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Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

2014 Farm Bill Decisions: Program Choice – A Big Picture Perspective

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September 11, 2014

***farmdoc daily* (4):174**

Recommended citation format: Zulauf, C., G. Schnitkey, J. Coppess, and N. Paulson. "2014 Farm Bill Decisions: Program Choice – A Big Picture Perspective." *farmdoc daily* (4):172, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, September 11, 2014.

Permalink URL http://farmdocdaily.illinois.edu/2014/09/2014-farm-bill-decisions-program-choice.html

Overview

The 2014 farm bill gives Farm Service Agency (FSA) farm owners a 1-time opportunity to elect their Title 1 crop program for the 2014 through 2018 crop years. Three program options exist: Agriculture Risk Coverage-individual (ARC-IC), Agriculture Risk Coverage-county (ARC-CO), and Price Loss Coverage (PLC) with the choice to buy the Supplemental Coverage (insurance) Option (SCO). This article examines the choice between ARC-CO and PLC. In contrast to ARC-CO and PLC, ARC-IC pays on 65% not 85% of program acres and is elected on a FSA farm basis, not a program crop basis. ARC-IC thus is an option to consider based on the ARC-IC farm situation, including when (1) production on the ARC-IC farm unit is highly variable or (2) if fruits and vegetables may be planted on the ARC-IC farm. For a discussion of ARC-IC, see, "2014 Farm Bill: Making the Case for Looking at ARC-Individual Farm," posted June 6, 2014 on *farmdoc daily*.

Encompassing Decision Question for ARC-CO and PLC

Because SCO is not an option with ARC-CO and because individual farm insurance must be purchased to use SCO; insurance decisions must be fully considered when making the Title 1 farm program decision, leading to the following encompassing decision question:

"For a FSA farm as a whole over the 2014-2018 crop years, are
expected ARC-CO payments + expected net payments of any crop insurance chosen
greater <u>or</u> less than
expected PLC payments + expected net payments of any crop insurance chosen +

expected net payments from SCO if also chosen?"

This question involves 4 different programs (ARC-CO, PLC, crop insurance, SCO) over 5 different years (2014-2018). Its complexity is one reason farm program calculators are being developed. To help interpret the results from the calculators, the encompassing decision question can be broken into big picture considerations, some of which are discussed below.

Decision Question Considerations

- The farm program decision is a shallow loss and multiple year loss management decision. ARC and SCO provide assistance with shallow loss, or losses associated with the deductible on individual farm insurance. ARC and PLC provide assistance with multiple year losses.
- It is common to hear that ARC-CO is more complex than PLC. This may be correct but ARC-CO is probably easier to understand than the PLC-SCO combination. ARC-CO is an integrated shallow multiple year loss program. PLC-SCO is not integrated. Two sets of calculations must be combined, one for shallow losses (SCO) and one for multiple year losses (PLC).
- An initial big picture consideration is, "Does SCO add coverage that is cost competitive with higher individual insurance after differences in farm vs. county losses are considered?" A loss at the county level may or may not align with the loss on an individual farm. The county loss may be larger or smaller than the farm loss. Hence, from the standpoint of managing a farm's risk, individual farm insurance is preferred over county insurance at a given coverage level. Moreover, SCO's subsidy rate of 65% exceeds the subsidy rate for the commonly-chosen enterprise individual farm insurance only at the 85% coverage level and then only by a small margin (65% vs. 53%). Combining these two thoughts, it appears that SCO is a clear consideration (1) if enterprise insurance is not available at higher coverage levels or (2) if the farm's cash flow is constrained. The latter can occur because SCO is cheaper at the same coverage level than enterprise insurance. In other situations, it appears that the desirability of SCO will depend upon individual producer preference.
- ARC-CO and PLC could alter crop insurance choices. ARC-CO is a county loss program with a coverage range limited to 76% to 86%. If the ARC benchmark revenue is reasonably close to the insurance guarantee, a farm, particularly if cash flow is constrained, may choose to buy individual insurance at 75% coverage and use ARC-CO to provide partial coverage at the 76% to 86% coverage level. Also, if prices are below the reference price, farms may choose to use PLC to provide downside price protection and thus buy cheaper yield insurance to cover yield risk. Both impacts occur only when limited circumstances exist. These circumstances may or may not occur from 2015 through 2018. Nevertheless, it is clear that, for a variety of reasons, the same insurance may not be purchased with ARC-CO as with PLC.
- The decision question can be simplified in a number of ways, but the most likely is to set aside the SCO and crop insurance components of the decision. There is nothing wrong with this approach, but the preceding two points strongly suggest that his decision needs be an active decision that makes sense for the FSA farm, FSA farm owner, and farm operator.
- ARC pays if county revenue is between 76% and 86% of the 5 prior year's Olympic average county revenue. In contrast, PLC pays if price is below the reference price. They cover fundamentally different risk situations. For example,
    - ARC pays on price declines; PLC pays if price is below the reference price.
    - Being a revenue program, ARC can pay on yield declines. PLC is a price risk only program.
- Both ARC-CO and PLC have a minimum price, the PLC reference price. However, if market price is below the reference price for multiple years, PLC will likely pay more because ARC's revenue benchmark changes with market conditions and thus declines if low prices persist.
- Farm survivability can be problematic when disaster price or yield situations occur or when small losses continue over several years. The latter explains the interest in shallow loss programs.
- ARC-CO's strength is assistance for shallow multiple year losses, but ARC-CO also provides some disaster price assistance since it has a minimum price, the PLC reference price. PLC's strength is assistance for multiple years of disaster prices, but SCO or high individual farm

insurance coverage can provide some assistance with cumulative shallow losses. Which combination is preferred will help guide the shallow loss – multiple year loss program choice.

- The 2014 farm bill allows an FSA farm owner to mix and match ARC-CO and PLC-SCO across FSA farms and program crops.
- ARC-CO and PLC payments, if any, for 2014 crop year will be reasonably known by February 2015. For more discussion of this topic, see "Resolution of U.S. Crop Year Price Uncertainly and Its Implications for the 2014 Farm Program Decision," posted August 28, 2014 on *farmdoc daily*.

Summary Observation

Big picture questions that need to be assessed in making the ARC-CO vs. PLC decision include, (1) "Is SCO cost competitive with higher individual farm coverage, especially enterprise insurance?"; (2) "Will program choice influence my insurance decisions?"; (3) 'How should reasonably well known 2014 payments be weighed against more uncertain payments for later years?"; and (4) "Should program choice be diversified?" Once these big picture questions are assessed, the question of what prices are expected for 2015 through 2018 can be considered, setting the stage for the farm program calculators to help aid the decision. In short, the calculators are no substitute for thoughtful consideration of big picture questions.

References

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