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Income Support or Subsidized Risk Management? Two Agricultural Policy Approaches

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Our results also imply that because most wheat farmers do not find either no-till or reduced-till profitable, the cost of conservation compliance plans that include conservation tillage might be quite high.

In summary, there is some evidence that there would be a significant decline in reduced-till on corn if farm program benefits are reduced. There is no evidence, however, that adoption rates for no-till would be similarly affected. For wheat, the results imply that conservation tillage practices are costly and not widely used. However, there is some evidence that program participation actually reduces adoption of no-till by a small amount in favor of conventional till. This result would indicate that elimination of government programs would increase adoption of no-till on wheat. And, for both corn and wheat, if program modifications include increased planting flexibility, then no-till adoption should increase as farmers move away from continuous corn and continuous wheat.

CARD researchers continue to explore the factors that influence tillage adoption. The analysis reported in this article is being extended to look at how geographic differences affect the results. Preliminary findings indicate that there may be significant differences in adoption patterns across production regions. These early results indicate that the costs and benefits of complying with conservation compliance provisions may vary significantly across production regions.

**Emerging Issues**

**Income Support or Subsidized Risk Management? Two Agricultural Policy Approaches**

(Bruce A. Babcock, 515/294-5764)

As Congress prepares to adopt a new set of agricultural commodity programs, farmers are debating among themselves about the proper role of government in agriculture. Fundamental questions include:

- Should government be in the business of supporting farmers' incomes?
- Should government be restricted to supporting income only when times are rough, providing an income "safety net?"
- Or should the U.S. government limit its involvement in agriculture to facilitating private provision of risk management tools?

These issues have come to the forefront because a group of Iowa farmers has proposed scrapping the current loan rates and deficiency payments in favor of revenue assurance, which would pay farmers only when revenue falls below a predefined threshold, whether triggered by low yields, low prices, or a combination of the two.

The premise of the Iowa group is that current government programs are set up largely to transfer income to farmers and that government programs should reduce risk, not increase income. Opponents of revenue assurance claim that the current set of programs provides an efficient set of risk management tools, so why should they be replaced by a new, untested program? A better understanding of what actually characterizes an income support program relative to a risk management program should help clarify the issues surrounding this debate.

**Risk Management vs. Income Support**

As all farmers know, farming is quite risky. Crops are subject to the whims of nature, and prices are subject to both supply shocks, such as drought and flood, as well as demand shocks, such as a change in trade policy. Most farmers invest heavily in establishing their crop before the outcome of the demand and supply shocks are known. The risk that matters to these farmers is that the eventual returns from the market may not cover expenses. A risk management program is one that helps farmers cope with this risk by providing payments when market revenue is low. Examples of risk management tools include crop insurance that pays out when yields are low, an option on a futures contract that pays off when price is low, and revenue insurance that pays off when market revenue is low.

- The transfer of wealth to farmers is the central objective of an income support program. That is, payments under a pure income support policy arrive even when farmers are not under financial stress. Probably the best example of an income support policy is the deficiency payment program as it was run in the mid-1980s. For most program crops, the target price was set well above the market price so that payments were made even when market price was higher than average. In addition, the number of bushels on which deficiency payments were made was fixed at a farm's program yield. As a result farmers received large deficiency payments even in years when prices and yields were better than average.

Improved timing of government payments so that they are received when farmers need them most, could greatly improve the efficiency with which commodity...
programs are run. That is, there is room for increasing the value to farmers of agricultural support at the same
or lower cost to the U.S. taxpayer.

Willingness to Pay for Program Payments

The value a farmer places on the benefits from participating in a government program is an important factor
determining the efficiency with which the program is run. A measure of this value is the amount a farmer
would be willing to pay every year to qualify for an average program payout of one dollar. That is, the
“program premium” is the amount a farmer is willing to pay to receive a one-dollar expected indemnity from
the program. The actual forms of the producer’s “payment” for benefits received under current pro-
grams are additional costs to satisfy Conservation Compliance, lost income because of acreage set-asides,
and less than optimal planting decisions made to preserve or build base acres.

The program premium for a pure income support program may be close to one dollar for most produc-
ers. There are few additional benefits from a program that pays off to all farmers regardless of their financial
circumstances.

The benefits of risk management programs, on the other hand, are most valued by those farmers least able
to withstand the consequences of poor market years. Such farmers place a higher value on a program that
pays off only in bad years than do producers who have better financial resources. The program premium for
vulnerable producers may be substantially greater than one dollar, whereas the premium would be close to one
dollar for more fortunate producers who can survive a season of significant revenue loss. Put another way,
those producers who are more averse to risk would be willing to pay more than a dollar for an average
payment of one dollar if payments arrive when the farm is experiencing financial distress.

The willingness to pay more than a dollar premium for a dollar of indemnity is the primary reason why there
is an insurance industry. The difference between the insurance premium and the expected indemnity is the
source of profits to the industry.

Current Farm Program Characteristics

Current farm programs have both risk management and income transfer characteristics. Deficiency
payments are still largely an income support program because payments often come when market returns are
adequate. But there is a risk management aspect to
deficiency payments as well. When price is low, the
per-bushel payment rate—the difference between the
target price and the market price—goes up, thereby
offsetting the negative consequences of low prices. But
often price is low because yields are high, and farmers
are not financially stressed. Thus, the risk manage-
ment attributes of the deficiency payment program are
limited.

The loan rate program acts largely as a price insurance program. Producers are guaranteed a price at least
equal to the loan rate regardless of how low market prices fall. Thus the program premium for the loan rate
program is likely to be more than one dollar for many producers. But there are some drawbacks to relying
solely on the loan rate program as a risk management tool. First, a farmer must have a crop to put under
loan in order to benefit from the program. That is, the
loan rate program does not insure against yield risk.
Second, the loan rate program may be used by farmers
with bumper crops who are under not financial stress.

The first weakness of the loan rate program can be
fixed by purchasing federal crop insurance, another federally subsidized risk management program. When
combined with the loan rate program, farmers who
purchase crop insurance and who participate in
commodity programs have some degree of protection
against low prices and low yields. For some produc-
ers, this combination can be a very cost-effective
management strategy against poor market returns.

Opponents of revenue assurance argue that the
combination of price and crop insurance provides all
the risk management tools that farmers need. Why
eliminate a program that provides good risk manage-
ment benefits in addition to the income support
benefits of the deficiency payment program?

One argument against maintaining the current struc-
ture of commodity programs is that future budget
levels will likely not be adequate to maintain both
income support and risk management programs. If the
primary goal of federal intervention in agriculture is to
provide risk management benefits, then jettisoning the
deficiency payment program will free up enough funds
to adequately fund risk management programs.

Proponents of revenue assurance maintain that their
program is the purest and most efficient risk manage-
ment program that can exist because it pays off only
when revenue (the product of price and yield) is low.
And the primary beneficiaries of revenue assurance
will be those producers who are under the greatest
financial stress. But how much more efficient can
revenue assurance be in providing risk management benefits than a combination of price and yield insurance?

Results from a recent study conducted by the author demonstrate that for between 10 and 20 percent less money, revenue assurance can provide the same level of farmer benefits as a combination of price and yield insurance. The efficiency gains arise because the combination of crop insurance and price insurance may pay off even when a farmer is not in dire need of funds. The unneeded payoffs come about either because crop insurance pays off when prices are extraordinarily high, or price insurance pays off when yields are extraordinarily high. Revenue assurance only pays off in years in which the product of price and yield is low.

As public support for farm programs dwindles, farmers are faced with the difficult task of deciding which program alternative is the most desirable. Should they lobby for a continuation of current programs that both support income and provide risk management benefits, or should they lobby for a well-funded program that focuses only on risk management? It is beneficial for both sides in the policy debate to understand who the primary beneficiaries are for both types of programs and the source of those benefits.

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Fall Ag Policy Conference to Focus on the Livestock Industry

Participants at CARDs 1995 Fall Agricultural Policy Conference will hear farmers, industry executives, economists, and legal experts explore all aspects of the livestock industry and its impact on rural areas. "Changes and Choices for Agriculture and Rural Communities," to be held December 13, 1995, at Kirkwood Community College in Cedar Rapids, Iowa, will feature 20-minute presentations by 11 different speakers with divergent perspectives.

Neil Hamilton, director of Drake University’s Law Center, opens the day with a session on “Agricultural Production and Environmental Policy.” He is followed by Ray Bjornson, Director of Pork Operations for Hormel Foods Corporation, speaking on “Developing New Uses for Agricultural Products.” Tom Stein, president of Knowledgeworks, a Minneapolis-based livestock technology software company, and radio commentator, will predict “The Future of Livestock Production and Management Control Systems.” David Johnson, director of product research for Des Moines’ Meredith Corporation, will offer some insights on “Consumer Trends: Implications for the Agricultural Processing Industry.”

Varel Bailey, farm owner and operator and legislative aide to Representative Greg Ganske, will discuss “The Role of Government in Agriculture.” Another farm owner and livestock producer, Marlyn Jorgensen, tackles the topic of “Community Entrepreneurship.”

Mike Duffy, a well-known Iowa State University Extension economist and associate director of the Leopold Center for Sustainable Agriculture, will share some of the recent findings on “Beginning Farmers: Who Will Farm the Land?” “The Quality of Life in Rural Communities” is the subject of the presentation from Cornelia Butler Flora, director of the North Central Regional Center for Rural Development.

Two CARD staff members will participate in the program. Dermot J. Hayes, head of the Trade and Agricultural Policy division and expert on meat export issues, will address the issue of “Global Market Forces.” CARDs director, Stanley R. Johnson, is slated to discuss “Large-Scale Landscape Management: New Approaches to Rural Development.”

The registration fee for the conference is $35 before December 6 and $40 after December 6. Advance registration is recommended. The fee includes the day’s sessions, meal and refreshment breaks, and a packet of materials. The event begins at 8:30 am and runs until 4:15 pm with two breaks and a noon luncheon.

If you would like more information on the conference, call Judith Pim at 515/294-6257. For registration information, call Cheryl Acheh at Kirkwood Community College, 319/398-4944.