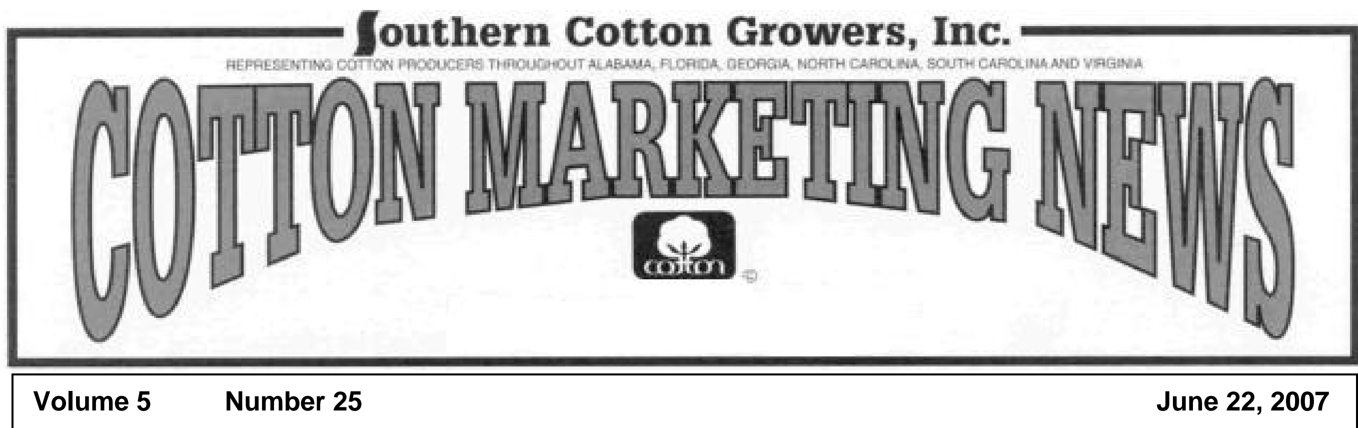

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Learning To Play the "Zero Sum Game"

In economics, there's a strategy or theory called the zero-sum game. In lay terms, what this means is that when the objectives or wants of individuals or firms are opposing and resources are limited (fixed), the wants of one individual can only be met by taking away from another. In other words, it's give and take.

Other the past 2 weeks, the House Agriculture Committee has begun discussion and markup of what will eventually become its proposal for the 2007 Farm Bill. To date, a "discussion draft" was released on June 15 and amendments offered earlier this week on June 19. The process toward the next farm bill has just begun but it has already been eye-opening. The Senate ag committee has yet to take up the measure but will soon. Eventually, House and Senate versions will go to Conference Committee where differences will be resolved. It is hopeful that the farm bill will be completed in September.

Thus far, proposed changes by the House committee from the 2002 farm bill seem to be minimal and in stark contrast to the Administrations proposal released back on January 31. Frankly, it seems most proposed changes thus far have been in cotton and peanuts. The House version (as amended) that is on the table right now would include:

- Payment Acres for both Direct and Countercyclical Payments would remain the same at 85% of Base Acres except peanuts reduced to 74% of Base Acres.
- The Direct Payment (DP) on cotton would remain at 6.67 cents per pound.
- Calculation of the Countercyclical Payment (CCP) would remain in its current formula- would not be "revenue based" as proposed by the Administration.
- Loan Rate on cotton would remain at 52 cents/lb. The Loan Rate on peanuts would be increased from $355 per ton to $375 per ton.
- The Target Price for cotton would be reduced from 72.4 cents/lb to 68.61 cents/lb.
- The Adjusted World Price (AWP), from which Loan Deficiency Payments and Marketing Loan Gains are calculated, would be based on the "Far East Price" and not the Northern Europe Price as is currently.
- Adjustments in the methodology for determining Loan Schedule premiums and discounts
- The Step 2 program, which was eliminated effective this past August 1, 2006, would not be reinstated but "Economic Adjustment Assistance" of 4 cents per pound would be provided to domestic users (US mills) only.
- The planting restriction on fruits and vegetables would remain.

There are other (minor) changes related to cotton but the above are the main ones. All of these are subject to change as the farm bill continues to move forward.

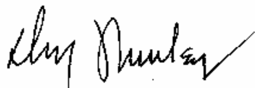
It has been known all along that budget (spending) constraints will be major in shaping the new farm bill. The "zero-sum game" concept comes into play—if someone wants more, someone or something else has to be less. In other words, the pie is no bigger we just have to slice it in different ways. Look at the provisions on the table right now…..

The Target Price on cotton could be lowered about 4 cents. This would result in less CCP. But the Loan Rate would remain at 52 cents, thus not reducing LDP's-- which would have happened if the Loan Rate had been lowered as proposed earlier. Because LDP's are received on actual production, I'd venture to say most producers, if having to choose, would rather have LDP money than CCP money.

With regard to switching to an FE price-- the Far East (FE) price has typically been a little less than the NE price. All other things being equal, this would lower the AWP and this increase LDP--- but, there are 2 components adjusting from the NE or FE price to the AWP and these are grade differential and transportation costs. Lower transportation cost FE compared to NE would reduce the transportation adjustment and raise the AWP. Higher cost would further lower the AWP and increase LDP.

The potential budget savings in CCP from a lower Target Price could help offset any potential increase in LDP. In addition, the savings on CCP will help fund the "Economic Adjustment Assistance" to US mills. Potentially (theoretically) these funds will help US mills reinvest and improve efficiency. The possible benefits of this would be to increase purchases of US cotton by US mills, thus reduce dependence on US exports to foreign mills and imports of foreign textile goods, and perhaps improve market stability and prices received by the US producer. So, in essence, producers are investing in US mills and their own future.

The peanut industry appears split but some are asking for a higher Loan Rate and a higher rate is included in the current amended House proposal. A higher Loan Rate, all other things being equal, could result in larger LDP's. In exchange for a higher Loan Rate, it is proposed that the Payment Acres for peanuts be lowered to 74% of Base Acres. For peanut producers with Base, this will reduce DCP payments. If, however, a higher Loan Rate results in higher market prices or larger LDP for peanuts, this would help offset the decline in DCP. The Loan Rate is key in both the LDP and CCP formula. The total impact of a higher Loan Rate would depend on how market prices react in relation to the change in Loan Rate.



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