

Today's Commodity Programs: A Safety Net Turned On Its Head?



DR. DARYLL E. RAY
Agricultural Economist
University of Tennessee



DR. HARWOOD D. SCHAFFER
Research Assistant Professor at
APAC, University of Tennessee

Twists and turns are part of life. As individuals, it is common to look back in wonderment, if not amazement, when considering how each of us “got to where we are.” Public policy also has its twists and turns. Sometimes those twists and turns cause the policy to veer from its original purpose or reason for being. Take for example commodity programs.

For as long as the authors of this column can remember, our understanding of commodity policy was that it is to provide a safety net for farmers. And we thought that we had a pretty good handle on what a farm safety net should be. A safety net should minimize damage to commodity prices/revenues during the “hard times,” the times when production chronically outruns demand such as during 1998-2001 crop years and during many previous periods. A safety net also should protect farmers against catastrophic on-farm production losses that result from the vagaries of weather. In exchange for this protection, these policies also protect consumers from extremely high prices.

It is not obvious why a safety net should be needed. In fact, it has been a mission of ours to explain to farmers, consumers, and policymakers why a safety net is important. We have sought to do this through this column and the talks that we give to groups to groups here and abroad.

It is our view that a safety net is needed because of the way crop markets work. Aggregate crop and food markets respond differently than the generic markets that are the subject of an introductory course in economics. For markets to behave the way they do in the textbook, producers and/or consumers have to respond to changes in price in a robust and timely manner. And many markets do just that.

However, when it comes to agricultural markets, the response on the part of consumers is muted – cheap food does not induce people to eat 5 meals a day. Similarly, there is a lack of a timely response on the producer side as well – who can afford to rent land and then leave it idle? And if that is not enough, weather-caused variability happens.

It is critically important to note that these market characteristics have nothing to do with the physical characteristics of major-crop farms, including their size and number. The market characteristics are the key. And they are no different today than they were in the 1930s, the 1800s and so on. Of course, during periods when demand growth exceeds that of production, the characteristics appear dormant but they are still there (actually farmers are the beneficiary those characteristics during those times).

Since the 1985 Farm Bill and especially since 1996's Freedom to Farm, commodity programs have moved away from safety net and price stabilizing concepts. Major policy instruments de-

signed to provide a safety net have been eliminated or dismantled. Today there are no price floors, no stabilizing reserves, or other supply management instruments.

The movement away from these policies has been partially based on the belief that grain exports make price-stabilizing policies unnecessary. It is argued that reasonably set price supports, reserve programs and setasides just get in the way. So the argument goes, just replace these programs with payments, if you must do something.

But if world trade were perfectly free, it is stated or implied, US crop agriculture's prosperity would be guaranteed and payments too could be eliminated.

Aside from what has happened in policy direction since the 1985 and 1996 Farm Bills, what is happening now? To us the whole notion of commodity programs and its attendant safety net concept has been flipped so it is now upside down. We have come the point – contrary to our understanding of the purpose of commodity programs – that making payments when they are not needed is just fine.

To see how incredible this all is, consider the following. How do you think Congress and the agricultural establishment would react if loan rate levels were somehow raised to \$1.04 per pound for cotton (85 percent of \$1.23), \$5.11 per bushel for corn (85 percent of \$6.01), and \$11.39 for soybeans (85 percent of \$13.40) at an annual cost of, say, \$8 billion for the 8 program crops? Then add a \$5 billion direct payment gift on top of that. The total would come to some \$14 billion taken from the US Treasury at a time when market prices are well above the cost of production.

No, we are not off our rocker. This year's crop revenue insurance makes those “price equivalents” available to farmers – at least those who are willing to pay “their” part of the premium. US taxpayers are underwriting a guarantee of record profits to farmers at a time of 9 percent unemployment and when people are losing their homes. Plus, there is the \$5 billion in direct payments.

Direct payments are paid even though prices are well north of all costs. They are an embarrassment whether it is in rural cafes or talking to our city cousins. And, there are demands to continue them in the next farm bill. Why? Because otherwise there would be no “baseline” money for farm programs. It is not because they make sense as a safety net, they don't, of course. They are totally inadequate when prices collapse.

Much of the agricultural establishment, especially insurance companies and their agents, prefers the revenue insurance products. But as is clearly seen, these products protect farmers' “pure” profits when prices are really high even though it costs tens of billions to do so. But here is the kicker. When, not if, prices fall and remain below the cost of production, these revenue insurance products guarantee a percentage of those below-cost prices. In fact, if market prices fell below variable costs, revenue insurance would pay a percentage of the below-variable-cost prices.

This flipping of the safety net makes no sense to us and likely will further erode public good well that could be desperately needed in the future. △

DR. DARYLL E. RAY: Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee

DR. HARWOOD D. SCHAFFER: Research Assistant Professor at APAC, University of Tennessee