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Farm Bill Negotiations: Selection between Three Programs

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After last year's failed attempt, Congress will again try to pass a Farm Bill this year. Mark up in both the Senate and House Agricultural Committees likely will occur in the near future. Given bills passed last year in the full Senate and by the House Agricultural Committee, along with proposals put forward this year by farm groups, it is possible to gain a feel for the types of programs likely to be included in the Farm Bill. This year, negotiations likely will be around three programs: a revenue program, a target price program, and a supplemental insurance program. A passed Farm Bill likely will include two, if not all three, of these programs, giving farmers choices among the programs. The exact nature of each program will be determined by negotiations.

Revenue Program

Both the Senate and House Agricultural Committee bills from last year included revenue programs. The Senate version is called Agriculture Risk Coverage (ARC) and the House's version is called Revenue Loss Coverage (RLC). A discussion of ARC and its farm and county level alternatives is provided here. Discussion of the House Bill is available here.

Both ARC and RLC are designed to make payments when revenue falls below an average of previous revenues. In ARC, the guarantee for each crop equals the previous Olympic average of 5-years of yields times the Olympic average of the previous 5-years of prices times .89. The .89 is a coverage level and varies across bills (the House had a .85 coverage level). When revenue falls below the guarantee, a payment is made. ARC and RLC payments are limited in amount so as to limit expenditures on the farm commodity program, to limit payments to operations with large acreages, and to prevent duplication of payments across the revenue and crop insurance programs.

Because guarantees are based on previous revenues, these revenue programs will tend to make payments in cases when prices decline and then stay low over multiple years. These are cases in which crop insurance will not make payments. Crop insurance resets its guarantee on that year's futures prices, thereby providing protection against price and yield declines within a year. However, crop insurance will not provide protection across years. If, for example, the projected price in 2014 is $4.50 rather than this year's $5.65, crop insurance will not provide protection against the decline from $5.65 to $4.50. Revenue programs are designed to fill this gap in a crop insurance based safety net.

The major advantage of this revenue program is that it will provide protection against multi-year revenue declines. Moreover, payments will decrease over time if prices remain low because the guarantee will decline as lower prices enter into the guarantee. Hence, farmers will be protected against price declines, but eventually farmers will have to adjust to new market conditions.

Criticisms of the revenue programs include that payments will decline over time if prices stay low. These programs also begin paying at relatively high coverage levels and only pay on a narrow band of coverage levels (ARC is from 89% to 79%, RLC is from 75% to 65%), leading critics of these programs to label them as "shallow loss" programs.

Target Price Program

A target price program makes payments when national, market year average (MYA) price falls below a set "target price". The counter-cyclical programs contained in the 2002 and 2008 Farm Bills are examples of target price programs. Last year's bill from the House Ag Committee has a target price program named Price Loss Coverage (PLC), as more fully described here. The Senate did not have a target price program. The recently released Farm Bill proposals by the American Farm Bureau Federation (AFBF) and the American Soybean Association (ASA) contain a target price program.

Target price programs traditionally set target prices in the legislation that are fixed for the length of the Farm Bill. Payments then occur when MYA price falls below the target price. When this occurs, the target price payment equals:

> target price rate (target price – MYA price) x payment bushels per acre x base crop acres x payment rate.

The payment bushels per acre usually are set based on historical yields from a base period. Similarly, base crop acres are set based on historical acres planted. The payment rate is less than one and is usually set to calibrate the expected outlays of the program with goals for spending from the program.

One of the major complications with target price programs is setting the target prices. Having target prices well below expected prices causes the target price to provide little downside price protection. This currently is the case for corn, soybean, and wheat. The target prices in the 2008 Farm Bill – $2.63 for corn, $6.00 for soybeans, and $4.17 for wheat – provide little effective price protection. Conversely, setting target prices too high relative to market prices can cause high target price program payments.

In addition, relative target prices across crops matter. Setting target price relative to expected price higher for one crop than for other crop causes more support to flow to that crop. Much of the complaint with the PLC program in the House Agricultural Committee revolves around this issue. In PLC, target prices for rice and peanuts cause payments to be higher for those crops than for corn and soybeans (see here for impacts a comparison of impacts of House Bill target prices on differing crops).

Target price programs have a number of advantages. They will provide continuing price protection as long as prices are low. This differs from the revenue program whose guarantee will adjust over time to lower prices.

Besides the difficulty in setting target prices, the disadvantages of target price programs are that they may make payments in cases in which revenue is not low. Low prices may be offset by high yields. In addition, target price programs do not adjust to market conditions. If target prices are above market prices, the target prices will not adjust downward overtime to reflect market conditions. This could lead commodity programs to be challenged for World Trade Organization (WTO) compliance.

Supplemental Insurance Programs

The Senate and House Agricultural Committee bills contain supplemental insurance programs. These include cotton STAX which is made available for only cotton. In addition, the Supplemental Coverage Option (SCO) is included in both Senate and House bills and is available for the program crops other than cotton (see here and here for further discussion of SCO). The AFBF proposal supported an SCO-like insurance program for all program crops plus some specialty crops.

These supplemental insurance programs enhance crop insurance coverage by providing payments for shallower losses than covered by the underlying crop insurance policy. For example, suppose a farmer takes a 75% coverage level on their farm-level crop insurance policy. The supplemental insurance policy will be available from a 90% coverage level to the 75% coverage level in the farm-level insurance. Protection in the 90% to 75% band is based on county yields or county revenues, depending on the form of the underlying farm-level policy.

Because shallower losses will be covered, supplemental insurance programs will enhance the within-year protection offered by crop insurance. If farmers want supplemental insurance coverage, they would have to purchase insurance policies, with premium costs subsidized by the Federal government (80% subsidy for cotton STAX and 70% subsidy for SCO).

Unlike the revenue and target price programs, these supplemental insurance programs do not address multi-year price protection, as guarantees will be reset each year based on current levels of futures prices. Moreover, there may be difficulty in designing these policies for all areas of the United States, as some counties may not have sufficient acres to calculate county yields.

Summary

Much of the Farm Bill debate likely will focus on the design of the revenue program versus the target price program. Some generalizations can be made about this debate. Midwest groups growing corn and soybeans likely will favor the revenue program while southern groups growing rice and peanuts likely will favor the target price program. As opinions among farmers differ within regions and crops, the above is an imperfect generalization.

Specifications of the programs will matter. It is possible to include a revenue program in a Farm Bill, but make is so unattractive that few farmers would select the program. This could be done by having a low coverage level in the revenue program guarantee. Similarly, a target price program could be made unattractive by having low target prices.

The key point in the debate will center on expected payments across crops. Hence, issues such as the levels of target prices in a target price program will become important. It is possible that revenue programs will contain minimum prices in there calculation so as to make programs more attractive to certain crops.

It is difficult to see farm groups opposing supplemental insurance programs. As currently designed, the supplement insurance programs do not address multi-year protection. Redesigns could add multi-year price protection (see here for some ideas). Without a redesign, supplemental policies could reduce multi-year coverage offered in revenue and target price programs. Inclusion of a supplemental insurance program has a cost, which in turn will affect the design of revenue and target price programs. Inclusion of supplemental insurance likely will lower coverage levels in a revenue program and lower target prices in the target price program. Hence, inclusion of the supplemental insurance program as currently designed will enhance within-year protection, but could reduce across-year protection.