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Agricultural Act of 2014: Commodity Programs

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The Agricultural Act of 2014 offers new programs and more choices than ever before (Chite, 2014). In previous farm bills, the decisions to participate in various commodity and crop insurance programs were not necessarily intertwined. However, with an ever-increasing focus on risk management and a strong emphasis on crop insurance, the Act introduces new interactions between commodity and crop insurance programs. Direct payments provided to crop producers regardless of financial loss in the three previous farm bills are gone (with the exception of a reduced payment on the cotton base).

To effectively manage risk in their operations, producers may want to consider analyzing their entire farm and risk management "portfolio" which would include projected market revenue, farm commodity payments, and crop insurance indemnities. Enrollment in the new commodity programs will be a one-time, irrevocable decision in 2014 or early 2015 so it is important for producers to determine the mix of programs that offers the most effective safety net over the next four to five years versus the program with the largest government payment in a particular year. Unlike the Average Crop Revenue Election (ACRE) program in the 2008 farm bill where payments were tied to planted acres of covered commodities (up to the number of base acres), the new commodity programs are paid on base acres of covered commodities. Covered commodities include wheat, oats, barley, corn, grain sorghum, long grain rice, medium grain rice, pulse crops, soybeans, other oilseeds and peanuts. Upland cotton is no longer a covered commodity and is provided a safety net consisting of a reduced direct payment, called a transition payment, in 2014 (and possibly 2015), marketing loan support, and an area-wide revenue insurance program.

Commodity Program and Insurance Choices

As shown in Figure 1, the following choices exist for covered commodities: 1) landowner chooses to retain or reallocate base acreage; 2) landowner chooses to retain or update payment yields; 3) producer or landowner chooses to enroll base acres in Price Loss Coverage (PLC), farm-level Agriculture Risk Coverage (ARC), or county-level Agriculture Risk Coverage (ARC); 4) producer chooses to purchase an individual insurance policy on planted acres; or 5) if producer purchases an individual insurance policy and is not enrolled in farm-level or county-level ARC, option to purchase a new supplemental insurance product, called the Supplemental Coverage Option (SCO), on planted acres (starting with the 2015 crop year). In addition, producers have the option to participate in the marketing loan program or loan deficiency program for loan commodities. Loan commodities include wheat, oats, barley, corn, grain sorghum, upland cotton, extra long staple cotton, long grain rice, medium grain rice, peanuts, soybeans, other oilseeds, graded wool, non-graded wool, mohair, honey, dry peas, lentils, small chickpeas, and large chickpeas.

Landowners may choose to reallocate their historical base acres to covered commodities planted in the last four years. Base acre reallocation is proportionate to the four-year average (2009-2012) of planted covered commodities. Prevented planted acres are also included in the base reallocation calculations. Since cotton is no longer a covered commodity, cotton base acres cannot be reallocated. All cotton base acres on each farm as of September 30, 2013 are converted to generic base acres. No commodity program payments will be received if cotton is planted on

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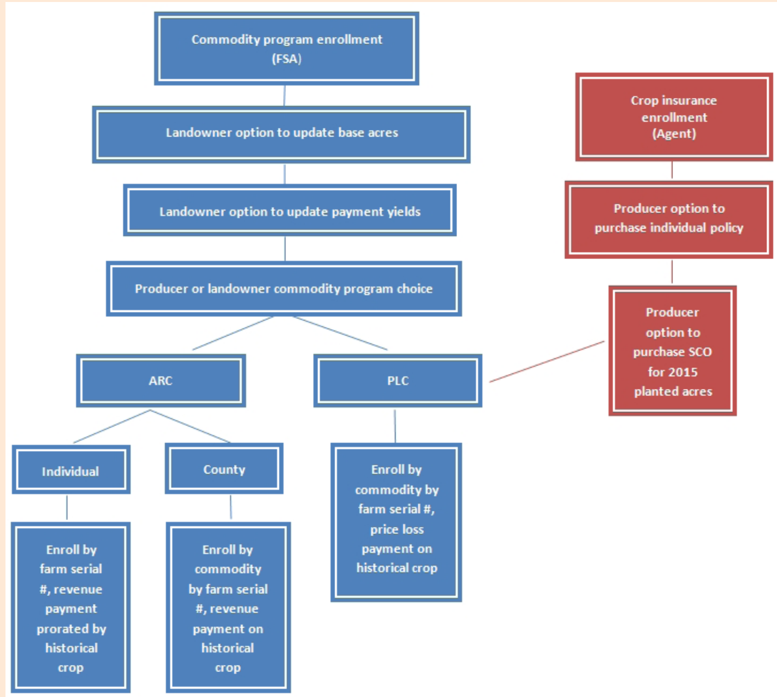
generic base acres. However, generic base may be planted to another covered commodity and that commodity would be eligible for ARC or PLC payments. So producers with cotton base would need to choose which of the new commodity programs (ARC or PLC) the planted covered commodities will be enrolled in during signup with the U.S. Department of Agriculture (USDA), Farm Service Agency (FSA). For example, if a producer chooses to plant 100 acres of corn on cotton base acres in 2014, the producer would be eligible to receive ARC or PLC payments on the planted corn acres in 2014. In general, one way to look at generic base acres is that on an annual basis, they become base acres for whatever covered commodity is planted on them. Unless a covered commodity is planted on generic base acres in a given year, the generic base acres are not relevant (as far as the commodity payment calculation).

As an example, assume a producer has 100 acres of wheat base acres and 100 acres of cotton base acres but the producer has been planting 200 acres of corn for the past few years. The producer can keep the 100 wheat base acres and be eligible to receive commodity program payments on the 100 wheat base acres (assuming the producer enrolled in one of the programs). The producer does not have to plant wheat (or any other crop) in 2014 to be eligible for commodity program payments in 2014. The producer also has the option to reallocate the 100 wheat base acres to corn and be eligible for commodity program payments on corn instead of wheat. Again, the producer does not actually have to plant corn or wheat in 2014 to be eligible for a payment in 2014 (but payments are not automatic and are only triggered by a price decline or revenue loss depending on whether the producer enrolls in PLC or ARC).

For the payment yield update, the updated yield will be equal to 90% of the average yield per planted acre of the covered commodity for the 2008-2012 crop years. Historical payment yields (as opposed to actual yields) are used to calculate PLC payments.

Figure 1: Commodity Program and Insurance Decisions for Covered Commodities



Agriculture Risk Coverage (ARC)

Producers of covered commodities have the option to enroll in either a new revenue protection program, called ARC, with the option to select farm-level coverage or county-level coverage, or a new price protection program, called PLC. For PLC and county-level ARC, producers can enroll on a commodity-by-commodity and FSA farm-by-farm basis. However, producers who elect farm-level ARC for a commodity on an FSA farm will be required to enroll all crops on that FSA farm in farm-level ARC. The county-level ARC program is paid on 85% of base acreage of the farm commodity while the farm-level ARC program is paid on 65% of total base acreage for the FSA farm including all commodities. Farm-level ARC might trigger payments more frequently than county-level ARC but producers would receive a payment on 20% less base acreage. It is important to note that with county-level coverage, producers could have a loss on their own farm, but would not receive a payment if the county does not suffer a loss as well. Producers with yields that do not follow closely with the county average may want to consider farm-level ARC or use crop insurance for individual yield risk.

The county ARC guarantee is equal to 86% of the previous five-year Olympic average marketing year price (drop the highest and lowest) times the previous five-year Olympic average county yield. If any of the five-year prices are below the PLC reference prices, a "reference price" will replace it in the calculation. Reference prices set by Congress in the 2014 Act are listed in Table 1. County T-yields are used in a similar fashion to replace low county yields in the calculation. The actual county revenue is the actual marketing year average price multiplied by the actual county yield. The farm-level ARC calculation includes all covered commodities planted on the FSA farm and considers the producer's share of all farms where he has an interest. The benchmark revenue for farm-level ARC is calculated as the five-year Olympic average of the sum of the revenues (yield times price) for all covered commodities on the farm using actual planted acres of the covered commodities.

The ARC payment is limited to 10% of the benchmark revenue so payments would be issued when actual revenue (county or farm) is between 76% and 86% of the benchmark revenue. For example, if the ARC guarantee is $200/acre, the maximum payment would be $20 per acre paid on 85% of base acreage.

Price Loss Coverage (PLC)

Although, the PLC program is very similar to the counter-cyclical payment (CCP) program in the 2008 farm bill, it includes new reference prices that are significantly higher than the target prices in the 2008 farm bill (Table 1). If the effective price, which is the higher of the national average marketing year price or the loan rate, falls below the reference price, a PLC payment will be issued. The PLC payment rate equals the reference price minus the effective price. A producer's PLC payment is equal to the payment rate times the payment yield times 85% times base acres for the crop. It is possible that if the price drops below the reference price and yields are at normal levels, PLC could result in a higher payment than ARC in a given year, especially when tied to the new SCO program.

New Supplemental Crop Insurance Programs

Producers of covered commodities who elect PLC also will have the option to enroll in a new supplemental crop insurance program, called SCO. SCO is designed to cover the difference between 86% and the level of coverage of the producer's individual insurance policy. Producers who elect ARC will not be able to enroll in the SCO program. Although not eligible for PLC, planted cotton acreage can also be enrolled in the SCO program. SCO is designed as a shallow-loss insurance program that covers county-wide losses and complements a producer's individual insurance policy. For SCO, producers are required to purchase an individual insurance policy such as a revenue protection (RP) or yield protection (YP) insurance policy. SCO takes on the characteristics of the underlying insurance policy meaning that if YP is the underlying policy then SCO would be yield protection only. The same would hold true if the underlying policy were RP. This is a new concept because producers have not previously been allowed to stack insurance policies for the same crop. However, SCO will not be available until the 2015 crop year which further adds to the complexity of the 2014 commodity program enrollment decision. SCO premiums are subsidized at 65% by USDA.

A similar area-wide supplemental crop insurance program, called the Stacked Income Protection Plan (STAX), will be available only to upland cotton producers starting in 2015 (Campiche, 2013). The premium subsidy for STAX is 80%. To further complicate the decision process, producers who purchase SCO or STAX can choose different coverage levels which correspond with the coverage level of their individual policy. Since overlap is not allowed, SCO/STAX coverage is limited by the coverage level of the producer's individual policy. However, it is important to note that these are area plans which cover county losses as opposed to losses on the individual farm. In many cases, farm APH yields may be higher than the county yields. A producer may have a loss on the farm but not receive a payment if the county does not also have a loss. This also works the other way too, so a producer could receive an indemnity payment when no loss occurs on the farm but the county does have a loss.

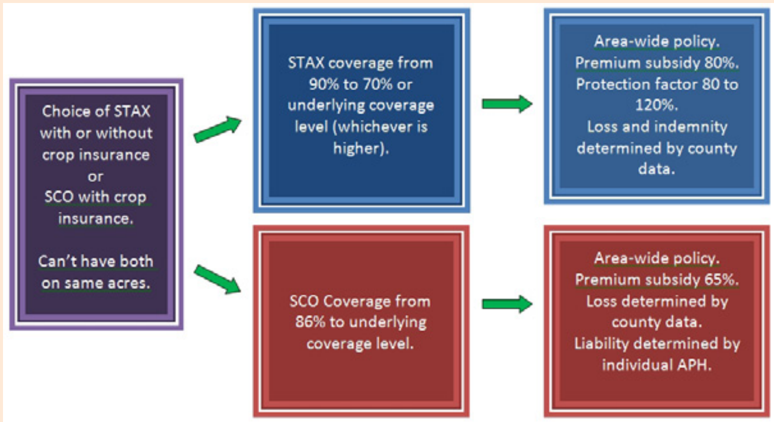
Table 1: 2014 Farm Bill Reference Prices vs. 2008 Farm Bill Target Prices

Crop	2008 FB Target Price	2014 FB Reference Price
Barley	2.24	4.95
Corn	2.63	3.7
Cotton	0.7125	NA
Grain Sorghum	2.57	3.95
Peanuts	495	535
Oats	1.44	2.4
Rice	10.5	14
Soybeans	5.8	8.4
Wheat	3.92	5.5

STAX vs. SCO for Upland Cotton Producers

Upland cotton producers have the option to elect SCO instead of STAX for planted cotton acreage (Figure 2). A key difference between SCO and STAX is that with SCO, the producer's APH yield is used to calculate the liability. So, producers will want to consider this when comparing SCO and STAX. STAX coverage can range from 90% of the county revenue guarantee to 70% or the coverage level of the underlying policy (if there is one), whichever is

Figure 2: Flow Chart of Upland Cotton Decisions



higher. Meanwhile, SCO covers from 86% of the county guarantee down to the coverage level of the underlying policy. For example, a producer with 80% coverage on his individual policy could only get up to 10% coverage with STAX or up to 6% coverage with SCO (86-80%). A producer with 70% coverage on an individual policy could get up to 20% coverage with STAX or up to 16% coverage with SCO. The wider the range being covered by either SCO or STAX would result in higher premiums. Unlike SCO, an individual policy is not required with STAX.

Summary and Conclusions

The 2014 farm bill includes major changes to the producer safety provided to crop producers. Direct payments that have been a key component of the producer safety net since 1996 have been eliminated as have Counter-Cyclical Program payments available since 2002. Crop producers and landowners have several decisions to make when USDA-FSA announces signup later this year. Initially, they will need to decide whether they want to reallocate their base acres which would serve to more closely align base acres to recent plantings. The major decision is whether they want to choose farm-level ARC, county-level ARC, or PLC.

Since this decision will stay with the farm for the life of the farm bill, producers are encouraged to consider which choice they feel the most comfortable with over the next five years rather than which might provide a short-term payment. Each producer will need to make this decision for every covered commodity grown on each farm. Once this decision is made, payment yields can be updated for any commodity enrolled in PLC.

While these decisions may seem daunting for even an average size farm, it is important to note that the safety net provided in this farm bill can be especially strong if producers will take the time to tailor their farm program choices to each of their farms. Once these decisions are made, there are several crop insurance changes that will also need to be considered.

For More Information

Campiche, J. (2013). Details of the proposed stacked income protection plan (STAX) program for cotton producers and potential strategies for extension education. *Journal of Agricultural and Applied Economics*, 45,3:569–575.

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