is support for Third World economic development. With relatively high income elasticities of demand for food (70 percent or more of each additional dollar of income is likely to go for food purchases in some of the countries), it is clear that the last frontier for increasing food demand is the Third World. Moreover, adequate nutrition, worldwide, has the support of a wide array of groups and individuals.

  If the poorest countries could be nudged into the development queue, with investment in education, health care and infrastructure, plus progress in implementing more open and democratic governance systems, the long-pursued goal of elimination of world hunger could be within reach. Gifting food to low income countries, while laudable from a humanitarian point of view, destroys their internal agricultural economy.

- The issue of food safety, including animal diseases as well as genetic modification of foods, should be addressed in a global food policy.

- Food security should be a component of a global policy.

- Fair and equitable sharing of germ plasm should be assured. This could help allay fears of some countries that their germ plasm is being appropriated without compensation by First World countries.

- Trade in agricultural products and commodities is an obvious candidate for inclusion in a global food and agriculture policy as a supplement to negotiated trade agreements.
• Agreed-upon policies committing major food producing countries to manage excess inventories could be a part of a global food and agriculture policy. Countries would be urged to take action in unison whenever disastrously low food prices occur worldwide with comparable steps taken to reduce food production. The flow of development funds from the United States into the World Bank and IMF and in the form of direct assistance could be used to leverage such responses from other countries.