Decoupling: It's Not a New Issue

by Robert D. Reinsel

When he said:

"I clearly recognize that in the long run every economic evil creates its own cure. If prices of farm products continue sufficiently long enough below cost of production, there will eventually be forced into bankruptcy enough farmers so that there will be no longer a disastrous surplus. At the same time there will be readjustments of land values, wages, etc., which will lower the production costs. Economic affairs always work themselves out if you leave them alone. However, it is equally certain that they will work themselves out even though you tamper with them. The disadvantage of tampering is that those who do the tampering are likely to be reviled by about half the population."

Wallace's statement remains as true today as in 1922, yet we continue to look for new ways to tamper with farm commodity markets. The coupling of agricultural programs to agricultural production has been a principal feature of commodity policy since the days of Henry A. Wallace. And, the search for alternatives to coupled programs has been continuous through the life of the programs. The history of the events that led to current programs may provide useful insights to the people concerned about farm programs for the 1990s.

Early Proposals

In the 1920s there was a rapid decline in demand for U.S. farm exports. At the same time, tractors, trucks and autos were replacing horses and the demand for horse feed declined sharply while the supply of commodities reaching the market expanded. The combined effect was a sharp decline in real prices of feed and food grains. Agriculture experienced a significant disadvantage in purchasing power relative to the nonfarm sector. Farmers sought aid from the Federal government to offset the perceived inequity. Equality for agriculture was the rallying cry that brought farm problems to the attention of Congress.

Although forewarned about tampering with the market by Henry A. Wallace in 1922, the first serious proposals to manipulate the market to raise farm income were developed by George Peek, of the Moline Plow Company, who sought a policy of equality for agriculture. Peek believed that there was a natural balance between agriculture and industry that had been lost and he argued strongly for programs to align agricultural prices with industrial prices. During the 1920s, Peek led the fight for an export dumping scheme that included the McNary-Haugen Bills. Introduced 5 times in Congress, and passed twice, the bills failed to secure enough votes to overcome Presidential vetoes.

Having failed to create an export dumping system, Congress created the Federal Farm Board in 1929 as a compromise solution to deal with market problems. However, the $500 million appropriation for grain and cotton purchases was not sufficient to induce price stability and, with inadequate financing and the lack of a mechanism for controlling production, the Board was declared a failure.

Although the efforts of the 1920s to aid farmers failed, the farmer lobbying and political action system created during those years provided the support for the programs of the New Deal that coupled price and income support with production.

A variety of emergency programs were rushed through Congress in 1933 in an effort to end the depression. One such program, the Agricultural Adjustment Act of 1933, was to be a self-financing program of price enhancement for agricultural commodities brought about by supply control contracts with producers. However, the processor taxes, which were to make it self-financing, and the acreage reduction contracts, which were to
control supply, were declared unconstitutional in the case of The U.S. vs Butler, often referred to as the Hoosac Mills decision.

Within two months after the Supreme Court decision, Congress converted the short-term program of the 1933 Act into a permanent program by passing the Soil Conservation and Domestic Allotment Act of 1936. Supply control was now to be carried out under the guise of soil conservation and payments were to come from the Treasury rather than through new taxes. Conservation was to be used as a device to cut production and transfer income to farmers. The 1936 Act was incorporated in the Agricultural Adjustment Act of 1936 which provides for commodity programs coupled to production. The designers and critics of the early commodity programs recognized that price support programs coupled to the production of specific commodities would not help those who received very little income from the sales of commodities on the commercial market. They argued for programs that were not tied to commodity production to assist those with small or subsistence farms.

The Resettlement Administration, which was created by Executive Order No. 7027 on May 1, 1935, contained the first program directed at the farmer with marginal resources. The agency attempted to move producers out of marginal production areas, such as the cut over areas of the Lake States and the mountain tops of Appalachia, to more productive farms or nonfarm jobs. Cooperative “Greenbelt” towns were created to assist the rural and urban migrants in finding low cost housing in urban areas. Led by Rexford Tugwell, the Resettlement Administration moved into uncharted water by facing the resource adjustment problem head on. However, its social planning activities, cooperative farming ventures and lack of legitimization by Congress led to the reorganization of the Resettlement Administration into the Farm Security Administration. In contrast to the goals of the Resettlement Administration, the primary aim of the new organization was to keep tenants and low resource producers on the farm.

During the debates over reorganization of the Resettlement Administration, the concept of “family size farms” became a major issue in agricultural policy and politics. The primary concerns of the Farm Security Administration were the poverty of tenants, especially share croppers, and the adequacy of facilities for migrant laborers. A major goal of the organization was to assist farmers in securing sufficient resources to support a family. Assistance was not tied to production of commodities. The policy debate concerning the social planning and income transfer programs was particularly heated. A major issue was the perception that the migrant labor camps and the cooperative ventures would give rise to the growth of communistic cells and communistic collectives.

In 19348, the Farm Security Administration, minus any cooperative ventures and any labor related programs became the Farmers Home Administration (FmHA). FmHA had the clear mission to retain marginal producers in agriculture by providing low interest loans to producers who could not get credit elsewhere. With the establishment of FmHA the positive resource adjustment aspects of the Resettlement Administration disappeared entirely and policy makers were left with loan programs to help people enter an excess capacity industry, farming. Commodity price support programs were to help keep them farming. Farmer assistance not coupled to production was discontinued.

The Agricultural Adjustment Act of 1938 which was to set the course for future commodity and price legislation had dropped all concern for the impoverished and made permanent the commodity approach to agricultural policy which tied income support to production. The Act had legitimized the concept of parity for agriculture, formalized the nonrecourse loan and permanently institutionalized the objective of raising income through price supports and supply controls. Producers’ incomes for supported commodities were coupled to the nonrecourse loan applied to production. Income support to commodity producers essentially became an entitlement program of price support for each bushel produced. Price supports at parity levels, which were well above the market, caused production to be greater than consumption at the support price.

The Brannan Plan

The first major test for decoupling from fixed high prices, while still supporting the income of commercial producers, was made in the late 1940s by U.S.D.A. Secretary Charles F. Brannan. Known as the Brannan Plan, his proposal was to allow prices to be set by the market. The differences between support levels and market prices were to be made up through direct compensatory payments. Brannan also proposed a limit on the amount of the crop from each producer that would be eligible for payments. Although not decoupled, in the sense that payments were to be tied to pro-

Many, not just farmers, experienced problems in the Thirties.
The commodity stored in this structure has been mortgaged to secure a loan made under a program administered by the Commodity Credit Corporation, an agency of the United States Department of Agriculture; according to the mortgage agreement, the property is to be held in trust for the credit corporation until the debt is paid in full.

The “Ever-Normal” label—a common sight in years past, production, the plan relied on the market to establish prices.

The plan encountered strong opposition because of the possible high cost of the direct payments and the prospect for sharply declining prices as a result of increased production. An important and perhaps fundamental issue in the debate was the question of welfare payments to farmers. Direct payments, as proposed by Brannan, gave the appearance of welfare and farmers preferred to avoid this appearance by having income transfers come through higher prices.

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Fear of falling prices, after the removal of high World War II price supports, and lack of support for the plan in Congress resulted in the death of the Brannan Plan and in the passage of the Agricultural Act of 1949. The Act kept farm price supports high while only modestly restricting acreage, thus allowing stocks to accumulate. Income was supported by nonrecourse loans.

The 1950s and 1960s

Maintenance of commodity prices above world market prices resulted in low exports and continuous stock accumulation throughout the 1950s. In 1954, Congress passed P.L. 480 which gave food distribution a major role in reducing surpluses through subsidized exports. Income support through supply restriction in the form of land retirement appeared, as the Conservation Reserve and Acreage Reserve, during the 1950s and 1960s. These programs permitted the retirement of excess resources over a ten year period and some land left production permanently.

USDA Secretary Freeman wanted to initiate a mandatory supply control program, in the early 1960s. However, when the supply control referendum for wheat failed he moved to a market oriented (but not decoupled) loan program with prices supported by acreage reduction programs and income supported by direct payments to producers. A bid program for whole-farm land retirement edged toward the concept of decoupling. It eliminated the tie between commodities and resource retirement. Payments were made to prevent crop production. Farmers received checks even though they didn’t plant any crops during the land retirement contract. The program reduced the cost of the land retirement. However, the volatile economics of the 1970s called new resources into production, as prices for commodities rose well above support levels.

Away from Parity

The Agriculture and Consumer Protection Act of 1973 continued to separate the price stability and income support objectives of programs as in the 1960s legislation, while maintaining the tie to production. Loan rates were held near world price levels and target prices were set near the loan rate. Income support would be achieved by direct payments coupled to production. The 1973 Act broke the tie between price support and parity, shifting the loan rate to near the world market price, while inferring, but not mandating, that changes in target prices should be related to changes in costs of production.

The Food and Agriculture Act of 1977 set minimum loan rates for wheat and feed grains but provided the Secretary flexibility to reduce loan rates by 10 percent per year to maintain a competitive position in world markets. However, the Act also created the Farmer Owned Reserve (FOR) and permitted the Secretary the flexibility to raise the loan rate for the FOR above the regular nonrecourse loan rate to encourage grain to enter the reserve. The FOR loan rate thus became the floor for prices. The target price for wheat, set at $2.05 in 1974 was escalated to $3.40 by 1978 and increased further to $3.81 in 1981. Loan rates were also increased from $1.37 to $2.35 from 1974 to 1978 and then to $3.20 by 1981 for regular loans and $3.50 for FOR loans.

In an effort to reduce and then eliminate price intervention, USDA Secretary Block developed a proposal, called the Agricultural Adjustment Act of 1981, which would have phased out commodity programs quickly. Farmer payments tied to production would have been eliminated. No substitute payments were suggested.

Block’s proposal was, for all practical purposes, ignored by Congress, which passed one of the most restrictive programs on

Definitions of Decoupling

The current literature on farm programs generally accepts one of two definitions of decoupling. The first is that of Senator Rudy Boschwitz who proposed to break the tie between production of agricultural commodities and income support. His proposal would abolish the nonrecourse loan and allow prices to be determined in the market. Income would be supported by direct payments to farmers based on past levels of production. Direct payments would be reduced annually to some lower level over time.

A second definition of decoupling was proposed by the U.S. Trade Representatives Office. Decoupling, in the trade liberalization proposal, means the removal of all programs that distort trade, but direct payments to farmers would be permissible so long as they were not tied to production and were not trade distorting.

I suggest that income support carried out through commodity programs, either price enhancement or direct payments, is tied to the commodity and therefore coupled. At the same time I choose to be somewhat ambiguous about the definition of decoupling. Not all programs tied to commodities distort prices, resource use or the distribution of output to the same degree. The closer a program comes to market pricing and to supports set at less than 100 percent of a moving average of market prices the closer it is to a market oriented sector and therefore in a sense decoupled.
A fundamental question being raised is how to permit the market to set prices and signal the need for changes in resources while offering some level of aid to farmers to deal with the vagaries of weather and the problems caused by structural excess capacity.

A Veto Message

"It is axiomatic that progress is made through building on the good foundations that already exist. For many years, indeed, from before the day of modern agricultural science—balanced and diversified farming has been regarded by thoughtful farmers and scientists as the safeguard of our agriculture. The bill under consideration throws this aside as of no consequence. It says in effect that all the agricultural scientists and all the thinking farmers of the last 50 years are wrong, that what we ought to do is not to encourage diversified agriculture but instead put a premium on one-crop farming.

"The measure discriminates definitely against products which make up what has been universally considered a program of safe farming. The bill upholds as ideals of American farming the men who grow cotton, corn, rice, swine, tobacco, or wheat, and nothing else. These are to be given special favors at the expense of the farmer who has toiled for years to build up a constructive farming enterprise to include a variety of crops and livestock that shall, so far as possible, be safe, and keep the soil, the farmer's chief asset, fertile and productive.

"The bill singles out a few products, chiefly sectional, and proposes to raise the prices of those regardless of the fact that thousands of other farmers would be directly penalized. If this is a true farm relief measure, why does it leave out the producers of beef cattle, sheep, dairy products, poultry products, potatoes, hay, fruit, vegetables, oats, barley, yea, flax, and the other important agricultural lines? So far as the farmers as a whole are concerned, this measure is not for them. It is for certain groups of farmers in certain sections of the country. Can it be thought that such legislation could have the sanction of the rank and file of the Nation's farmers?"

Taken from President Coolidge's veto message for the fourth McNary Haugen Bill, February 5, 1927.

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