PolicyPennings by Dr. Daryll E. Ray

Focus on farm income variability leads to "fire-insurance-like" policy alternatives

One of the challenges of developing a coherent set of farm policy recommendations is developing consensus on the purpose of agricultural policy. It is much like a story we once read about the building of a church in a small Kansas town early in the last century. The contractor was heard to exclaim, in a fit of frustration, that when you get ten members of that church together, they have eleven different opinions on how it should be built.

So it is with the reasons for the existence and nature of agricultural policy and the need for a farm bill. Everyone has a different diagnosis.

If it is determined that a farm program is needed, developing a sensible one, requires careful examination of the most common reasons given for farm policy. In a prior column we examined the oft-heard argument that the reason farm programs began in the 1930s was to reduce poverty on the farm, and because farm household income today is above the national average, there is no need for farm programs.

While rural poverty was a serious issue in the 1930s, we looked to the author of those early farm programs, Secretary of Agriculture Henry A. Wallace to identify the rationale behind the New Deal farm programs.

The programs Wallace developed were not based simply on alleviating rural poverty, but on identifying the long-term cause of poverty among the nation's farmers—the lack of timely self-correction in aggregate agricultural markets in response to changes in prices, particularly lower prices. It was for that reason that he began to institute supply management programs, a theme that we will get back to in a moment. Farm programs deal with a market problem not poverty per se.

Another reason that is given for farm programs—some would say the only defensible reason—is to reduce farm income variability. All economic sectors face income variability and unanticipated shocks and agriculture is no exception. So, if income variability is the rationale then why give preference to farmers? Why focus on farmers and not the retailers on Main Street in most rural communities? We can't tell you how many times we have heard that argument over the last forty years.

Focusing almost exclusively on farm income variability as the problem results in solutions that range from direct decoupled payments, to subsidized insurance programs, to farm savings accounts, to educating farmers on the use of puts and calls and forward contracting, to federal emergency payments.

Many of these solutions ignore the extent to which farm income variability is but a symptom of the basic problem: the lack of timely adjustment on both the supply and demand sides to lower prices.

Other economic sectors are able to overcome shocks to a greater extent and more quickly than agriculture. With a miniscule level of price responsiveness on the part of aggregate crop agriculture, the lows are lower and longer than they are in other sectors.

If the problem in farm income were simply the result of events like a hail storm, insurance would work well because insurers would be facing random events whose rate of occurrence is predictable much like the probabilities that underlie residential fire insurance. But when the cause of low farm income is systemic, any insurance against that sort of risk becomes very expensive.

That is the long and short of it. The variability issue comes down to addressing two types of risk: systemic and random.

Farm programs have historically addressed systemic risk with the use of policy tools that manage inventory, thereby providing the price-responsiveness mechanism that aggregate crop agriculture lacks.

Once the systemic cause of farm income variability is taken care of, additional tools, including insurance products, provide means to deal with random risks.

The issue of farm income variability cannot be discussed realistically as if the only sources of income variability are random events. Insurance approaches are not equipped to deal with a series of years in which all farmers experience "low" prices.

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