

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

### Market-following programs, once perfected, would be no protection at all

As the annual crop tours end, it is evident that, in the absence of an extremely early frost or other weather event, the US corn and soybean crops could achieve record levels of production. Unless there is a rapid increase in the ethanol, feed, or export demand, there is no reason to expect that the sub-\$4 corn prices and falling soybeans prices are over. Even with the low prices, analysts are predicting that insurance payments will be minimal. They note that payments adjust to market conditions, as if that were a good thing.

Now, if adjusting to market conditions is a good thing, then why on earth do we have farm programs at all? If the programs we designed are market-following, providing protection and making high payouts when prices are high and little protection and few payments when farmers need them the most, what interest does the taxpaying public have in such programs? What benefits do they derive from their investment in such a policy?

If we value the concept of allowing the market to set the price, then why do we interfere in crop/revenue insurance markets by subsidizing 62 percent of premium costs and providing other payments to the crop insurance industry? If the premium is \$1,000 but the farmer is only willing to pay \$380, why do we provide a public subsidy? If the farmer is unwilling to pay the \$1,000, does that mean that the market is saying that such a product is not needed? Certainly the insurance companies are not going to offer a product that provides them with \$620 in losses for every \$380 in premiums they collect.

Once upon a time, agricultural economists believed that farm programs were justified because of a market failure—neither the quantities supplied nor the quantities demanded adequately respond to lower prices in a timely fashion, resulting in extended periods of low prices, even prices that are well below the cost-of-production. If this lack of price responsiveness of the quantities supplied and demanded for aggregate major-crops is still with us, then why is it a virtue to develop policy instruments that are market following or, for that matter, have programs that dole out the same amount of government direct payments whether times are bad or exceptionally great—which we used to do and EU continues to do?

It would seem that the rational thing to do would be to develop policies that run counter-cyclical to the market, providing support when prices are below the cost of production and no payments when prices are high. When it comes to crop prices, insurance is a ham-handed policy that does more damage than good by increasing signals for more production when prices are high—the very signal amplification that farmers

do not need.

That is not to say that insurance does not have its place; it does for barns, cars, houses, and hail. And the insurance industry offers all that with no subsidy—the willingness to pay matches up with the cost of providing the product.

There are two reasons for offering publicly subsidized yield insurance: 1) to keep farmers in production when crop production problems are widespread like the 2012 drought and 2) when production problems are localized and an ad hoc disaster program would not kick in. By providing farmers with some protection, they will be able to remain in production.

As a food-consuming public, it is in our best interest to keep farmers on the land when they are faced with a weather-related disaster like a drought or a flood; we benefit in the long-run from a stable agriculture. No one benefits from bankrupting a large number of farmers who are hit with a series of weather-related problems, least of all consumers.

And, from a public policy perspective there are good reasons to provide protections to consumers when prices are high and to farmers when prices are low.

But it makes no sense to write a market-following policy when market failure is the problem.

Some argue that crop prices are on a new plateau much like what happened the 70s and after. But it is important to remember that this time there is no support-price floor and we are not about to idle 25 to 30 million acres in a Conservation Reserve Program. This time around, there are no policy instruments to support a new plateau.

The essence of the market failure in agriculture is that, in the short-to-medium-run, farmers will continue to produce even when the price is well below the cost of production. Historically farmers have been willing to burn through their capital in hopes that next year will be better.

Unfortunately, at least in the short-to-medium-run, increased input costs do not a new plateau make.

If the present low prices fall further and/or hold for a couple of years or more, we will need to reevaluate the current configuration of commodity policies.

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>.