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The Dairy Cliff: The Economic Significance of Permanent Agricultural Law in America

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Recent focus on the fiscal cliff has overshadowed a less publicized but highly significant development that will occur on October 1 if Congress fails to act. Specifically, American agricultural policy will return to permanent law when the current, temporary farm bill extension expires. This is expected to increase prices between 40% and 100% for many basic commodities, add billions of dollars to annual food costs for consumers, and require tens of billions of dollars in additional federal expenditure (Leonard). This threat is a result of decades of temporary farm bills, the most recent of which expired on

September 30, 2012 andwas renewed by the American Taxpayer Relief Act of 2012 before the farm commodity supports specified by permanent law took hold (Monke 1).

Permanent law is primarily a combination of the Agricultural Adjustment Act of 1938 and the Agricultural Act of 1949. The Agricultural Adjustment Act of 1938 was established during the Great Depression. It consists of mandatory price supports for certain commodities such as corn, cotton, and wheat in order to increase supply and provide financial assistance to farmers. In addition, the act consists of marketing quotas to prevent supply from outweighing demand for specific goods (Womach 9). The Agricultural Act of 1949 extended price supports to milk and other agricultural products (Womach 7). As a result, permanent law is a collection of price and income supports for basic commodities, as well as controls that attempt to balance supply and demand for certain commodities. Specifically, permanent law sets minimum prices based on the cost of inputs, production, and living expenses. The prices that farmers receive are determined by the ratio between costs and revenue from 1910 to 1914, called parity. Parity-linked prices are not adjusted to account for changes in productivity, although real commodity prices are adjusted to reflect this (USDA Economic Research Service viii). The government supports parity-linked prices through nonrecourse loans or directly purchasing goods, which guarantees farmers a buyer without effective restrictions on production for most goods. In contrast, certain goods have acreage allotments and limits on marketing to reduce production (USDA Economic Research Service x).

As a result of nonrecourse government loans based on parity determinations, many farmers have an incentive to maximize production. Farmers put their crops up as collateral and then forfeit them when the loans mature. This allows them to receive 50 to 90 percent of parity, well above current market prices (Monke 11).

The reversion to permanent law will have the greatest impact on dairy production. The U.S. Department of Agriculture (USDA) will be forced to buy dairy products from farmers, which it currently does to raise demand and consequently raise the price that farmers receive. This will not only result in vast, unnecessary government purchasing of milk, but also double market prices, a phenomenon popularly known as the “dairy cliff” (Monke 11). The impact on dairy production is only one example of the inefficiency and high costs that the government and consumers will incur from a return to permanent law.

Furthermore, the reversion to permanent law will cause domestic agricultural production to come under greater government influence. There are numerous potential problems. Firstly, the government will have to rely on command-and-control methods such as acreage allotments to balance the surplus created by price supports. In reality, attempts to manage acreage allotments will likely be ineffective and inefficient because they are complicated by the diversity of rules for different commodities. The system also assumes that the government has the means to project supply and demand and balance them accordingly. Secondly, increase in reliance in government intervention will provide more opportunities for fraud. Thirdly, government purchase of excess supply will not only create a lot of waste, but also be paid for by taxpayers.

Although there is no recent analysis of the possible economic impacts of the reversion to permanent law, a 1985 report by the USDA predicted a $20 billion increase in annual food costs for consumers and a $50 billion increase in government spending within five years following reversion to permanent law. The same report predicted that increase in spending would require the Federal Reserve to either expand the monetary supply or increase borrowing. Expanding the monetary supply would increase inflation rates by 1 to 2 percent annually. Alternatively, increasing borrowing would increase interest rates by the same amount. In either case, growth in real economic activity and employment was expected to decrease by 1% annually within five years (USDA Economic Research Service xi).

Overall, the reversion to permanent law poses serious threats to consumers, taxpayers, government spending, and the economy as a whole. Given the dramatic implications of the reversion, it is highly unlikely that Congress will fail to pass a new farm bill or extend the current one. However, this does not address the fundamental issue. Despite technological developments and other changes in American agriculture, Congress has continued to implement temporary fixes to the agricultural industry without changing the antiquated permanent law since 1949.

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