

## PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

### Safety net programs for agriculture

Beginning with the 1985 Farm Bill and coming to fruition in the 1996 Farm Bill, policy makers have sought to move away from inventory management policies that were designed to balance out supply and demand for agricultural commodities at a price that allowed US farmers to remain in production. The argument for this change is the belief that everyone is better off when market forces prevail—ignoring the problem of market failure that was the reason the policies were instituted in the first place. When prices tanked in the 1998-2001 period—long periods of low prices is the market failure—and US farmers were in a financial bind, the US Congress approved 4 years of emergency payments and the 1996 legislation was scrapped a year early.

Beginning with the 2002 Farm Bill, Congress instituted a series of policies designed to maintain the “market orientation” of the 1996 Farm Bill and avoid returning to the earlier policies. By ignoring the issue of market failure, it is our observation that agricultural policy makers have had to come up with policy directions that have been far more problematic than the policies they were designed to replace. What follows is our analysis of those policies.

The latest and least defensible is the use of revenue insurance as the primary safety net for agriculture, where the term “revenue insurance” includes stand-alone products and as a high-profile alternative in the current farm bill. It is the least defensible policy direction because it fails as a safety net.

It is the only major-crop farm-policy approach in memory that can potentially provide more subsidized income during times when prices are above full-production costs than when prices are below even cash variable costs for a series of years.

Revenue insurance is the epitome of an upside down risk management program. The addition of harvest-time pricing takes a faulty program and makes it worse by potentially further-increasing payments to farmers when they need it the least, while running up the cost to the public when farm income is already at high levels.

The time farmers need risk management programs the most is when the market price persists below the cost of production of even the most efficient major-crop farming operation. Since revenue insurance coverage is valued by observed prices, revenue insurance pulls the net from the safety net when prices plummet and when revenue insurance is needed most.

Farmers depend upon public goodwill when it comes to the passage of farm legislation. When the general public comes to understand that they have been footing the bill for high revenue insurance payments when farmers are making money hand over fist and

providing them with little or no protection when the price is well below a measure of the cost of production that would allow farmers to remain on the farm, they may become soured on farm programs in general.

The direct payments of previous recent farm bills are only slightly better than revenue insurance. Direct payments are payments that are paid whether prices are high or low and whether the farmer produces the crop or doesn't. The rationale is that they are decoupled from production decisions, but it is our observation that they are only decoupled in theory. Any income that comes into a farm household affects production inasmuch as it provides a financial cushion. That extra income also gets captured by fixed resources. We saw that when the direct payments were instituted under the 1996 Farm Bill, cash rents went up as landlords sought to capture part of those payments.

In the years between 2002 and 2006 when farm prices remained low, these payments often made a significant difference to farmers, enabling them to remain in the black. But, direct payments became unsustainable during the years that followed when farmers were receiving \$5 billion, prices and farm incomes were at historic highs, and farmers were receiving large revenue insurance payments as well.

Direct payments were paid when prices and incomes were high as well as low, but unlike revenue insurance, under no circumstances were payments larger during the prosperous times than the hard times.

Next in line are Counter-Cyclical Payments (CCP) that were made when the season average price paid to farmers for a given crop was below a specified benchmark that was below the full cost-of-production. To manage government costs, these payments were made only on a percentage of production, but they did provide some significant relief.

The problem with CCPs is that they allowed farmers to continue to produce a crop when the price was well below the cost of production. While allowing US farmers to remain in production, this had a negative impact on farmers elsewhere in the world because they had no protection from the low prices. Worse yet, it allowed US crops to be exported at prices that were below the cost of production and that is called dumping.

The original selling point of this type of program was that, by allowing prices to fall, quantities exported would explode or least get the quantities of grain exports to grow past what they were in the early 1980s. That has not happened and the US share of major-crop world exports has plummeted, even for soybeans, which has enjoyed significant growth in US exports.

**Cont. on p. 2**

**Cont. from p. 1**

So where does that leave us? All of the policies that have been implemented in an attempt to get away from the “outdated policies of the past” seem to have created more problems than they have solved.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). Harwood D. Schaffer is a Research Assistant Professor at APAC. (865) 974-7407; Fax: (865) 974-7298; [dray@utk.edu](mailto:dray@utk.edu) and [hdschaffer@utk.edu](mailto:hdschaffer@utk.edu); <http://www.agpolicy.org>.