POLICY INITIATIVES FOR TEXAS AGRICULTURE TO ADDRESS DROUGHT AND INCREASED RISK

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Department of Agricultural Economics
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A policy issue paper is an attempt to verbalize an emerging policy issue. Conclusions drawn are tentative and based on industry observations and economic theory. It does not report final research results, although it may include some quantitative information to support particular positions taken in the paper. AFPC welcomes comments and discussions of these results and their implications. Address such comments to the author(s) at'

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It is important to recognize that some problems and opportunities are uniquely local or state in nature; some are regional, covering more than a single state; some are national and some are international. States are best equipped to deal with problems that are uniquely local and state. Regional problems tend not to be adequately addressed at the national level because of the felt need/desire to treat everybody the same.

With globalization and increased economic interdependence, there are fewer problems that are truly national in scope, and national governments are finding it more difficult to independently deal with international issues. Yet, both the state and federal government have important roles to play in dealing with farm problems. This discussion attempts to sort out the nature of the problems facing Texas agriculture and the options for dealing with them at federal and state levels. The paper recognizes that there are constraints on both spending and the willingness of government to become deeply involved in regulatory and management activities.

The Policy Setting

From 1933 through 1973, U.S. agriculture was treated as a closed economy. Farm prices were supported above international levels and were relatively stable by virtue of the government's willingness to buy and store commodities at the support price.

In the early 1970s, U.S. policy makers grasped the potential for expanded exports. To make this policy switch politically acceptable to farmers, they set a target price and lowered the support price to a level where they did not significantly interfere with exports. Farmers were paid the difference between the target price and the market price in the form of direct payments from the government, subject to mandated payment limits.

The target price program provided an income safety net for farmers when prices fell below the targeted level. With increased production and lower prices it also resulted in high levels of government costs. Farmers of program crops, at times, received 30 percent or more of their gross income from the government.

While Texas farmers faced a higher level of adversity due to yield variability, they also arguably enjoyed higher levels of income protection on those crops that were indigenous to Texas agriculture; namely, cotton, rice, feed grains, peanuts and sugar. They, therefore, were able to withstand single-year adverse weather conditions. When weather adversities occurred in a successive period of years, Congress provided for disaster payments-for which Texas was a major recipient.

Disaster payments were distasteful to policy makers because their magnitude was unpredictable and thus difficult to budget. The payments also tended to be concentrated in states such as Texas, Oklahoma, New Mexico, Montana, North Dakota and South Dakota. Subsidized federal crop insurance sold by the private sector was thought to be the answer. The plan was for the federal government to pay approximately 30 percent of the cost and then establish premiums based on actuarial loss experience. This approach was fully implemented with the Crop Insurance Reform Act of 1994.

While it is easy to oversimplify, insurance works by spreading the risk when the insured has no control over the probability of loss. In agriculture, farmers who have not been able to reduce production risk through management, diversification or some other method and reside in higher risk areas are more likely to buy insurance. As a result, insurance premiums have tended to

increase in areas of high risk to the point where insurance cannot be afforded. This is believed to be the situation in significant parts of Texas.

Livestock producers pride themselves on not being farm-program dependent. Although, largely not recognized, they benefited from the high supplies feed grains and low prices generated by crop policies - particularly under the target price program that existed from 19731996.

The 1996 Farm Bill dramatically increased the level of price and income risk facing Texas farmers and ranchers by eliminating the target price tie between the level of market price and the amount of direct payments to farmers by the government. It also directed the Secretary of Agriculture to only hold emergency levels of government stocks. In addition, it gave farmers flexibility to plant whatever crop they desired, except for restrictions on fruits and vegetables where no previous production history existed.

The 1996 Farm Bill reflected a desire for less government and greater certainty in the level of spending. Its long-term success was based on the belief that strong export demand would support the level of farm prices and incomes-a role previously played by government.

In 1997, lump sum payments to crop farmers nationally reached a peak of approximately $6.3 billion. In year 2002, they will have declined to $4.0 billion. What happens after 2002 will be decided in future Farm Bill debates. What seems clear is that the government's willingness to directly subsidize production agriculture has declined. In the -process, risk- - whether it be due to price or yield fluctuation-has increased. It is also clear that with increased price risk, farmers are more vulnerable to yield risk in that they may not be financially capable of investing in production risk management activities.

A major thrust of federal policy involves developing additional methods of managing the risk associated with agriculture. Some of the major risk management tools include:

- Crop insurance.
- Futures and options and contract markets.
- Increased agronomic and market information.
- Geographic diversification and enterprise flexibility.
- Financial management.
- Integrated pest management.
- Drought-tolerant crops.
- Cooperative pooling.
- Improved information for making risky decisions.

Problems Confronting Farmers and Ranchers

The problems confronting Texas farmers and ranchers in managing risk are inherently complex. They are made more difficult by the 1996 changes in government programs which lead to increased price variability and, after 1997/98, reduced levels of government support. Serious concerns are developing regarding the ability of significant segments of Texas agriculture to adjust or even survive in the absence of direct government assistance. This is not to say that agriculture will go away, but the type of enterprises grown in different regions of the state could change dramatically, as well as who operates and owns the resources in Texas agriculture. Coping with these conditions is difficult enough under normal weather conditions. They are considerably more complex under the current weather adversities - - large production losses in dryland farming and ranching and increased costs for irrigated production.

Specific problems - - roughly ordered in terms of their immediacy - - include:

- Covering input costs incurred in the current production season. Crop producers have committed out-of-pocket expenses to program crops that range from $50 to $500 per acre, depending upon the crop. Ranchers are experiencing reduced prices due to herd liquidation, reduced weights for calves marketed, and increased production costs resulting from purchasing supplemental feed.
- AFPC analyses suggest that financial restructuring could be required for well over half of the Texas dryland crop producers-which is 60 percent of the total number of Texas crop producers. Many of these farmers, particularly in areas such as the Rio Grande Valley and Coastal Bend, are already fully extended financially due to past weather adversities.
- Farmers and ranchers lack the tools required to assess their level of financial exposure utilizing alternative risk management strategies. With reduced government support, access to such quantitative risk assessment tools is essential.
- Production and marketing technologies or practices designed to reduce risk associated with crop and livestock production are not adequately developed and/or have not been widely adopted. Such technologies include the development of drought-tolerant crops, the control and eradication of pests such as the boll weevil, the development of pest tolerant crops and livestock, and the development/adoption of irrigation technologies that more efficiently utilize water. Effective marketing needs improved outlook information and a better understanding of forward pricing alternatives and their impact on the economic viability of the farm or ranch. Some of these technologies or practices are available for adoption while others require development.

- There needs to be new and improved risk management policies. It is evident that crop insurance programs are not operating in a manner that effectively deals with the problems of Texas agriculture. Moreover, some argue that general agricultural policies do not effectively deal with the problems of higher risk agriculture.

Federal Options For The Current Crisis

There are many policy options for reducing the impacts of risk that are being pursued at the federal level. Some of these are designed to deal with the short-run issues of drought relief. Others involve long-run changes in policy designed to deal with the more risky environment that government has played a role in creating. The following policy options are currently being considered by the federal government-ordered roughly in terms of their potential for solving immediate problems affecting farmers:

- Allowing farmers to receive advances on their lump sum contract payments, with no increase in total payments through 2002.
- Reinstating supplemental animal feeding subsidy programs for up to 30 percent of supplemental feed needs.
- Emergency low interest loans available through the Farm Services Agency (FSA) when an agricultural disaster is declared. President Clinton on July 23,1998 announced that all counties in Texas had been designated as agriculture disaster areas for 1998.
- Providing supplementary benefits for those having previous crop insurance claims that are actuarially increasing premium rates.
- Purchases of commodities and their donation to people in poorer nations to meet humanitarian needs and to raise the level of U.S. prices of commodities such as wheat.

Some recently rejected federal options to deal with current conditions involving both adverse weather and low prices include:

- Raising price support/loan rates under the nonrecourse loan program.
- Lengthening the nonrecourse loan period from 9 to 15 months.

Options for Texas

Texas policies to address current conditions need to be targeted toward unique conditions facing its farmers and ranchers. Such policies need to be proactive in dealing with the short-run situation while improving the longer-run competitive position of Texas agriculture.

- **Compensating for lost income.** As a result of the drought, many Texas farmers and ranchers will not be able to generate sufficient revenue to cover production costs. Such costs may include seed, chemicals, fertilizer, fuel, feed, or seedlings (in the case of forestry land owners). Qualified producers would need to verify purchased inputs. This could include proof of purchase by farmers and ranchers of inputs utilized to produce farm products in counties declared to be federal disaster areas. Such inputs would need to have been purchased for 1998 crops and livestock. Responsibility for verifications and payments would be assigned to an existing state agency or coordinated with other federal assistance through FSA. In order to limit budget exposure and equitably apply Texas government support, some have suggested limiting the proceeds to the amount of property taxes paid on the associated land or some multiple thereof. A tie to production flexibility payments could also be used as a benchmark to monitor and control subsidy expenditures to program crop producers.

- **Expand FARM Assist Pilot Program.** The Financial And Risk Management Assistance Program (FARM Assist) is being developed as a comprehensive farm and ranch management educational and service program to quantitatively evaluate alternative risk management applications. The pilot program will be available this Fall in Northwest Texas and needs to be available statewide. This research and education program is designed as a decision support system to aid individual farmers and ranchers to effectively adjust to a more risky economic environment. This program, which places an agricultural risk management specialist in each Extension District, would cost $1.7 million annually to expand statewide. The 75' legislature provided $500,000 in each year of the biennium for the pilot effort. Therefore, an additional $1.2 million would be needed annually to take the program throughout the state.
- **Initiate a state loan program to assist with 1998 financial losses.** This program would assist qualified farmers and rancher's adversely impacted by weather to restructure their capital financing. This assistance could include interest rate subsidies and/or loan guarantees.
- **Develop and implement a comprehensive approach to evaluating state policies effecting Texas agriculture in an era of increased risk.** Representatives from farm organizations, state agencies, elected officials and other stakeholders would provide the leadership for the development of a statewide strategic plan for agriculture. The Agricultural and Food Policy Center at Texas A&M University could be funded to provide analytical support for this process and proposed policy alternatives.

- **Support major new research and extension initiatives to reduce biological, weather, and market risks confronting Texas agriculture.** Higher levels of risk unique to Texas must be overcome if its agriculture is to be competitive. This requires a major new research and extension thrust that amplifies the research and educational resources of the State.

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