Congress considers moving-average loan rates

NEWARK, DE — To keep commodity loan rates more in line with market trends, Congress is considering several proposals for moving-average loan rates as it deliberates over contents of the 1985 farm bill.

What's the rationale behind moving-average loan rates, and how well can they be expected to work?

In the past, commodity loan rates — which are announced prior to each crop year — have been tied to various criteria such as parity, cost of production and (since 1981) minimum levels legislated by Congress. None of these criteria has proven satisfactory for long, according to University of Delaware extension farm policy specialist Gerald F. Vaughn.

"Loan rates set by legislation are relatively inflexible, so they don't move with market ups and downs," the economist says. "When they become a price floor above market-clearing levels, such loan rates contribute to huge and burdensome commodity surpluses."

Farm policymakers are now looking for a more flexible approach. One that's gaining attention would base loan rates on a moving-average of recent market prices.

"Expected prices would be the best guide for farmers in making production and marketing decisions," Vaughn says. "But because it's impossible to accurately predict the next crop year's prices, a moving-average based on price trends over the past few years would be a good substitute for farm policy purposes."

According to Vaughn, commodity prices over the past three to five years, or the past five years excluding high and low years, ought to provide an adequate average for this calculation. Under this method, as each new crop year comes and goes its prices would become part of the calculation and a previous year would be dropped. This means the average would move up or down in line with market trends.

"To guard against a precipitous drop in the moving-average loan rate if market prices suddenly plummeted and stayed depressed for a prolonged period, a minimum loan rate level could be set, though this shouldn't be above market-clearing levels," the economist says.

"The loan rate could be set at a specified percentage of the market price moving-average, such as 75 or 85," he continues. "A higher percentage could take the loan rate to above market-clearing levels during a year of sharply falling market prices, which would lead to costly government acquisition and storage of commodity surpluses. A lower percentage probably would offer farmers too little price protection."

Compared to past loan rate levels, which were higher and less flexible, Vaughn says the moving-average approach would have certain advantages. It would be more market-oriented and less a hindrance to U.S. exporting, as well as less likely to be capitalized into the value of land and other fixed farm assets.

"Moving-average loan rates still might get out of line with market trends if extreme price changes occurred within a short time," the farm policy specialist says. "The main concern with a moving-average approach, however, is that we have had little experience with the concept."

The Agriculture and Food Act of 1981 provided for setting loan rates for soybeans and upland cotton based on past movements in market prices, but minimum loan rates were legislated for both crops. Since 1982 for soybeans and 1983 for upland cotton, these minimums have been higher than the loan rate levels the moving-average calculation would have set. So it's difficult to evaluate the effectiveness of moving-average loan rates for these crops.

"Designing the moving-average loan rate as an effective policy tool for a wide range of commodities probably would also requrie tying target prices for deficiency payments to market prices. Otherwise, if target prices remained fixed at 1985 levels while moving-average loan rates shifted to lower levels, the widening gap between loan rates and target prices would likely lead to larger government outlays for deficiency payments," the economist predicts.

Even with moving-average loan rates, Vaughn says production control programs would probably be necessary to avoid falling prices from increased production. If this were to happen, the loan rate could at times again become the price floor, holding prices above market-clearing levels.

A recent USDA study tested the possible effects of moving-average loan rates by simulating their use for major crops over the 1986-1990 crop years. The study showed that such loan rates provided temporary price protection without interfering with price signals from the marketplace. However, it also shoed that unless accompanied by production control programs, the moving-average loan rates tended to provide a lower level of price protection.

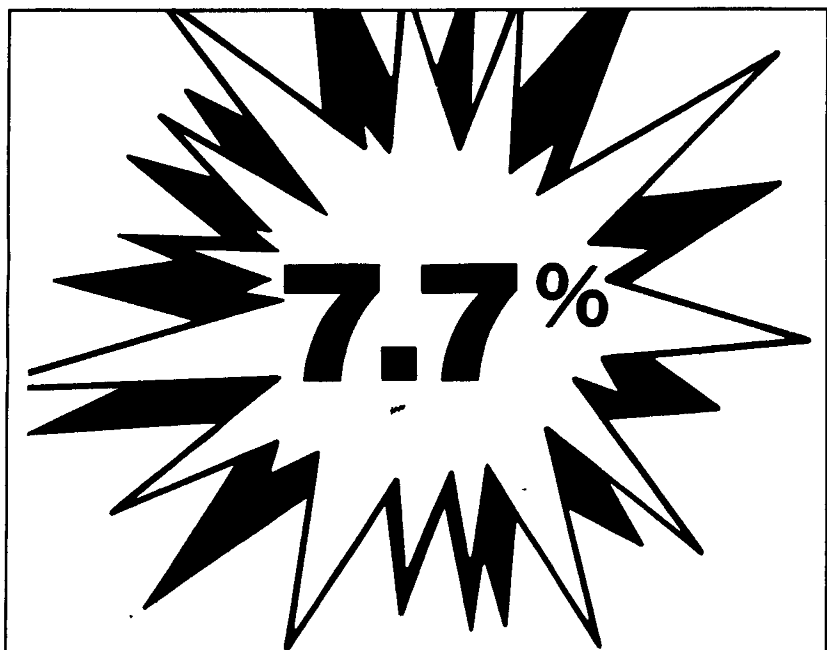
"Moving-average loan rates could help provide a safety net for farmers while making possible market-clearing prices in both domestic and world markets," concludes Vaughn. "This assumes that other elements of the 1985 farm bill would share these objectives and not work at cross-purposes against moving-average loan rates."

Delaware offers Argentina farm tour

NEWARK — The University of Delaware will be sponsoring a farm and dairy tour of Argentina scheduled for Jan. 2 to 16, 1986.

Highlights of the tour include a look at Argentinian dairying, ranching and grain production, as well as visits to the corn belt, pampas and Andes mountains.

The tour is not limited to Delaware residents. Registrations are currently being taken, and a down payment is due by Nov. 1. For more information contact Dr. George Haenlein, Extension dairyman, Townsend Hall, University of Delaware, Newark, DE 19717-1303.



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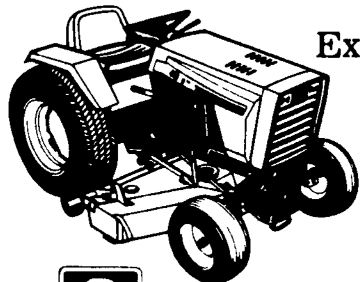

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