APAC Agricultural Policy Analysis Center

The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

The ethanol euphoria

Nearly every agricultural policy proposal being placed on the table is centered around the comment, "But, is this proposal WTO (World Trade Organization) legal?"

To that end we would like to add a question of our own, "Does the proposal being made take into account the unique characteristics of crop agriculture—the very real issue of the lack of timely market self-correction by aggregate crop agriculture. If a policy proposal does not address the self-correction issue, then the policy solution could leave crop farmers financially worse off, with the benefits accruing to other parties.

Presently the emphasis of many is in the direction of expanding the green box to include (1) rural development programs, (2) subsidized income insurance for agricultural producers, and (3) direct payments that are not linked to the production of any commodity. These proposed programs are in addition to the conservation and environmental programs that we talked about in the previous column.

People, who have lived in rural areas and watched their children leave the community in search of better economic opportunities, do not need to be convinced of the importance of rural development programs. Not only do rural development programs stimulate the kind of economic development that increases the pool of attractive jobs for rural community youth, these programs also provide an increased number of off-farm jobs for the producers and spouses who cannot make ends meet on farm income alone.

What rural development programs can't do is provide a solution for the price/income problems that force farmers to seek off-farm income in the first place. No help for self-correction here.

What about income insurance? How can one argue that subsidized income insurance for farmers is not tied to prices and production, unless the payments are made independent of farm revenue? Income independent of farm revenue? We don't know how to accomplish that. But if it could be done, such payments would seem to become guaranteed payments to all farmers, indistinguishable from direct-decoupled payments.

Aside from the "is it WTO legal" issue, farmers should consider the very possibility of declining protected income levels during extended periods of low prices. With 70 percent of a declining income base, insurance payments will spiral down quickly.

Almost by definition, direct-decoupled payments are WTO-legal. The decoupled feature so revered by WTO is not without its challenges for US farmers. As we saw in the 1996 Farm bill, farmers take hits when prices are high and when prices are low. When prices are high farmers are criticized for taking payments when they are not needed. When prices are low, the constant payment level has limited ability to fill the market revenue gap.

As we have seen with the current direct-decoupled payments, the certainty of direct payments causes them to be readily capitalized into land values, resulting in higher land rents and higher costs of production.

In each of these instances the primary financial beneficiaries are often people other than farmers. With rural development, it is the youth of the community who benefit from jobs that allow them to remain in the community after high school or college. Subsidized income insurance programs benefit insurance companies and their agents while doing little for farmers that couldn't be solved by better market prices. Major beneficiaries of direct-decoupled payments are non-farm landlords and the balance sheets of farmers who own land.

A question farmers may want to ask is "had any one of these programs been adopted earlier, how would agriculture have fared during the low price years of 1998-2001 or the export-crash of the 80s?"

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