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MINISTÈRE DE L'AGRICULTURE DE L'AGROALIMENTAIRE ET DE LA FORÊT

Analysis

CENTRE FOR STUDIES AND STRATEGIC FORESIGHT
—
no. 74 June 2014

The new Farm Bill: strengthening subsidized crop insurances and counter cyclical payments

The new American Farm Bill of 2014 gets rid of decoupled payments. On the other hand, counter cyclical safety net programs for revenue or prices are reinforced: reference prices for wheat and corn increase by 32 and 40%. Moreover, public support of the insurance programs is confirmed. Thus, in case of a lasting drop in crop commodity prices, direct payments could increase to higher levels than with the previous Farm Bill. The dairy sector is given a new farmers' margin guarantee program, as well as a dairy products' market purchase program. The pooling and monthly minimum price fixing for dairy farmers is extended. Securing the farmers' activities without compromising the export competitiveness of the agricultural sector seems to be the guiding principle of the new act.

After more than three years of negotiations and the extension of the 2008 law in 2012 and 2013, president Obama has signed, on the 8th of February 2014, the new Agricultural Act. This act, which is the main federal legislative tool regarding agriculture, nutrition and rural development, will be enforced from 2014 through 2018. After long and intense debates regarding the reduction of the SNAP (supplemental nutrition assistance program) budget, Democrats and Republicans reached a compromise that consolidates the possibility of public intervention in agriculture.

This note presents the changes that come with the new act regarding farm support. Other legislative changes, many of which are still work in progress, will only be briefly mentioned.

1 - A tradition of public intervention regarding agricultural and food sectors

As soon as 1933, the US have engaged a strong agricultural policy, combining price support and supply regulation. Half way through the sixties, they gave priority to direct support, with a first "loan rates" price safety net equivalent, and a second safety net with higher "target prices"[1]. American crop production was thus entitled, until 1996, to a counter cyclical support coupled to prices and production, as well as supply control measures (set aside payments, public storage, export aids). 1996 was a turning point, as the administration introduced decoupled direct payments (which were calculated with each farmer's past acreage and production references), and got rid of the target prices counter cyclical safety net. However, as soon as 1998, emergency measures had to be taken, and *ad hoc* payments were introduced by the Clinton administration to compensate a non-expected drop in crop prices. In 2002, the target prices safety net got reintroduced, and decoupled payments reduced. As a result, only a few years after decoupling farm support, counter cyclical payments reappeared (figure 1), but on a historical yield and acreage basis. Moreover, in the 90's, a large spectrum of federal subsidized insurance products were made available to farmers[2].

The following Farm Bill, in 2008, extended a crop growers' support based on three pillars: a) counter cyclical support on prices or, should they choose it, revenue (ACRE program: *Average Crop Revenue Election*), b) decoupled payments and c) subsidized insurance products. Statutory support could also been counted on in case of natural disasters.

This set of policies can generate an important budgetary uncertainty: contrary to the European Common Agricultural Policy's budget, US Department of Agriculture spending is not capped and directly linked to the economic situation. As a result, in the early 2000's, low prices and the consequent use of the counter cyclical payments generated an important increase in budgetary spending. Towards the end of the 2000's, the high crop prices and the economic crisis drove the cost of farm support down, while the number of SNAP beneficiaries heavily increased (figure 2).

In 2013, direct support to agricultural production, though important, represented only a small part of the Farm Bill spending, 75% of the budget being used to distribute

1. Devienne S., Bazin G., Charvet J.-P., 2005, « Politique agricole et agriculture aux États-Unis : évolution et enjeux actuels », *Annales de géographie*, n°641, pp 3-26.
2. Claquin P., 2011, *ACRE, un nouveau type d'aides confirmant l'orientation anticyclique de la politique agricole américaine*, Analyse n°33, Centre d'études et de prospective.

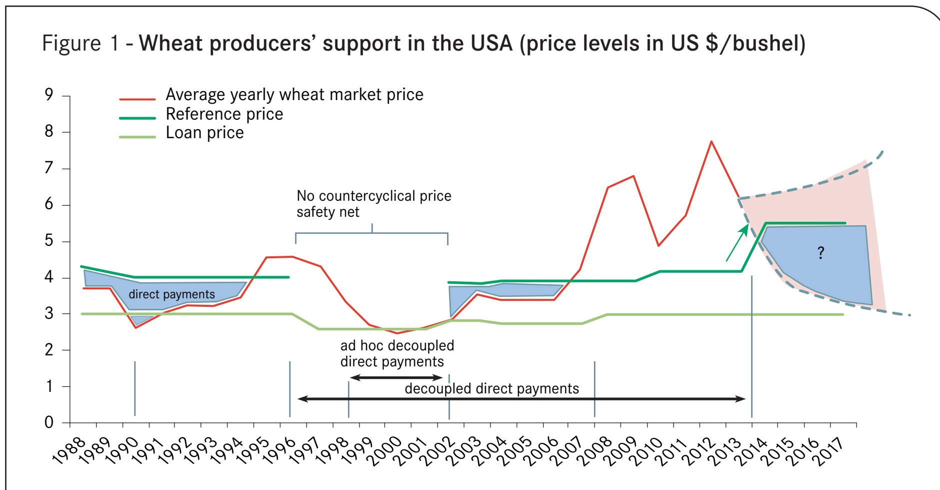


Figure 1 - **Wheat producers' support in the USA (price levels in US $/bushel)**

For the 2002 - 2014 period, the countercyclical payments in fact compensate the difference between the reference price and the effective price. The wheat price used here is the weighted average farm price. (http://www.ers.usda.gov/data-products/wheat-data.aspx#25171)

Source: USDA data and US legislation

food stamps to Americans in need. The budget of the new 2014 Farm Bill foresees a 1% reduction of the sum dedicated to SNAP and related nutrition assistance programs, while a 5% reduction had been discussed. Moreover, the 2014 Farm Bill contains provisions to promote local and healthy food consumption among SNAP recipients (in particular, establishing a $100 million program over 5 years to encourage SNAP recipients to buy fruits and vegetables at farmers' markets and other similar outlets.

According to a 10 year government forecast, food stamps should remain the biggest expense of the USDA with $ 70 billion a year of a 95 billion budget. These estimation are however based on the expectation of future economic recovery and lasting high crop prices. One cannot exclude the risk that future natural disasters or lasting low commodity prices may induce an important increase in public spending directed towards agricultural support.

2 - Field crops: two counter cyclical direct payments programs

The new Farm Bill terminates the decoupled direct payments program, which limits had been identified since 1998. Their termination was expected and waited for from the start of the political negotiations in 2011, in favor of the reinforcement of risk management tools. Farmers will now have to do a choice, which they will stick with for five years, between a) a price safety net with reinforced reference prices (figure 1) the *Price Loss Coverage program* (PLC), and b) a federal guarantee on a part of their revenue, the *Agriculture Risk Coverage program* (ARC). The loan rates program, which will be available to all, is extended as it was, except for cotton (Box 1). The annual subsidy cap for these programs per person or legal entity is $ 125,000[3].

The PLC works the same way as its predecessor, the CCP of the previous act, but it is triggered by reinforced target prices. Payments occur when the annual national-average market price falls below the reference price (Box 2). Reference prices were, in the new bill, raised from $ 164 to 217 per metric ton for wheat (+32%), $ 104 to 146 for corn (+40%), $ 104 to 195 for barley (+87,5%).

ARC protects 76 to 86 % of the reference revenue of a given crop. With this program, if one year's county revenue drops below 14% of its reference revenue, the farmer gets no payment. If the loss is greater than 24%, the farmer gets a payment of 0,85 x 10% of the county revenue according to base acreage. A farmer can loose 100 % of the farm yield one year, there will be no payment should that year's county losses not exceed 14 %. The reference county revenue is calculated as a county average. It is the average from the most recent five crop years, dropping each of the years with the highest and lowest county yields, highest and lowest national average prices (this is known as the five-year Olympic average) (Box 3). Each farmer choosing ARC can also decide to get the "individual" option. In that case, they enroll all farm crops into the program, and can then calculate the reference with their own yields, not the county's, and payments occur if the farm

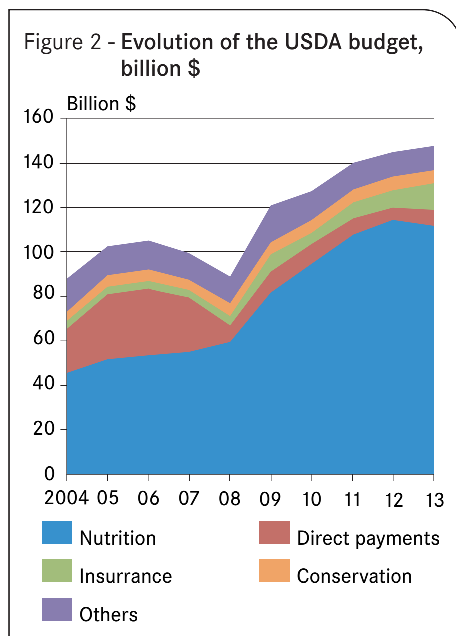


Figure 2 - **Evolution of the USDA budget, billion $**

Source: USDA

Box 1 - Cotton producer's support has been largely reshaped

In the 2014 Farm Bill, American cotton producers, who provide the world with 15% of its cotton, will gradually loose decoupled direct payments and will not benefit of a PLC safety net program, all though they were able to enroll in the CCP. Indeed, the US has yielded to Brazil's request, which has complained at the WTO: cotton will now benefit only from slightly reinforced loan rates and insurance. However, the producers will be able to buy a new type of shallow loss insurance, STAX, which premium is 80% subsidized and that can cover 86% of the harvest or revenue.

Box 2 - Example of calculation of payments for a farmer choosing PLC

A farmer choosing PLC will get payments if annual national-average market prices fall under the target prices:

Payment = (target price – market price) x farmers' payment yield x base acreage x 0,85

3. https://www.fsa.usda.gov/FSA/newsReleases?area=newsroom&subject=landing&topic=pfs&newstype=prfactsheet&type=detail&item=pf_20140328_insup_en_pmtlmt.html

revenue drops, not the county's. The ARC shares some similarities with the previous Bill's Average Crop Revenue Election[4] program revenue guarantee, which was also a choice, and that had been chosen for only 15% of the US crop land. The "deeper", less common losses can be taken care of by crop insurance, if an insurance product has been purchased that year.

According to first estimations of some American agricultural economists, which of course rely heavily on future yields and prices, the budgetary costs of these measures vary from 1 to 15 billion dollars[5]. All depends of the choices farmers will make in late 2014, and the yields and prices in the coming years. Every single crop grower has to consider the risks he is willing for at least five years, and which of the programs is best. The Illinois University economists, as well as their fellows at Kansas State[6], estimate that with relatively stable prices, at nowadays' high levels, producers would benefit to enroll their soy and corn in ARC, wheat in PLC. That is if prices don't drop for long. Farmers will be able to make their own calculations thanks to online software payed for by the USDA. Those who choose the ARC take a risk for the last years of the program, should lower prices last. Farmers that grow different crops can choose to enroll some in the PLC, others in the ARC County. The individual ARC, that requires that all crops be enrolled with it, seems not to be a good choice. According to J. Coppess and N. Paulson, of the University of Illinois[7], this program will only attract farmers that are very specialized, or that work in counties with an important climatic variability and which average production doesn't compare to theirs (local climates, severe local droughts). The individual ARC would only be chosen in particular cases.

Box 3 - **Details concerning County and Individual ARC**

A farmer choosing ARC County for one of his of her crops is entitled to payment covering 76 to 86% of the county reference revenue, (reference revenue = olympic county average yield x olympic federal price).

If the actual year's county revenue is between 14 and 24% of the reference county revenue, it is converted to a per acre revenue, and the farmer receives payments on 85% of his or her base acreage.

A farmer choosing individual ARC has to enroll all farm crops. The reference revenue would be the same as above, but with farm's Olympic average yields. Payments are triggered if the farmer's actual revenue, not the county's, falls between 14 and 24% of the revenue

Should the farmer want more coverage, for deeper losses, he or she can buy insurance.

3 - Subsidized insurances are reinforced

Apart from the changes concerning direct payments, insurances programs are extended and strengthened. The classic insurance products are subsidized at an average rate of 60%, and users are required to good conservation practices. Young starting farmers and ranchers will have even more advantageous help to get insurance products.

As we have seen, the ARC state program takes care of 76 to 86% of the revenue with direct payments. However, according to a recent study[8], this could seem a paradox in regard of the principles of insurance. Indeed, the shallow losses, the most frequent ones, (76 to 86% of the revenue) are managed by the government, when it is generally a job for private insurance alone - the State being usually solicited for "extreme" losses. However, one can understand this difference between direct payments and insurance coverage as a way to optimize WTO rules regarding insurances.

PLC choosers will have access to a new insurance product, the *Supplemental Coverage Option* (SCO). This product enables the farmers to buy county based insurance for a portion of their revenue or harvest that runs from 86% down to the classic insurance level chosen. This new complementary product enables the farmers to buy insurance for their shallow, most frequent losses, with county references.

One must also remember that the federal administration has other tasks regarding crop insurance, apart from the subsidizing of premiums. Indeed, the *Risk Management Agencies* (RMA) of the USDA are in charge of managing and overseeing insurance providers. It helps define the premium rates, is in charge of the subsidies – both those aimed at the producers and those aimed at the private insurance companies to help with their administrative and operating expenses, approves and supports new policies that the private insurance companies develops, and reinsures the private insurance companies. The RMAs employ over 450 civil servants in the US, and have a working budget of $ 69 million.

4 - Dairy: margin guarantee for farmers, FMMOs and new intervention tools

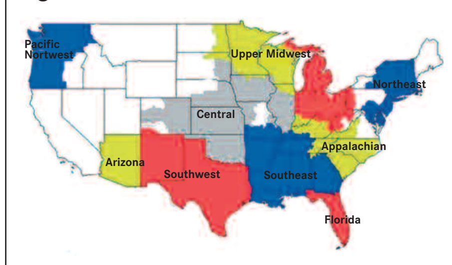
Since the 1930's, the dairy sector has been the target of specific policies, aimed at reducing price volatility and balancing supply and demand[9]. The 2014 Farm Bill brings forth changes, extending, eliminating and introducing programs.

The *Federal Milk Marketings Orders* (FMMO) are kept as they were. These are regional entities of the federal administration that have been created on the farmers' initiative. They set minimum prices for milk and organize negociations. The objectives of FMMOs are to promote orderly marketing conditions and to assure an adequate supply of fluid beverage milk, which nowadays concerns 70% of the US's production. Similar systems a administered directly by some states, such as California (figure 3). Prices are calculated each month using formulas with prices for major dairy products as inputs. The highest prices are paid for fluid beverage milk and lower prices are paid for milk used in manufactured dairy products. Through a market-wide revenue pooling system, a minimum "blend price" is paid to farmers, which is a weighted average of the minimum prices paid by milk handlers. As a result, the processors that get the most value out of their milk contribute financially to those that specialize in less valuable goods: as an example, fresh bottled milk producers redirect a part of their earnings to those that manufacture milk powder[10].

Moreover, three programs, the DPPSP (federal intervention), the MILC (price safety net) and the *Dairy Export Incentive Program*, are eliminated, while two new

4. J.-C. Debar, 2011, *États-Unis : le programme ACRE, nouvelle étape dans l'orientation anticyclique de la politique agricole*, étude réalisée à la demande du ministère de l'Agriculture.
5. FAPRI, 2014, *U.S Baseline briefing book. Projections for agricutlural and biofuel markets*, MU Report 02-14.
6. http://farmdocdaily.illinois.edu/2014/02/arc-and-plc-in-2014-farm-bill.html
http://farmpolicy.com/2014/02/25/farm-bill-ag-economy-and-food-policy-issues-tuesday/#more-14766
7. http://farmdocdaily.illinois.edu/2014/02/evaluating-commodity-program-choices-in-new-farm-bill.html
8. Ichter R. et Thourot P., 2014, Farm Bill 2014 – 2018 - Des assurances tous azimuts, Paysans n°344, pp. 5 à 9
9. Kroll J.-C., Trouvé A., Deruaz M., 2010, *Sortie des quotas laitiers. Tome 2 : analyse des différents modes de régulation des marchés laitiers dans le monde*, INRA CESAER, UMR 1041, Dijon.
10. OCDE, 2004, *An analysis of dairy policy reform and trade liberalization / An analysis of international dairy trade liberalization.*

Figure 3 - **The 10 FMMOs in 2013**[4]



Source: USDA

programs, the *Dairy Producer Margin Protection Program* (DPMPP, or MPP - Dairy) and the *Dairy Product Donation Program* (DPDP), will be enforced:

The DPMPP allows dairy farmers to insure a part of their margin with the Government. Each farmer chooses a part of production to protect (25% to 90% of their reference), as well as the margin guaranteed, which can be 4 to 8 $/wt. When the federal margin, determined by the USDA, is below the level chosen by a farmer for two consecutive months, he is entitled to compensation. The access to the program with a minimal guarantee is free, provided an inscription fee of $ 100 has been paid. Then, depending on the level of security chosen and the size of the operation (farmers producing more than 2 million kilos per year pay more), the costs vary: the "premium", fixed and paid to federal services, varies from $ 0 to $ 1,36 for $ 4 to $ 8 per cwt margin guarantee, this last price of $ 1,36 corresponding to the maximal guarantee of 8 USD in big farms[11]. A study of the economics department of the USDA[12] tried to estimate the non-desired effects of a similar insurance program, used on a much smaller scale (LGM dairy). The study concludes that the DPMPP should work well in preventing risks without being an important incentive to produce more. However, other studies point to the fact that there is a risk to see farmers speculating, optimizing their margin protection levels by anticipating feed and powder prices[13].

A new program, the *Dairy Product Donation Program*, aims at enabling the Government to intervene on the dairy products' market when the average margin falls bellow the threshold of $ 4/cwt. Should this be the case for two consecutive months, the government can buy milk products and distribute them for free to food aid organizations (food banks, charity), in order to stimulate demand and discharge the market. The distribution is to be free and immediate. No beneficiary organization is allowed to sell the products. The rhythm of the intervention depends on various factors, such as the distributors' capacity to move the goods, and is decided by the administration. Also, in case of an important difference between US and world prices, the program will be suspended, in order not to limit export possibilities.

Finally, a supply control mechanism in the event of a crisis, which had been proposed during negotiations, was finally refused, the Congress choosing not to introduce any supply regulation tools. This program was indeed designed to encourage milk production reduction in exchange for subsidies. However, a very light incentive to produce less in case of a crisis has been incorporated to the DPMPP: producers will not be able to guarantee the margin of an increasing production, should this increase exceed the average federal increase. In other words, if a dairy farm produces 10% more than its reference one year, when the federal mean production has only increased by 5%, the farmer can only insure the margin of 5% of his or her increased production.

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Apart from the main agriculture support programs presented in this note, a few other important measures of the new Farm Bill should be mentioned. In addition to extended classic insurance products for fodder producers and support in case of natural disasters, specific insurance programs for organic production are expanded. A new program to support producers in case of cattle, beehive or fish losses due to extreme epidemics or weather events is reinstated. Agricultural cooperatives are also taken into account: the allocated budget to promoting cooperation is extended, while a working group focused on improving cooperation between coops and the USDA will be created.

Though the budget of conservation programs is, for the first time, slightly diminished by 600 million USD per year, a kind of "conditionality" is reinforced, making soil and wetland protection compliance requirements to get access to insurance programs. In order to insure erosion sensible land or wet grasslands at a lower price, the farmer commits to new techniques against erosion, or not to drain or plough wet grassland.

Overall, although decoupled payments are eliminated, the Federal Government keeps, with the new Farm Bill, a central role in the regulation of the agricultural sector. The counter cyclical systems of guarantee on prices or revenue are reinforced, as well as subsidized insurance products, though cotton farmers loose their target price safety net in exchange for a reinforced shallow losses insurance following a WTO dispute. New measure concerning the dairy sector introduce a strong public margin guarantee tool used in the event of a crisis, as well as a program that enables the Government to buy dairy products. In the event of a serious drop in field crop production or prices, direct payments may exceed forecasts and federal spending grow, as it did during the previous periods. To prepare farmers for such events, the Bill reinforces crop insurance, which takes upon itself the responsibility to assume the less frequent risks, and strengthens counter cyclical safety nets. With these amber box measures (which spending is caped, because considered more distorsive than green box measures by the WTO), the USA aim at conserving an exporting and productive agriculture, safe from growing economic and climatic risks. But America takes the risk to exceed it's spending WTO cap.

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11. Pour plus d'information concernant ce dispositif, consultez les analyses du conseiller agricole à Washington (http://fr.ambafrance-us.org/spip.php?article1824).
12. Burdine K., Mosheim R., Blayney D., Maynard L., 2014, *Livestock Gross Margin-Dairy Insurance: An Assessment of Risk Mangement and Potential Supply Impacts*, USDA, Washington DC.
13. Pour plus d'informations, consultez les équipes du conseiller agricole à Washington (http://fr.ambafrance-us.org/spip.php?article1824)

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Typesetting: SSP Beauvais
Legal deposit: on publication, © 2014