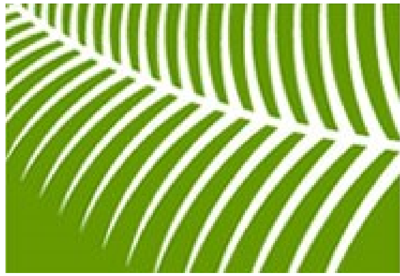

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Evaluating Commodity Program Choices in the New Farm Bill

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February 6, 2014

***farmdoc daily* (4):21**

Recommended citation format: Coppess, J. "Evaluating Commodity Program Choices in the New Farm Bill." *farmdoc daily* (4):21, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, February 6, 2014.

Permalink: http://farmdocdaily.illinois.edu/2014/02/evaluating-commodity-program-choices-in-new-farm-bill.html

The new farm bill (which can be found here) has revised the farm safety net, requiring farmers and landowners to sort through a series of decisions. This article will provide initial analysis and information on the choices in the new farm safety net for the 2014 crop year.

Background

On February 4, 2014, the 2014 Farm Bill (named the Agriculture Act of 2014) cleared its final Congressional hurdle. The President is expected to sign the bill into law on February 7, 2014, then it goes down to the United States Department of Agriculture for implementation. The commodity programs in Title I of the farm bill and the choices required all begin with the 2014 crop year. The final regulations will further determine program and decision parameters, as well as when farmers can begin to sign up. The discussion below is based on the legislative text. It will be updated or revised as needed based on the regulations.

The difficult negotiations between competing approaches to the farm safety net resulted in the compromise approach in the final bill that require the decisions discussed herein. In short, the House farm bill required the owners of a farm to choose between a county revenue program and a fixed-price program. The Senate version of the farm bill provided both a price and revenue program for all farms and covered commodities but within the revenue program it required a choice between county level revenue or individual farm level revenue. The final bill requires a choice among a price program, a county revenue program or an individual farm revenue program.

Discussion

Title I of the 2014 Farm Bill includes a price-based assistance program called Price Loss Coverage (PLC) and revenue-based assistance programs called Agriculture Risk Coverage (ARC) (*farmdoc daily* January 30, 2014). Reflecting significant concerns about market and planting distortions, the compromise utilizes base acres for all program payments (i.e., payments are made on a percentage of the farm's base acres); neither program makes payments on the acres actually planted to covered commodities with the exception of cotton base acres (now termed "generic base acres") that are planted to covered commodities. Cotton is no longer a covered commodity due to the World Trade Organization (WTO) dispute with Brazil.

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First, owners of a farm will be provided a one-time opportunity to either retain their current base acres or to reallocate their base acres among those covered commodities planted during the 2009 through 2012 crop years. If the owners choose reallocation, the farm's base acres going forward will be in proportion to the four-year average of acres planted to each covered commodity in those crop years, including any acreage that was prevented from being planted to a covered commodity in a crop year. Other base acre provisions, such as adjustments for acres that exit the Conservation Reserve Program (CRP), are similar to the 2008 Farm Bill except the program decisions outlined below must be made for CRP acres when they exit. An election to reallocate base acres cannot, however, result in an overall increase in the farm's base acres.

Second, the owners of a farm will be provided a single opportunity to elect to update payment yields for covered commodities. Payment yields are currently a part of the farm records at USDA (along with base acres) and, similar to the Counter-Cyclical Payments program from 2008, payment yields will be used to calculate the PLC payments for any covered commodities on which PLC has been elected. If a yield update is elected, the new payment yields will be equal to 90 percent of the average yield per planted acre of the covered commodity in the 2008 through 2012 crop years.

Third, beginning with the 2014 crop year all of the producers on a farm must make a one-time, irrevocable election among the price (PLC), county level revenue (County ARC) and individual farm level revenue (Individual ARC) programs. The PLC election can be made on a covered-commodity-by-covered-commodity basis, however, Individual ARC applies to all covered commodities on the farm and a farm cannot elect PLC for some commodities and Individual ARC for others. This feature essentially makes the programmatic choice as PLC and County ARC on a covered-commodity-by-covered-commodity basis, or Individual ARC for all covered commodities. If County ARC is elected for a covered commodity it is ineligible to receive PLC payments and the commodity is also ineligible for the Supplement Coverage Option (SCO) created in the crop insurance title of the bill. If Individual ARC is selected, it applies to all covered commodities and they would all be ineligible for PLC and SCO.

All of the producers on a farm must make this program decision for the 2014 crop year and it must be unanimous. If they fail to make a unanimous election for the 2014 crop year, they will not receive any payments for that crop year from the programs. Additionally, the farm will automatically be deemed to have elected PLC for all covered commodities beginning with the 2015 crop year. Notably, the term producer includes everyone sharing in the risk of producing a crop and entitled to share in the crop available for marketing from the farm. It includes owners, operators, landlords, tenants and sharecroppers. This unanimous program decision has similarities to the 2008 Farm Bill election between the Counter-Cyclical Payments program and the Average Crop Revenue Election (ACRE) program. Because direct payments have been eliminated, however, there is no reduction in payments for electing the revenue-based programs. But farmers will still need to involve landlords in this decision and everyone involved must agree.

Fourth, as noted above, revenue-based assistance through ARC requires that all producers agree to "select" the same coverage level: county or individual farm. Again, if owners of the farm choose Individual ARC that applies to all covered commodities on the farm. The calculations and payments for County ARC and Individual ARC are similar but with important differences. County ARC makes revenue-based payments on 85 percent of the covered commodity's base acres when actual county revenue is between 86 percent and 76 percent of the benchmark county revenue. The benchmark county revenue is calculated using the 5-year Olympic rolling average (drop the highest and lowest crop years) of county yields for the commodity and the 5-year Olympic rolling average of its national prices. Individual ARC calculations include all covered commodities planted on the farm with revenue-based payments made on 65 percent of the farm's total base acres. The calculations for Individual ARC must also take into consideration the individual producer's share of all farms in the same state in which the producer has an interest and for which Individual ARC has been selected. Individual ARC makes payments whenever the actual revenue for all covered commodities on the farm is between 86 percent and 76 percent of the benchmark revenue, which is calculated using a 5-year Olympic average of the sum of the revenues (prices multiplied by yields for each commodity) for all covered commodities. More specifically, each covered commodity's price and yields are multiplied for each crop year, then the 5-year Olympic average of each commodity's revenue are added together for the benchmark.

Stepping back from the program specifics, the general policy and political context for the 2014 Farm Bill's safety net may provide perspective. This farm bill was written in an era of heightened scrutiny over federal debt and deficits; it was considered politically necessary to reduce the bill's spending for passage in a budget-obsessed Congress. Fairly relentless criticism of commodity programs, particularly direct

payments, in an era of high commodity prices and strong farm incomes also complicated matters. These combined to bring about the end of direct payments and altered the existing structure of commodity policy. The oft-stated principle underlying the changes in this farm bill was a focus on helping farmers manage the considerable risks they face in crop production -- a move away from existing income support. In a politically-challenging environment, the debate centered on how to make the farm safety net more defensible to the general voting and taxpaying public, as well as effective and relevant on the farm.

Real challenges emerged, however, and significant concerns were raised with the two main policy proposals. Crop insurance already provides valuable risk management tools that many were reluctant to interfere with, while federal subsidies tied too close to actual production risk raised concerns about distorting production decisions creating market and trade problems. Therefore, the final agreement decoupled both Title I programs and they end up being more of an approximation of risk-based assistance than actual risk management -- supplement to what is provided through crop insurance. While this is familiar territory for price-based programs, decoupling revenue policy from production is a new direction that has yet to be tested. It remains to be seen how well revenue payments on base acres will function on the farm. Experience on the ground will inform the next debate.

ARC provides assistance in the deductible range of crop insurance utilizing indications of actual losses (county-wide or multiple-commodity revenue movements from a recent average) and an emphasis on multi-year price risk. Concerns were expressed that the market-oriented nature of the assistance could become ineffective if prices are depressed for a sustained period of time. PLC is traditional income support policy utilizing price floors for commodities to help with market uncertainties such as sustained, low prices. Concerns about the distortive potential of this policy were strongly voiced in the wake of Brazil's successful challenge of cotton supports at the WTO. Concerns were also raised that policies using reference prices fixed for the life of the farm bill may not reflect actual market conditions. In this view, if the prices are fixed too low then the program may not help with actual price risk, missing the impact on tight farm margins from volatile markets and input costs; fix the prices too high and they run the risk of being viewed like direct payments, criticized for providing assistance in times when farm incomes are strong.

While the legislative, policy and political parameters are finally known, further analysis is needed to estimate how each program will likely function for most commodities and farms under different risk scenarios. Comparing ARC and PLC (including updated yields and SCO) for commodities and farms, looking at farm finances, breakeven price levels, production costs, market expectations and how the programs fit with crop insurance could be valuable to the decision making process. For example, a recent estimate (*farmdoc daily* November 5, 2013) indicating the break-even price for corn at $4.30 per bushel raises a question about whether the $3.70 per bushel PLC corn reference price will be effective. A similar question exists for soybeans where a recent estimate (*farmdoc daily* November 12, 2013) of the break-even price is $10.70 per bushel and well below the PLC soybean reference price of $8.40 per bushel. By comparison, the benchmark levels for ARC need to be calculated. The ARC structure also needs to be evaluated for how it relates to break even prices or other metrics for farm risk, as well as how it compares to PLC. Such analysis should go a long way towards helping individual farmers determine which program might be more effective.

Conclusion

The 2014 Farm Bill's safety net requires farmers and landowners to elect which program design they prefer based on what they think will be most effective for their operation, particularly in conjunction with crop insurance. Significant analysis is needed to compare the new programs and provide valuable information to the farm's decision makers, who will be locked into the program choice for the life of this farm bill.

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