

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Farm programs indirectly affect agribusiness sales—increasingly with direct cash subsidies

During World War I, the price of essential agricultural products like corn and hogs rose as the conflict created havoc for European farmers. European agricultural production plummeted as soldiers plowed the ground with trenches from which they fought each other. At the same time that warfare reduced European agricultural production, it also increased the demand for food as soldiers arrived from outside of Europe.

With the Yanks coming into the war on the side of Great Britain and France, the administration urged US farmers to increase their production of things like corn and hogs to help feed the boys overseas. No sooner had US farmers fully ramped up production than the war was over and the European farmers wanted to feed their own people. As European agricultural production recovered, US exports plummeted and soon US agriculture was in a depression, a decade before the Great Depression.

With little or no money, farmers were not buying many plows or any other agricultural implements. But, because they had responded to the call to increase production as a part of the war effort, farmers felt that they deserved some help from the federal government.

George Peek, President of Moline Plow Company, along with Hugh Johnson, the company's general counsel, proposed a farm relief act that in essence created a two price market, a higher price protected by higher tariffs and a lower export price that was subsidized by a fee paid by consumers of agricultural products. The legislation became known as the McNary Haugen Farm Relief Bill, named after its two Congressional sponsors.

Though supported by farm leaders and the major farm organizations, it was twice defeated in Congress and the two times it did pass, it was vetoed by President Calvin Coolidge.

With McNary Haugen, the benefits to farm implement manufacturers and dealers were indirect; if farmers were making money, they would purchase new equipment.

In the wake of the Great Depression came the New Deal and the farm legislation that followed. It was during the New Deal that it was generally recognized that the rationale behind the need for farm legislation was a market failure in the crop sector—the lack of timely response on both the supply and demand side to changes in price, especially large changes in price. Market failure in and of itself is not sufficient justification for governmental response. Thus the second crucial factor is that agriculture produces an essential product for the nation's well-being: food.

With the advent of the New Deal in the decade after McNary Haugen, much of the support for farm legislation came from farmers. Farmers and farm groups lobbied for various policy changes over the decades that followed as the bi-partisan Farm Block developed in Congress to respond to their concerns.

That began to change as agribusiness reasserted their influence following the 1983 planting season, when a combination of a) farmers responding to the Reagan administration's offer of Payment In Kind grain from CCC stocks in exchange for reduced planting and b) bad weather that further reduced agricultural activity resulted in lower sales of farm inputs, fewer repairs, and reduced sales of farm equipment. Agribusiness firms did not want to see a repeat of 1983 and thus they lobbied against policies like setasides that would reduce the need for farm inputs.

Beginning with the 1985 Farm Bill, their influence began to be felt as they lobbied against the then current high loan rates which they blamed for the reduction in agricultural exports that began in 1980. They blamed the higher loan rates for keeping the price of US agricultural commodities above the world price. Increased exports driven by lower loan rates, they believed, would use up any surplus production and allow farmers to keep all of their land in production and thus keep farmers in the market for their products.

Farmers did not get the expected increase in exports, but with the adoption of the 1996 Farm Bill, agribusiness achieved their goal anyway—the elimination of setasides. Some of the acreage that had been in setasides was put back into production, prices plummeted followed by massive LDPs and emergency payments between 1998 and 2001. Not wanting to return to policies that would limit surplus production in times of low prices—and actually deal the root cause of chronic price and income problems in crop agriculture—crop insurance becomes the preferred solution.

Insurance has long been a normal part of most farming operations. Farmers insure their barns and houses against fire and storm. They purchase insurance for their cars, trucks, and other pieces of equipment. They use hail insurance to protect their crop from loss before they can harvest it. These insurance products work well because the insurance companies are insuring a random risk for which they can calculate a premium that allows them to cover their costs, ensure a profit, and set aside the necessary reserves.

But the present crop and revenue insurance products that are a major part of the current farm program

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are not like these other insurance products; these products involve systemic risk—that is, price risk that affects every farmer at the same time, unlike fire, hail or other the more random occurrences of insured risks. Systemic risks put insurance companies in jeopardy at any premium that—in this case—farmers could afford and would be willing to pay. In short, without the massive government subsidies that are paid directly to the insurance companies, the insurance companies involved would cease to offer these revenue insurance products.

In the past and for the most part, when agribusiness firms have become involved in trying to influence the direction of agricultural product, their strategy has been to try to see that farmers make a profit so farmers can afford to purchase their products. Generally, the pass through to these firms of any government funds involved in the farm program they lobbied for has been indirect. Farmers have used their income, including any government payments, to purchase the seed, farm chemicals, equipment, and repairs offered by these firms. Also, any relaxation of production constraints results in increased input purchases and lower ingredient costs for agricultural processors.

With the federal crop insurance program, we have a radical shift in the nature of farm programs. In this case, the subsidy goes directly to the crop insurance industry. The insurance sector uses a portion of those funds, along with the premium portion paid by farmers, to indemnify farmers against systemic as well as

more random losses that incur.

This shift toward revenue insurance has created a new and powerful farm-bill constituency. Given the massive amounts of money and huge profits involved, it is not surprising that the crop insurance industry is lobbying hard to make their products the central feature of the 2012 Farm Bill. In addition, it is understandable that this industry is fighting proposals to move the revenue insurance program to the Farm Service Agency where it fits, saving the federal government billions of dollars.

The core policy question becomes: do the interests of the insurance industry coincide with the farm-bill interests of farmers, taxpayers, and society at-large? A couple of farmers we recently talked with put it this way, “when the general public becomes aware that crop revenue insurance guarantees farmers’ profits when prices are high and billions in profits and fees to the private insurance sector, the federal crop insurance program may be as hard to defend as the Direct Payment program.”

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