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Food Security Act of 1985: Price Support Programs

by

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FOOD SECURITY ACT OF 1985: PRICE SUPPORT PROGRAMS

INTRODUCTION

Some economists believe that price supports for the agricultural sector are detrimental to the entire farm economy. These economists claim high support payments have contributed to the increased accumulation of grain stocks because the government is providing an alternative market for producers.[1] Also, the payments provide an incentive for farmers to produce, even in periods of declining prices.[2] The end result is that the government accumulates more stocks because the supports are more attractive than the market prices.[3] Both the acquisition of large stocks and the increased deficiency payments have, in turn, led to extremely high farm program costs.[4]

Another important problem has been the decline in the export market for American produced grains. The consensus among most economists in that price support programs have contributed to this decrease in one way or another.[5] Essentially, the high support levels bid the commodity out of the export market and put it into farm program stocks.[6] With declining exports, there is more grain supply within the domestic market. This over-supply then perpetuates the lower domestic market prices while the support levels provide a price umbrella for foreign purchasers.[7]

Taking these factors into account, it becomes at least questionable whether price supports actually help farmers in the long run. Regardless, the past programs have interfered with the free market for so long that many producers are now dependent on them. The Food Security Act of 1985[8] appears to recognize this dependence. Apparently, the 1985 Bill attempts to gradually reduce the programs over a period of time. Immediate repudiation of existing programs would surely be devastating to those dependent farmers. The evidence is convincing, however, that the programs are not the answer they were hoped to be.

The Food Security Act of 1985 provides comprehensive price support programs for a variety of commodities. Although this article will focus on the provisions relating to wheat and feed grains, the analysis is pertinent to the other commodity programs as well. First, a detail of the major provisions of

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1. CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS, 99TH CONG., 1ST SESS., U.S. COMMODITY PRICE SUPPORTS AND COMPETITIVENESS OF AGRICULTURAL EXPORTS 25 (Comm. Print 1985) [hereinafter cited as RESEARCH SERVICE].
2. *Id.*
3. *Id.* at 27.
4. *Id.* at 42.
5. *Id.* at 25.
6. *Id.* at 38. This problem is further magnified if the support levels are not adjusted for the exchange rate effects.
7. *Id.* at 42.
8. Food Security Act of 1985, Pub. L. No. 99-198, 99 Stat. 1354 [hereinafter cited as Food Security Act].

the 1985 Bill which apply to price support programs will be presented. Following this description will be a summary of the changes made from the previous legislation. Finally, an analysis will be presented referring directly to criticisms of the 1985 Bill's programs for price supports.

PRICE SUPPORT PROGRAMS

The drafters of the new farm legislation had five primary goals to accomplish.[9] They were: first, to establish an effective farm policy that is budget responsible; second, to become price competitive in both the domestic and the world markets; third, to replace government domination with an improved market place for the producer; fourth, to allow profitability to return to agriculture; and finally, to guarantee consumers a plentiful and stable supply of commodities.[10] In an attempt to realize these goals, Congress included price support programs in the legislation. The two programs that will be focused on are the loan-purchase program and the target price program.[11]

Loan-Purchase Program

A loan-purchase program has been in effect in one form or another to over fifty years.[12] Under the 1985 Bill, the Secretary of Agriculture is required to make loans and purchases available to producers.[13] These loan-purchases are loans in which the crop or the commodity itself serves as collateral.[14] If the market price does not exceed the loan rate during the term of the loan, the farmer merely defaults by turning over the commodity.[15] If the market price exceeds the loan rate, the loan is paid off at the loan rate plus interest.[16] The loans are made available on the quantity of grain calculated by multiplying the program acreage planted by the program yield for the farm.[17] The loan-purchase program effectively sets a market floor on prices and allows farmers to use the cash during the loan period. The 1985 Bill, however, does make some changes from previous legislation.

One change in the 1985 Bill involves the method of computing the loan rates. The 1985 Bill allows the Secretary to set the loan rates, with certain

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9. 176 CONG. REC. H12504 (daily ed. Dec. 18, 1985) (statement of Rep. Smith).

10. *Id.* It is interesting to note that these goals contain a certain amount of contradiction. For example, while decreasing the price to become competitive, the profitability of producers will surely decline, at least in the short run.

11. Also included in the 1985 Bill is the means to implement a referendum concerning marketing quotas for wheat. *See* Food Security Act, *supra* note 8, §§ 301-307, 99 Stat. at 1378 (to be codified at 7 U.S.C. §§ 1332-1336, 1338).

12. *See generally*, Note, *Federal Direct Price Support Payment Programs*, 31 S.D.L. REV. 363 (1986) and Note, *The Commodity Credit Corporation's Price Support Loan Program: Should it Continue?*, 31 S.D.L. REV. 350 (1986).

13. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1383, 1395 (codified at 7 U.S.C. §§ 1445b-3, 1444e).

14. *See generally*, Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1383, 1395 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

15. *Id.*

16. *Id.*

17. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1384, 1397 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

restrictions, at the level necessary to maintain the competitive relationship with other markets and to encourage exportation.[18] In addition, for 1986 only, the Secretary is required to reduce the loan level by not less than ten percent.[19] For the years 1987 through 1990, the loan rate must be set by the Secretary as indicated, but not less than seventy-five percent nor greater than eighty-five percent of the simple average market price received during the past five years, excluding the high and low years.[20]

Although these general provisions govern the setting of the loan price, certain other limitations and discretions are relevant. One limitation requires the loan rate to be limited to a five percent decline in any one year other than 1986.[21] The Secretary, however, has been given discretion on this limitation as well. If the average price received by farmers for the previous crop was not more than 110% of the previous year's loan rate, or the determined loan level would discourage exports and cause excessive stocks, the Secretary of Agriculture has the authority to reduce the loan rate up to an additional twenty percent.[22]

Besides modifying the methods for calculating the loan rate, Congress has also modified the repayment provisions by providing for repayment of loans at a variety of possible levels. Specifically, repayment may be made at any time up to maturity at the lesser of two amounts.[23] The first possible amount is the original loan rate.[24] The second alternative is the higher of three possible amounts: (1) seventy percent of the original loan level; (2) seventy percent of the original loan level without considering any discretionary reduction of the rate because the average producer price did not exceed 110% of the loan rate;[25] or (3) the prevailing world market price.[26] Effectively this means that repayment is made at the world market price limited by a ceiling price of the loan rate and a floor price of seventy percent of the loan rate.[27]

The loan-purchase programs available under the 1985 Bill are not new to agriculture. The changes have occurred in the calculation of the loan rate and the repayment level. The idea is to gear the loans directly to the market prices for the commodities. By setting the levels this way, the programs are designed to be responsive to changes in the market. The loan programs, however, still provide the price floor that is the foundation of the purchase-loan programs.

18. *Id.*, 99 Stat. at 1383, 1395.

19. *Id.*, 99 Stat. at 1383, 1396. The reduction, however, may not go below $3.00 per bushel for wheat, or $2.40 per bushel for corn. *Id.*, 99 Stat. at 1383, 1395.

20. *Id.*, 99 Stat at 1383, 1395.

21. *Id.*, 99 Stat. at 1383, 1396.

22. *Id.*

23. *Id.*, 99 Stat. at 1384, 1396.

24. *Id.*

25. *See supra* note 22 and accompanying text.

26. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1384, 1396 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

27. *Id. See supra* notes 23-26 and accompanying text.

Target Price Protection

The target price protection policies have also been in effect in one form or another throughout the past fifty years.[28] Under the 1985 Act, the Secretary of Agriculture is required to have a target price program.[29] This program creates a guaranteed level at which commodities can be sold.[30] The guaranteed price level is used to protect the amount of income that a producer will earn on a specific crop.[31] Under the 1985 Bill, deficiency payments will be made to participating producers if the market price, during the first five months of the marketing year, falls below the target price.[32] The 1985 Farm Bill, however, does make some changes from the previous target programs.

Somewhat different from the previous target price programs, the 1985 Bill has contemplated decreasing target prices. Specifically, the 1986 and 1987 target prices have been frozen at their respective 1985 level.[33] For 1988 through 1990, the target price is to be set by the Secretary with certain limitations. In 1988, the target cannot be less than ninety-eight percent of the 1986 and 1987 targets.[34] Similarly, the 1989 target cannot be less than ninety-five percent of the 1986 and 1987 targets.[35] The 1990 target, however, cannot be less than the lower of ninety percent of the 1986 and 1987 targets or $4.00 for wheat and $2.75 for corn.[36]

The new Bill also provides the Secretary with certain options relating to target prices for wheat. One such option permits the adoption of a flexible program where the producer's target price is set according to the percentage that individual wheat producers reduce the acres planted for harvest.[37] The second option allows individual targets to be determined by the number of bushels that are produced on a farm.[38] Both of these options allow the Secretary considerable discretion.

Under the 1985 Bill, the target price payment per bushel is determined as the target price minus the higher of two figures.[39] One figure is the loan level.[40] The other is the lower of the national weighted average market price

28. *See generally, supra* note 12.

29. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1384, 1397 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

30. If the price of the commodity falls below the target, a deficiency payment is made. That payment brings the producer's income back to the level set by the target price.

31. *See supra* note 30.

32. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1385, 1398 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

33. *Id.*, 99 Stat. at 1386, 1398. These levels are $4.38 per bushel for wheat and $3.03 per bushel for corn. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. Food Security Act, *supra* note 8, § 308, 99 Stat. at 1386 (to be codified at 7 U.S.C. § 1445b-3).

38. *Id.*

39. Food Security Act, *supra* note 8, §§ 308, 401, 99 Stat. at 1385, 1398 (to be codified at 7 U.S.C. §§ 1445b-3, 1444e).

40. *Id.*, 99 Stat. at 1386, 1398.

or a set amount for each year.[41] Also important in considering these payments is that any deficiency payments up to five percent may be made in kind.[42]

The 1985 Bill provides for emergency compensation under certain circumstances.[43] Specifically, emergency compensation is available when the Secretary reduces the loan rate based on low market prices or the current world supply and demand situation.[44] In this situation, the Secretary can maintain target prices and therefore, increase deficiency payments as is necessary to provide the same total return to producers that would have materialized, had the loan rate not been reduced.[45]

The overall pattern for the new target price policy seems to be one of reducing the target prices slowly over a five year period.[46] It is important to remember that the Secretary of Agriculture has considerable discretion in setting the level of the target prices. The fundamental policy of supporting producers' incomes, however, is still involved in the new policy.

General Change in Farm Policy

The 1985 Farm Bill presents a departure from previous legislation in the area of price supports. Previous legislation attempted to remedy short-run situations without accounting for changing market conditions. These changing conditions required changes in farm legislation to assure that policy remained responsive to the actual agricultural economy. Frequently, however, changes in legislation did not coincide with changes in the market. Previous legislation, therefore, often worked against the agricultural economy rather than for it.

The Agriculture and Food Act of 1981 handled the loan-purchase program somewhat differently than the 1985 Act. The Secretary had discretion to set the loan rate between a maximum and a minimum rate. The maximum rate was ninety percent of parity.[47] The minimum support rate was set by statute at a fixed amount per bushel.[48]

In comparison, the 1985 Bill set a minimum price for 1986 only.[49] For the years after that, the loan level is to be set at a percentage of the previous average market price.[50] While still making the loan available, this policy is designed to keep the loan level below the market price. By keeping the levels

41. *Id.*, 99 Stat. at 1385-86, 1398. The set amounts for wheat are: 1986-$2.55; 1987-$2.65; 1988-$2.82. The set amounts for corn are: 1986-$2.04; 1987-$2.19; 1988-$2.24. *Id.*, 99 Stat. at 1386, 1398.

42. *Id.*, 99 Stat. at 1387, 1399.

43. *Id.*, 99 Stat. at 1386, 1398.

44. *Id.*

45. *Id.*

46. *See supra* notes 34-36 and accompanying text.

47. 7 U.S.C. § 1444d (West, Supp. 1985). *See supra* note 12.

48. *Id.* The actual rate is then set between the maximum and minimum rates while considering the costs of production, supply and demand conditions, and world prices.

49. *See supra* notes 17-20 and accompanying text.

50. *Id.*

low, the producers will be encouraged to stop building up surpluses.[51] This method of setting the loan rate is intended to be responsive to any changes in the market price, although responsiveness is tempered since a three-year average is used.[52]

In the area of target prices, the 1981 Bill established minimum target prices for each of the covered years.[53] Interestingly enough, these target prices continued to increase every year.[54] Therefore, when it was desirable to establish a lower target price due to increasing stocks, for example, the legislation was prohibitive of any such reduction.

On the contrary, the 1985 Act freezes target prices for only a two-year period.[55] Following this freeze, the target prices are scheduled for continuous reduction.[56] The apparent goal is to reduce the target prices so that grain will not be produced merely because of the government program. Reduction of the target prices will make the producers more responsive to what the market is capable of absorbing, alleviating some of the excessive production and accumulation problems.

The general scheme of both the loan and target price programs is towards reduced government interference with the price signals farmers are receiving so they may be better able to adjust to actual market conditions.[57] Essential to the overall scheme is what has been termed market-clearing price supports. These supports are to be kept at low levels to discourage increased production and the build up of surpluses.[58] By managing the supply of commodities,[59] the market should be able to clear out the excess and eventually lead to an increase in producer prices for the commodities.[60]

ANALYSIS

Although the Food Security Act of 1985 was enacted by the Legislature, it was not without opposition. Even those who supported the Bill did so for many different reasons. One recurring position by various Congressmen is especially important. That position is that there was no existing viable alternative to the 1985 Bill.[61] For this reason, some legislators felt compelled to

51. H.R. REP. NO. 271(I), 99th Cong., 1st Sess. 494 *reprinted in* 1985 U.S. CODE CONG. & AD. NEWS 1103, 1598 [hereinafter cited as H.R. REP. NO. 271(I)].

52. *See supra* note 20 and accompanying text. This amounts to a three-year average since the high and low years are excluded.

53. 7 U.S.C.A. § 1445b-1 (West, Supp. 1985); *see supra* note 12.

54. *Id.*

55. *See supra* notes 33-36 and accompanying text.

56. *Id.*

57. H.R. REP. NO. 271(I), *supra* note 51, at 463, *reprinted in* 1985 U.S. CODE CONG. & AD. NEWS at 1567.

58. *See supra* notes 51, 56 and accompanying texts.

59. Supply management relates to controlling production, and therefore the supply, so that it is equal to or less than the demand.

60. Market-clearing comes from keeping supply below the demand level so that the existing stocks are used up. Increased prices occur when the stocks are eliminated and supply is still at a level below that of demand. *See generally, supra* note 51 and accompanying text.

61. 176 CONG. REC. H12508 (daily ed. Dec. 18, 1985) (statement of Rep. Bereuter).

vote for the Bill rather than be without a modern farm policy.[62] In light of this type of support, this article will next examine in detail some of the major criticisms of the 1985 Act.

Perhaps the strongest criticism of the 1985 Bill's general price support programs asserts that it will reduce farm income.[63] The argument goes that decreases in price supports will decrease gross income to the farmer since he gets less from his commodities. Couple the decrease in support with the continuance of acreage reductions and it means less money for less commodities. This result is in direct conflict with one of the specific goals of the legislation.[64]

Numerous econometric[65] studies predict a reduction in farm income from eighteen to twenty percent.[66] The Congressional Budget Office places the figure as high as twenty-five percent.[67] This decline becomes especially critical in light of the existing condition of the farm economy. Currently, the Agriculture Department estimates that twenty percent of the farmers have a negative cash flow and have problems making their loan payments.[68] It seems obvious that reductions in income on top of negative cash flows would be devastating to many farmers.

Critical to an understanding of the effects of this legislation on the farm economy is an introduction to the overall elasticity[69] of demand for agricultural products. Prior to the 1970's the demand for agricultural products in the domestic market was generally inelastic.[70] This means that changes in the price do not result in corresponding changes in the demand. During the 1970's, however, the United States began to heavily export agricultural commodities.[71] Along with this increase in exports came a change in the elasticity for those products. Because foreign customers are generally more price sensitive than the domestic customers, elasticity increased as a larger share of production was sold abroad.[72] When the amount of exports started to rapidly decline, the elasticity of demand moved back towards its basically inelastic status.

For the producer, this means that as prices go down, there will be no corresponding increase in the demand for agricultural commodities. Without an increase in demand, either less has to be produced, or more has to be

62. *Id.*

63. H.R. REP. NO. 271(I), *supra* note 51, at 797, *reprinted in* 1985 U.S. CODE CONG. & AD. NEWS at 1634.

64. *See supra* notes 9-10 and accompanying text.

65. Econometrics refers to "the application of mathematical form and statistical techniques to the testing and quantifying of economic theories and the solution of economic problems." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 720 (1976).

66. 176 CONG. REC. H12522 (daily ed. Dec. 18, 1985) (statement of Rep. Conyers).

67. *Id.*

68. 176 CONG. REC. S17886 (daily ed. Dec. 18, 1985) (statement of Sen. Zorinsky).

69. Elasticity refers to the "responsiveness of a dependent variable to changes in a casual factor." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 730 (1976).

70. RESEARCH SERVICE, *supra* note 1, at 40.

71. *Id.* at 41.

72. *Id.* The differences in foreign elasticity are explained by the availability of substitutes as well as alternative suppliers in the foreign market. *Id.*

stored, or some combination of both. Since the 1985 Bill includes acreage reduction[73] the policy is set to reduce the production. The combination of lower prices and decreased production will result in lower incomes for farmers in the short run.[74] The only way around the lower incomes would be an increase in demand, which would then allow a corresponding increase in production. This increased production would then offset the decreased prices and provide either stable or increasing incomes. Because the demand for agricultural products is inelastic, however, the decrease in price alone will not increase the demand.

The apparent goal of the Bill is to get the price low enough to once more be competitive in the export market. This expansion of the export market could provide the necessary increase in demand to keep production high and maintain farm incomes. Some economists, however, believe that it could take as long as a decade for the demand to substantially increase in response to lower farm commodity prices.[75] If this delay is accurate, the reduction in farm incomes resulting from the 1985 Bill will stay with the farmer for quite some time.

The short-term effects of this situation seems hard to deny. The incomes of producers will go down. This reduction in incomes to farmers could have the effect of further reductions in production.[76] This reduced production would then tend to inhibit the further decline in prices. So long as the long-term effects of the new farm policy can eventually increase the demand, there would be a corresponding increase in farm income. The effects of this legislation, therefore, seem to be in a cycle. Although unfortunate, the cycle will turn down before it can turn up.

The next major argument against the 1985 Bill is that it costs too much. The projected cost for the price support legislation is approximately fifty-two billion dollars over the next three years.[77] The proponents of the Bill, however, claim that it will cost billions of dollars less than previous legislation.[78] They claim that, while the first three years will run about 1.7% of the total federal budget, this will be down to around one percent by the fifth year.[79] The average for the five years would then be about 1.5%.[80] The anticipated reductions in the later years are because of decreasing support levels. Once again, the cyclical nature of this legislation is apparent since it will cost more before it can cost less.

Another criticism of the price support program is the amount of discretion that is left up to the Secretary of Agriculture. As was shown in the

73. Although beyond the scope of this particular article, the applicable sections are: Food Security Act, *supra* note 8, §§ 1010-1014, 99 Stat. at 1454-57 (to be codified at scattered sections of 7 U.S.C.).
74. RESEARCH SERVICE, *supra* note 1, at 56.
75. *Id.* at 45.
76. *Id.* at 48.
77. 176 CONG. REC. S17930 (daily ed. Dec. 18, 1985) (statement of Sen. Harkin).
78. 176 CONG. REC. H12500 (daily ed. Dec. 18, 1985) (statement of Rep. De La Garza).
79. *Id.*
80. *Id.*

explanation of the Bill's provisions, the Secretary has considerable latitude in most areas of the new price support policies. This discretion requires special scrutiny because of the major changes the Secretary has the power to make. Even the proponents of the Bill are careful to recognize that good results depend on the administration using the policy well.[81] Specifically, the proponents hope that the Secretary will both target family-sized farms for supports and move vast amounts of grain into the world market.[82] There are, however, no guarantees. Much of the future of agriculture could depend on how well the Secretary manages his responsibility.

Finally, many opponents of the Bill see the new policy as a relatively minor change from previous legislation. This attitude is apparent in the references to the "warmed-over price support programs"[83] or the "same old tired programs."[84] They contend, therefore, that the problems which existed before will not be remedied.

Specifically, the opponents claim there is no realistic promise that commodity prices will increase.[85] Without an increase in prices, farm incomes will go down. The proponents, however, claim that the increase in price will occur in the long run when supply is in line with demand.[86] Similarly, the opponents contend that the broad discretionary authority granted in the Bill will not lead to an effective surplus control program.[87] Finally, the program is criticized because it provides benefits indiscriminately.[88] Since all of these criticisms deal with the discretionary authority, no conclusion can be made. Only the future will tell whether the Secretary handles his discretion effectively.

CONCLUSION

Although the price support programs have been criticized as ineffective, they have been continued in the 1985 Bill. The programs, however, demonstrate a fundamental change in policy. That change is away from rigid price supports and toward programs that are responsive to market conditions. The trend is also away from government subsidy and toward a free economy. The journey toward this goal will not be without its casualties. This legislation is not a bail-out for farmers who are in trouble. On the contrary, this bill attempts to realign the entire farm economy. Unfortunately, this will probably mean disaster for some farmers in the short run. If the storm can be weathered, however, the future may be brighter for agriculture. Those that can sur-

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81. 176 CONG. REC. S17939 (daily ed. Dec. 18, 1985) (statement of Sen. Stafford).
82. *Id.* at S17927 (statement of Sen. Boren).
83. 176 CONG. REC. H12509 (daily ed. Dec. 18, 1985) (statement of Rep. Bereuter).
84. *Id.* at H12505 (statement of Rep. Glickman).
85. *Id.*
86. *See supra* notes 69-76 and accompanying text.
87. 176 CONG. REC. H12505 (daily ed. Dec. 18, 1985) (statement of Rep. Glickman).
88. *Id.*

vive the bad days ahead may once again be able to reap the long-term profits of a farm economy that supplies the majority of the world's food.

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