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PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Lucas and Peterson: Crop insurance is not a safety net when prices collapse

Until now, Congressional farm bill action has centered on the Senate where the Agriculture Committee has forwarded a bill to the full Senate. The commodity title of this legislation eliminates Direct Payments, relies on crop insurance, and provides farmers with the option to participate in a shallow loss program at either the farm or the county level. It has been criticized by Southern farmers—especially growers of cotton, rice, and peanuts—as providing inadequate protection for their crops. To date the bill has not been scheduled for floor action.

Recent interviews of House ag leaders by Jerry Hagstrom of *The Hagstrom Report* highlight some critical issues that deserve attention as the House Agriculture Committee begins deliberations on the 2012 Farm Bill.

Hagstrom writes, House Agriculture Committee Chair Frank "Lucas said that the Senate's 'shallow loss' that would cover some losses beyond crop insurance is 'a great tool' in good times when prices are high, but would not provide proper safety if prices plummet.

"Because payments under the shallow loss program would depend on revenue comparisons that would gradually go down under such circumstances, 'there would be a free fall to the bottom,' Lucas said. On the other hand, target prices written into the bill would trigger prices whenever prices reached a certain level.

"'You write a farm bill for the bad times,' Lucas said.'"

In that same article, Hagstrom quotes House Agriculture Committee Ranking Member Colin Peterson as saying, "'Crop insurance looks like a really big deal, but if prices go down…you're going to be insuring yourself for a loss,' Peterson said. 'I do not see crop insurance as a safety net.'"

According to Hagstrom, Lucas intends on including both a shallow loss program and target prices in the House legislation, allowing farmers to choose between the two.

Economists and analysts inside and outside of Washington have largely ignored the insurance elephant in the room that Lucas and Peterson see so clearly: the inability of crop insurance to protect farmers against extended periods of low prices.

As we have pointed out repeatedly in this column and elsewhere, the very mechanism that makes crop revenue insurance attractive when prices are rising, since "revenue guarantees change each year with changes in annual prices," also makes it ineffective when prices tumble for multi-year periods of time. Peterson's statement, "I do not see crop insurance as a safety net" is correct. Crop insurance is an excellent tool to insure farmers against random risks—risks like hail damage, but a safety net it is not.

To compensate for the inability of crop insurance to provide a safety net, Lucas is proposing to raise crop target prices. While he offers no numbers, presumably the target prices would cover a significant portion of the cost of production, something that the current target prices do not provide.

This is definitely one way to address the safety net problem, and it is consistent with farm program philosophy of recent farm bills: if crop prices fall, back-fill major farm-revenue reductions with government payments.

To be a true safety net, target prices will have to be increased significantly, and could be costly to taxpayers. Farmers are paid on some proportion of all of the production of the affected crop, and when crop prices fall, they tend to fall across the board, meaning that target price payments need to be paid on multiple crops at a given time.

Something needs to done. Relying only on insurance products—as appealing as that sounds—does not provide the safety net for the bad times that are sure to come. (Too many decades of observing agriculture prevent us from buying into the usual assertion that "this time is different.")

Lucas and Peterson deserve credit for recognizing the need to provide a true safety net and proposing an approach that is capable of protecting farmers during the bad times. Whether it would be adequate would depend on the target-price specifics.

The target price approach has some down sides, however. In addition to the potentially large taxpayer cost, the extremely low prices during the bad times send unrealistic price signals to crop users, penalizes crop farmers around the world, and opens up the possibility of Brazil-type WTO legal actions. Also, target prices do not help stabilize crop prices nor do they help protect export markets when the extreme "times" are the reverse: when crop markets become very, very tight.

An alternative approach would be to help farmers with a more market-oriented approach that does not rely on government payments. Allowing production to out-run demand and then depending on the government to make up the difference with payments is not

Originally published in *MidAmerica Farmer Grower*, Vol. 33, No. 20, May 18, 2012
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the way it works for other industries.

Not allowing burdensome supplies to reach the market is a much better approach. But individual farmers cannot do that alone and food is an everyday consumer requirement that does not vary with price. That is why farm programs exist and can, with the use of grain-reserve and related inventory management programs, be win-win-win for farmers, consumers and taxpayers.

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