



# Impacts of the 1996 Farm Bill on Price and Income Risk

## Curriculum Guide

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### I. Goals and Objectives

- A. To explain changes in 1996 Farm Bill provisions compared with previous legislation.
- B. To draw conclusions regarding the impact of policy change on risk confronting farmers, lenders and related agribusinesses.

### II. Description/Highlights

- A. Since 1973 the target price program had reduced price and income risk by providing direct payments to farmers whenever the market price fell below the target price.
- B. Lump-sum payments, while supplementing income, do not increase when market prices fall. Thus, risk increases.
- C. A marketing loan provides price protection for cotton and rice by paying the difference between the loan rate and the world market price to producers in the form of a marketing loan/pop payment.
  - 1. For commodities other than cotton and rice, the world market price is less likely to fall below the loan rate because the U.S. is a major price determining factor.
- D. Loan rates have been lowered in order to keep the U.S. competitive in the world market when excess supplies develop.
  - 1. Raising loan rates or extending the loan period could price U.S. commodities out of the world market.
  - 2. Raising loan rates would also increase both the probability of making marketing loan payments and the amount of these payments.
- E. The impact of flexibility was underestimated by many economists.
  - 1. The old program fixed cropping patterns to the farmer's acreage base which was based largely on production as many as 30 years ago.
  - 2. In the meantime, technology had changed what crops could be economically grown in many areas.

3. In addition, world demand patterns had changed to favor feedgrain and oilseed production. This satisfied increasing world demand for chicken, pork and fed beef.
- F. Government-held stocks, in the past, were a major price stabilizing factor.
1. Loan rates were maintained at a higher level. As a result, commodities accumulated in the hands of the Commodity Credit Corporation (CCC) rather than moving into the world market.
  2. Proposals made in the debate over the 1996 Farm Bill to raise loan rates or extend the loan, while supporting the price, would also reduce export demand.
- G. Lower stocks increase price volatility because decisions on what and when to sell are no longer made by the government under political restraint.
1. Rather, these decisions are made by the private sector based on economic motives/needs.
  2. The private sector, including farmers, are learning how to manage inventories under conditions of considerable price risk. Those who learn the most in the shortest time will be in the best position to survive and profit.

### III. Potential Speakers

- A. Public policy extension educators
- B. Farm organization leaders
- C. Elected U.S. Congresspersons and Senators
- D. Farm Service Agency professionals

### IV. Review Questions

- A. Why does the 1996 Farm Bill increase risk?  
Answer: Because it removes the target price, provides flexibility and reduces the government's role in managing stocks.
- B. How are lump-sum payments allocated?  
Answer: Among commodities and producers, based on the history of payments received.
- C. Why is the government hesitant to raise loan rates?  
Answer: Because higher loan rates would reduce exports and increase the amount of payments made under the marketing loan program.

### V. For More Details

Ronald D. Knutson, J. B. Penn and Barry L. Flinchbaugh, Agricultural and Food Policy, 4<sup>th</sup> ed. (Upper Saddle River, NY: Prentice Hall, Inc.) 1998.

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## ! Provisions Affecting Price and Income Expense

- ☞ Lump-sum payments substituted for target price.
- ☞ Flexibility extended to farmers switching cropping patterns.
- ☞ Stock holding by government reduced.

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## ! Government Contract Payments

- ☞ Fixed for life of bill through 2002.
  1. Peak in 1998 at \$5.8 Billion.
  2. Drop in 2002 to \$4.0 Billion.
  
- ☞ Allocated to commodities and farms based on program participation history.
  
- ☞ Target price eliminated.
  
- ☞ Marketing loan retained.
  1. Main beneficiary has been rice and cotton.
  
- ☞ Effect of switch is to increase farmers' risk exposure.
  1. Fixed payments regardless of price.
  2. Payments no longer increase when target price falls.
  
- ☞ Lower loan rates increase amount price could decline.
  1. Maintain competitiveness in world market.

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## ! Flexibility

- ☞ Previously, farmers required to plant within base to receive payments.
- ☞ Producers effectively lock into producing base acreage.
- ☞ Now farmers can produce virtually any crop in any quantity.
  1. Exceptions: fruits and vegetables without production history.
  2. Exceptions: peanuts and tobacco without quota.
- ☞ More switches in cropping patterns than many anticipated results in greater price risk.
- ☞ Farmers' ability to anticipate and lock-in favorable prices becomes critically important.

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## ! Stocks

☞ Previous government stock-holding programs restricted:

1. Eliminated Farmer Owned Reserve (FOR).
2. Reserve stock programs limited in quantity.
3. Commodity Credit Corporation (CCC) stocks forfeited under nonrecourse loan moved into market or used as food aid.

☞ Lower stocks mean more price volatility.

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## ! Conclusions

- ☞ More price and income risk.
- ☞ Remaining safety net consists of:
  1. Fixed contract payments.
  2. Nonrecourse loan.
  3. Marketing loan.