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Questions That Will be the Focus of the Upcoming Farm Bill Debate

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Farm Bill markup likely will begin soon in both the Senate and House Agricultural committees. Much of the focus for traditional program crops will be around three programs: a revenue program, a target price program, and a supplemental crop insurance program (see here for more detail). While the exact nature of the programs will depend on negotiations, what is almost certain is that the programs' rationale will be risk management. Given a risk management focus, Farm Bill negotiations will need to debate and somehow resolve the following seven questions.

Question 1: Will support provided to some crops be greater than the support provided strictly by risk management considerations?

Risk management programs provide a level of payments that more closely follows gross revenue than do the historical Farm Bill Title 1 programs (see here for more detail) For example, a continuation of the current direct payment program results in higher payments for rice and peanuts than for corn, soybeans, and wheat. Modifications of the risk management focus may be needed to gain political support for differing regions and crops.

Preferential treatment can be implemented by various measures. For a revenue program, minimum prices could be put in place, as was done for rice and peanuts in the 2012 Senate Farm Bill. Target prices can be set higher relative to expected market prices for some crops than other crops, as was done for rice and peanuts in last year's House Agricultural Committee Farm Bill. In a supplemental crop insurance program, higher subsidy levels and higher loss multiples can be given to some crops over other crops, as was done for cotton in their STAX program compared to the Supplemental Coverage Option (SCO) proposed for other program crops in the 2012 Senate Farm Bill and 2012 House Agricultural Committee Farm Bill (see here and here for more detail).

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Question 2: Will the programs focus on across-year or on within-year protection?

A supplemental crop insurance program will enhance crop insurance protection, thereby increasing within-year protection. A revenue and target price program respectively protect against revenue and price declines that occur across years. Because all three of the programs must fit within budget parameters, the greater the focus on a supplemental insurance program the lower will be across-year protection, and vice versa.

The discussion in the preceding paragraph presumes that the supplemental insurance coverage provided by STAX and SCO programs is the same proposed in last year's Farm Bill drafts. Both of these programs based their revenue guarantees on crop insurance's pre-plant projected prices. These projected prices are based on harvest futures prices for the crop year. This design choice results only in within-year protection. An alternative design option is to base prices on historical prices, which would introduce the potential for across-year protection.

Question 3: Will the across-year programs focus on price or revenue protection?

It is easier to forecast payments with a price program. Prices lower than the support price will results in payments. In contrast, payments by a revenue program depend on low revenue not low price. Low prices may be offset by high yields resulting in no payments. Thus, forecasting payments by a revenue program requires consideration of the interactions of yield and price when determining revenue and thus revenue program payments. On the other hand, low revenues, not low prices, are generally a more accurate indicator of poor financial performance. Thus, revenue programs generally are viewed as targeting payments better to years in which revenues are low.

Question 4: Will the support levels for across-year programs react to changes in market conditions?

The revenue programs in last year's Farm Bill drafts had support levels that reacted to the market. The revenue support targets were set using the product of a moving average of historical prices and historical yields. In contrast, the target price proposals in last year's House Agricultural Committee Farm Bill did not react to the market. The target prices were set at levels fixed for the life of the farm bill.

Most target price programs have not had market moving targets built into the program. However, it is possible to build a target price program that would react to the market. Rather than having legislated fixed prices, target prices could be set using an average of previous prices that move over time. Lower market prices would lower the target price while higher market prices would increase the target price.

Reacting to the market implies certain characteristics. Of particular importance, a period of low prices that persist for several years will result in lower payments during later years of the low price cycle. Conversely a program that does not react to the market will have similar payments in the first and later years of the low price cycle. These differences have important international trade implications. In the first situation, U.S. agriculture adjusts while in the second situation all of the adjustment is borne by foreign countries. The latter situation increases the likelihood of U.S. programs being sued at the World Trade Organization.

To summarize, arguments for adjustments are that farmers need to react to new market conditions and declining payments from a commodity program give farmers' time to react. Arguments against market oriented targets are that adverse conditions cause pain whether the adjustments occur during the early or later years of changes in market conditions.

Question 5: Will the program use historical or planted acres to indemnify producers?

Last year's revenue program largely was based on planted acres while last year's target price program made payments on historical base acres. Generally, risk management is enhanced by basing payments on planted acres.

To some extent, the answer to this question is related to whether the program will react to market conditions. If a program reacts to market conditions, it can more easily be based on planted acres. Fixed target prices raise concerns when a fixed target price is set high relative to the market price. This will cause producers to plant more of the crops with higher fixed target prices, especially if payments are

based on planted acres or if planted acres are significantly smaller than base acres. Hence, historical bases, especially historical bases that are updated close to the time that fixed target prices are set, have to be used when the program does not react to the market, or else production distortions become potentially more important.

Question 6: How much overlap will be allowed between Farm Bill programs and crop insurance?

Crop insurance has become a large program that many farmers view as their primary risk management program. Given this emphasis, how will the Farm Bill programs complement crop insurance? Most insurance products purchased today are revenue products, making it potentially easier to minimize overlapping payments from crop insurance and multiple year revenue programs. Low prices can trigger payments by both crop insurance and target price programs, but historically this overlap in payments has not been addressed in designing target price programs. On the other hand, overlapping payments by crop insurance and across-year revenue programs have been an integral part of the design discussion, both in the design of the ACRE program in the 2008 Farm Bill and in the design of the ARC and RLC programs in the 2012 Farm Bill drafts.

Question 7: Does a farm have to have a loss to trigger payments?

Farms will not necessarily have to have a loss to receive program payments. For example, prices may be low enough to trigger target price payments but the farm may not have a revenue loss because yields are high enough to offset low prices. In a similar manner, if a revenue program is based on county revenue, county revenue may be low while farm revenue may not be low.

Having a farm loss condition in the program causes payments to go to only to farms that have losses. On the other hand, inclusion of a loss condition increases the complexity of the program.

Summary

Designs of the Farm Bill programs will largely answer the above seven questions. In some cases, these are contentious issues across regions and across crops. For example, some may want a revenue program while others desire a target price program. Hence, resolution of these issues likely will require compromise, perhaps leading to unclear answers to the above questions. It is highly unlikely that any party to the Farm Bill negotiations will receive all their desired answers to the above questions and will therefore have to choose which of these questions are more important to them.