PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Crop insurance and the WTO

We have sat through meetings in which leaders of the major farm organizations and officials from the USDA promoted crop insurance as a way to provide risk management for US farmers without opening the door for WTO challenges to US safety net programs for farmers.

As discussed in last week's column, crop revenue insurance has come under fire in recent weeks. The funding for the insurance program is currently under challenge from the reconciliation bill that cuts the overall rate of return for crop insurance companies from 14.5 percent to 8.9 percent. Another challenge has come from the Sensenbrener-Kind bill that would eliminate subsidies for the Harvest Price Option and make additional cuts to the program totaling $24 billion over the next ten years.

There is also a growing realization that crop revenue insurance performs best as a safety net when prices are abnormally high but provides much less protection when prices remain depressed. .

Now another challenge is being voiced that relates to WTO compliance. We have always thought the belief that using the insurance program as the primary risk management program in the expectation that it was safe from a WTO challenge was a lot of "whistling in the dark." A recent International Food Policy Research Institute (IFPRI) paper, "Agricultural Insurance and the World Trade Organization," by former USDA Chief Economist Joseph Glauber, now senior research fellow in the Markets, Trade and Institutions Division of IFPRI raises serious concerns about the vulnerability of government-subsidized crop insurance programs to WTO challenges (http://tinyurl.com/p8ohm9g).

According to Glauber, "A landmark achievement of the 1986 Uruguay Round, and specifically of the AoA (Agreement on Agriculture), was the full inclusion of agriculture in a system of multilateral rules and disciplines, including disciplines governing agricultural support. With the launch of the Uruguay Round, trade negotiators in Geneva began to debate how best to "achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT [General Agreement on Tariffs and Trade] rules and disciplines" by 'improving the competitive environment by increasing disciplines on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their cause.'"

Exceptions to the financial discipline were "green box" policies that were held to be minimally trade distorting. These policies include nationally sponsored agricultural research programs, extension services, and investments in infrastructure like highway construction and improvements to channels, locks, and dams. Direct payments, like the US had from 1996 to 2013, that based on historical acreage were also held to fall into the green box, though they were eliminated in the 2014 Farm Bill as politically unsustainable in period where farmers were receiving record income from the market.

It is interesting that though many believed that insurance programs were non-trade-distorting, most developed countries, including the US, reported these payments as "amber box." Amber box payments are held to be trade distorting and are subject to reduction over time.

Looking at the dollars returned as indemnities received can be seen as one measure of the benefit that farmers receive from the insurance. In 2014, farmers paid $3.853 billion in premiums into the US crop insurance program and received $9.057 in indemnities for losses. In simple terms, farmers received $2.35 in indemnities for every dollar they paid in premiums. When the delivery costs of the insurance products are added in, in 2014, farmers received $3.21 in indemnity payments for every dollar paid by the farmer in premiums. Before those subsidies were available, farmers shied away from crop insurance. We still remember the howl from farmers when they were required to take out crop insurance in order to be fully eligible for disaster programs.

According to Glauber, "In both the US—Upland Cotton case and the four antisubsidy cases in which crop insurance was investigated, the authorities found that US programs conferred a specific subsidy. In no case have US arguments that its crop insurance program does not confer benefits to a specific crop prevailed." Glauber's analysis would suggest that a subsidized crop insurance program is not immune from WTO challenges in the future.

The AoA and the desire to fit agricultural into a trade regimen is problematic –in that it does not take into account the nature of agricultural markets and the absolute necessity for a regular and stable supply of food for human survival. We should come to an understand agriculture and how it functions first. Then we can look at how and under what principles we structure trade rules.

We are reminded of an occasion when Daryll was making a presentation along with another agricultural economist. Daryll made his presentation after the other economist and they clearly offered different the policy proposals. But in part of his presentation Daryll talked about the low price elasticity of supply and the low price elasticity of demand. When Daryll finished, the other economist leaned over and whispered to Daryll, "I don't disagree with your analysis of the problem. I just don't like its policy implications."

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Making agricultural policy without first taking into account the cause of the low price/low income problem is like attempting to treat a person's breathing problem without first determining whether the problem is a bacterial infection a viral infection, congestive heart failure, or a punctured lung that is filling up with blood.

It is our impression that many economists, policy makers, and members of Congress are willing to try any approach when it comes to agricultural support but appear to do so separate from considering the causes of extended low prices—the low price elasticity of supply and demand and the fixity of resources.

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