

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Save revenue insurance from the eventual public ridicule that beset direct payments?

The need to make an election between Price Loss Coverage (PLC) and Agricultural Risk Coverage (ARC) has the effect of forcing farmers to begin to think what crop prices could look like in the next five years. The next five years is the period during which farmers will be locked into either PLC or ARC by the one-time election they will have to make this fall.

If one believes the USDA ten-year baseline numbers, the price of corn for the next five years will be: 2013 crop year - \$4.50/bu., 2014 crop year - \$3.65/bu., 2015 crop year - \$3.30/bu., 2016 crop year - \$3.35/bu., and 2017 crop year - \$3.45/bu.. We have heard considerable discussion suggesting that many think the figures are too low and for the sake of corn and other crop farmers, we hope they are correct.

But if the USDA is correct, or even close—setting aside consideration of PLC, ARC, and the new Supplemental Coverage Option (SCO)—how will revenue insurance perform under those conditions? With the 2014 price coming in at \$3.65 and if the farmer buys revenue insurance, it will provide a portion of that depending upon the coverage options selected, well below the Olympic average—with the years included in the calculation determined by yield—cost of production of \$3.80 for the 2008-2012 crop years.

But suppose the recent drop in crop prices is the beginning of a multi-year trend. It will be impossible for revenue insurance to provide farmers with crop/revenue protection as time moves along.

Revenue insurance is an “upside down safety net.” When prices are very high, that is well above total production costs, revenue insurance can guarantee farmers “pure profits.” Under those conditions, taxpayers subsidize insurance that often guarantees farmers revenue that is above all production costs—leading to charges that farm programs support wealthy farmers.

This is nearly unprecedented as an agricultural policy and yet this characteristic is being overlooked by those who normally are the most critical of government sanctioned arrangements that have the effect of supporting farmers’ incomes, even at levels that only cover a fraction of total production costs.

On the other hand, when prices are below production costs—whether measured as total, out-of-pocket, or variable—revenue insurance only protects a percentage of a low price that is already below the measure of production costs. Relying on revenue insurance, as the primary safety net for agriculture, works when a safety net is not needed, but fails miserably when it is.

There may be a reason why those who are championing revenue insurance, and especially those who have made a living directly or indirectly from developing and/or promoting insurance products, are

downplaying the very real threat of substantially lower crop prices in the years ahead. Sure, events may prevent prices from dropping further, but history would suggest that they can drop and stay at low levels for years at a time.

We all have a positive feeling about using insurance. It obviously has its place in our society, but we have to be realistic and not generate unreasonable expectations among farmers or ourselves. Revenue insurance could be on a path similar to the one that eventually beset direct payments, but occurring because the farm price/revenue circumstances are the reverse.

When prices are well above the cost of production, subsidized revenue insurance will increasingly come into disfavor from taxpayers, and when prices are well below the cost of production, farmers will find that revenue insurance does not provide much of a safety net.

That brings us to a suggestion for revenue insurance that would avoid raising the ire of both farmers and consumers alike. Allow the price to be the function of the cost of production rather than the futures market. We know that the oft-cited advantage of revenue insurance is that it follows the market. But if it followed the market perfectly, it would be of no help at all as we can see from the USDA baseline projections.

What if we set the price guarantee at what the 5 year Olympic average—with the years determined by yield—of what the USDA calls operating costs plus some percent of the allocated overhead for 100 percent of planted acres (excluding silage)? If 90 percent of allocated overhead were used, it would provide farmers with a \$3.63 price guarantee in 2013, which is above the prices the USDA projects for 2015-2017.

Such a program would provide farmers with a safety net, when they need it most, while protecting taxpayers when prices are well above the cost of production.

While this plan does not directly take excess production off the market during long periods of low prices, it provides farmers time to adjust to market conditions. But most of all it provides farmers with a true safety net and it takes the Las Vegas aspect out of the current program where farmers have to bet on how low they think prices will go and for how long.

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