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From Farm Income Support to Risk Management

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CORNHUSKER ECONOMICS

From Farm Income Support to Risk Management

| Market Report | Yr Ago | 4 Wks Ago | 2/24/12 |
|--|-----------|--------------|----------|
| <u>Livestock and Products,</u> | | | |
| <u>Weekly Average</u> | | | |
| Nebraska Slaughter Steers, 35-65% Choice, Live Weight. | \$112.00 | \$122.00 | \$127.70 |
| Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb. | 152.22 | 189.01 | 186.21 |
| Nebraska Feeder Steers, Med. & Large Frame 750-800 lb. | 129.31 | 153.90 | 155.22 |
| Choice Boxed Beef, 600-750 lb. Carcass. | 169.90 | 184.26 | 195.42 |
| Western Corn Belt Base Hog Price Carcass, Negotiated. | 80.76 | 85.07 | 86.71 |
| Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean. | 91.77 | 84.14 | 85.76 |
| Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct. | 172.50 | 147.50 | * |
| National Carcass Lamb Cutout, FOB. | 361.89 | 387.00 | 378.19 |
| <u>Crops,</u> | | | |
| <u>Daily Spot Prices</u> | | | |
| Wheat, No. 1, H.W. Imperial, bu. | 7.58 | 6.27 | 6.08 |
| Corn, No. 2, Yellow Omaha, bu. | 7.02 | * | * |
| Soybeans, No. 1, Yellow Omaha, bu. | 13.31 | * | * |
| Grain Sorghum, No. 2, Yellow Dorchester, cwt. | 11.68 | 10.93 | 10.93 |
| Oats, No. 2, Heavy Minneapolis, MN, bu. | 3.87 | 3.23 | 3.47 |
| <u>Feed</u> | | | |
| Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton. | 130.00 | 250.00 | 225.00 |
| Alfalfa, Large Rounds, Good Platte Valley, ton. | 72.50 | 137.50 | 145.00 |
| Grass Hay, Large Rounds, Good Nebraska, ton. | * | 100.00 | 100.00 |
| Dried Distillers Grains, 10% Moisture, Nebraska Average. | 204.25 | 206.00 | 212.50 |
| Wet Distillers Grains, 65-70% Moisture, Nebraska Average. | 68.75 | 71.88 | 74.00 |
| *No Market | | | |

The debate over the next farm bill fired up in late 2011 when it looked like a closed-door-negotiated agreement could become part of a grand budget-cutting plan put together by the so-called “Super Committee.” But then, the Super Committee failed to reach an agreement on how to cut the federal budget deficit and the whole farm bill package failed to advance as well.

Now, the work has restarted on the farm bill in 2012, with even greater challenges. Questions remain about how big the spending cuts will be, what direction the farm programs will go, and even what the political climate and timeline will be for a new farm bill to emerge from Congress. The process has begun, with Senate Agriculture Committee Chair Debbie Stabenow initiating a set of farm bill hearings that began at the end of February. But the direction remains a major question.

Looking back at nearly 80 years of federal farm policy provides some perspective on program design and direction. It also illustrates how changing conditions and economic factors eventually affect the design of farm policy, even if the changes appear much more evolutionary than revolutionary, to use an old adage of farm policy.

When the first farm bill was passed in 1933, the fundamental policy goal was raising farm income. Average farm household income at the time substantially lagged that of non-farm households. Raising farm income was seen as both an equity issue and an economic development issue, given the economic dependence of so much of the country on agriculture.

In 1933, the way to raise farm income was to raise farm prices through price support programs that restricted supplies. In an agricultural economy where imports and exports were a small share of the market (particularly during the Depression years), restricting supplies had the effect of pushing higher prices onto consumers (including livestock producers) and increasing income back to the farm. Commodity loan programs, acreage reduction programs, marketing restrictions and government storage programs all served to restrict supplies



on the market in an attempt to raise prices, and in turn raise farm income.

These supply control/price support programs continued for decades, but eventually became less effective in achieving the goal of higher prices. The growing globalization of agriculture meant that trade flows and world supply and demand fundamentals drove price levels and not United States domestic policies. When the “Russian Grain Robbery” of the early 1970s occurred, it became obvious that the traditional supply control programs were no longer effective policy tools. Supporting farm income remained an important policy goal, but the shift was beginning from supply control/price support programs to income support programs.

While supply control/price support programs attempted to restrict supplies to prop up prices, and thus farm income, the new income support programs simply made direct payments to producers to offset income losses when prices fell below legislated levels. The first shift was the introduction of the target price/deficiency payment program in the early 1970s, shifting part of the safety net from price support to income support. But some price support tools remained, culminating in a run of low prices and burdensome supplies building up in government stocks in the early 1980s. The infamous Payment-in-Kind (PIK) program of 1983 was an attempt to reduce production and simultaneously reduce government stocks hanging over the market by paying farmers in grain for acres not planted to a crop that year.

That led to the 1985 Farm Bill and a further shift away from price support. Traditional commodity loan programs were changed to a marketing loan, allowing loans to be repaid at market prices (keeping grain moving in the private market), instead of being forfeited to the government in lieu of repayment (which previously had led to large government stocks). Government stocks programs, including the Farmer-Owned Reserve also disappeared, and acreage reduction (set-aside) programs were finally eliminated in the 1996 Farm Bill, meaning the government had finally gotten out of the supply control business (not counting dairy programs, sugar programs and the 30-million acre Conservation Reserve Program).

The income support features of farm programs are still in place today, at least for the price-based safety net tools such as the marketing loan, the Counter-Cyclical Payment and the Direct Payment. These tools seem irrelevant now, given the current high price levels, but they were significant components of the farm income safety net just a decade ago. Then, with corn below \$2 per bushel and soybeans below \$5 per bushel, the income support programs provided the signal to producers to keep producing when the market was asking for less. So, while the effect of supply control/price support programs was to restrict supplies to keep prices higher in the market, the effect of income support programs was to encourage production even when the market was already saturated, keeping prices lower than would otherwise have occurred.

While the income support tools still exist today, it appears that farm policy is gradually transitioning to a new goal of risk management. The Average Crop Revenue Election (ACRE) program added in the 2008 Farm Bill marked a major shift from income support to risk management, with a revenue guarantee tied to moving-average prices and yields. But, the risk management era really began back in 1980, with legislation that privatized crop insurance delivery. Additional legislation in 1994 and 2000 substantially increased premium subsidies and other incentives, propelling rapid growth in crop insurance participation and protection. Now, with the increase in crop prices and values the total crop value protected by crop insurance is in excess of \$100 billion. The expected government costs for premium subsidies and company support is currently about eight to nine billion dollars per year, making it the single largest part of the farm income safety net at present.

Looking ahead, it seems apparent that risk management will be the primary focus of farm programs for the future. Not only are the income support tools less relevant for today’s prices, the general public is readily questioning the need for income support at a time of record farm incomes and record federal budget deficits. Agricultural groups have generally recognized this need for a shift as well. In the midst of the late-2011 debate and development of potential farm bill language, many of the agricultural groups quickly developed and released farm bill recommendations to the agricultural committees. In general, those proposals recognized crop insurance as the core part of the future safety net, with a revenue safety net revised from the current ACRE program added on to complement the insurance coverage. The proposals also generally assumed the elimination of Direct Payments, the \$5 billion-per-year fixed payments to producers that have become political target #1 in everyone’s deficit-reduction plan.

A new farm bill with a farm income safety net designed around crop insurance, a complementary revenue safety net and a reduced or eliminated Direct Payment is clearly a safety net for managing risk, not guaranteeing income. In today’s high price - high income environment, market volatility, production variability and resulting revenue risk appear to be the greatest challenge for producers. The new farm bill and the new farm income safety net may focus in on just this need and continue the gradual evolution of farm policy in response to underlying economic fundamentals.

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