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Farm Program and Crop Insurance Decisions Moving Into the 2015 Crop Year

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As the 2014 year closes and the 2015 crop year is set to begin, a new era of commodity support programs in the form of a price program, a county revenue, and an individual farm revenue program will be coupled with new crop insurance products aimed at providing shallow loss revenue protection. These new programs provide a new approach to the risk management aspect of the American farm safety net. Farm owners and producers are charged with varying degrees of commodity program choices that will remain in effect for the five year duration of the 2014 farm bill. The farm serial number-by-farm serial number decisions that remain vetted with the farm owner include options to reallocate covered commodity base acreage and/or updating program yields for covered commodities. Farm program election is on a covered commodity-by-covered commodity basis, which is left to the producer(s) on the farm. (A farm owner who shares risk in the production of a crop via a share rent is considered a producer by definition. If the landowner receives a cash rent, that party is not privy to participate in the farm program election decision since no risk is shared in the crop.) However, all producers on a farm must unanimously agree on the program chosen. Covered commodities can be enrolled in a new revenue program called the agriculture risk coverage program (ARC) or a new price program called the price loss coverage program (PLC). To add more detail to what is already considered a landmark piece of farm legislation, the ARC program bares two coverage options: county or individual levels. In addition to new revenue and price support commodity programs that began in the 2014 crop year; two new crop insurance products are available beginning with the 2015 crop year. They are the supplemental coverage option (SCO) and a cotton-specific product called the stacked income protection plan (STAX). This policy brief summarizes the pending timeline for these crucial decisions as well as providing clarification on the decision making authority for base reallocation, payment yield update, ARC/PLC program election, in addition to the SCO and STAX insurance policy endorsements for the 2015 crop year. The following pages represent a summary of the multiple educational efforts by university personnel as well as key informational releases form farm trade outlets and government agencies.

The timeline for the farm program decisions that will need to be made by farm owners and producers can be separated into three periods. Period one is began on September 29, 2014 and ends on February 27, 2015. This period involves base acre reallocation and the updating of payment yields. Period number two, began on November 17, 2014 and will end on March 31, 2015. This period regards ARC/PLC program election. Period three will begin in mid-April 2015 and conclude sometime in the summer of 2015. This is when ARC/PLC contracts will be signed (enrollment) for participation in ARC/PLC for the 2014 and 2015 crop years.

Under the 2014 farm bill, current base acres for covered commodities can be retained or reallocated to reflect the farm's recent planting history. The concept of base acres continue with the new farm legislation since both the ARC and PLC FSA-administered support programs make payment to base acres. The farm owner has the sole authority as well as the opportunity to elect to reallocate the base acres for covered commodities on the farm, as of September 30, 2013. The reallocation of base acres is the ratio of the 2009-20012 average acreage planted (to include prevented planted acres) covered commodities to the 2009-2012 average of all acreage planted on the farm to covered commodities. Crop years in which a covered commodity was not planted are not excluded. If the acreage was planted (or prevented) or was devoted to another covered commodity in the same year (other than a covered commodity produced in an established double-cropping practice), the farm owner can elect the commodity to be used for that crop year in determining the four-year average, but may not include both. A major point of emphasis is that the reallocated base acres cannot result in the total number that exceeds the number of base acres in effect on the farm on September 30, 2013.

Another major issue that will effect Mid-south producers is that cotton base acres are automatically retained as ‘generic base acres’ but cannot be reallocated. Generic base will be retained for the life of the bill- it cannot be increased or decreased. In the likely event that covered commodities are to be planted on these generic acres, those planted acres will be eligible for ARC or PLC payments. The commodity program that covers these generic base acres (e.g. ARC or PLC) will be determined by the program crop actually planted on those generic base acres and the program chosen by the producer for that commodity. Thus, even though the commodity programs are decoupled from current production decisions, program coverage on generic base acres is coupled to current planting decisions. Generic acres will be allocated/attributes on an annual basis, based on the actual plantings on those acres.

The decision to reallocate is important because of the emerging lower commodity prices that are forecasted and because PLC and ARC are programs pay on base acres. The decision to reallocate base acres can encompass two different management approaches employed by the farm owner: (1) to minimize farm revenue risk (including price and yield risk) or (2) to maximize farm program payments. The decision to reallocate base acres will be contingent upon the selection of the ARC or PLC for different crop produced on a farm.

The second decision a farm owner can elect is to update the payment yield on a covered commodity-by-covered commodity basis. This payment yield would only be used in calculating any PLC payment for each covered commodity on the farm for which crops that the PLC election is made. The payment yield update is equal to 90% of the average yield per planted acre of the covered commodity on the farm from the 2008 to 2012 crop years. For crop years in which the acreage planted to the covered commodity were zero, those yields are excluded in the calculation. This is in contrast to the base acre reallocation formulation that includes the zero value. If the yield for a farm for any of the 2008 to 2012 crop years was less than 75% of the average 2008-12 county-level yield, a yield will be assigned by USDA equal to 75% of the average of the 2008-12 yield. In other words, the calculation of the average yields cannot include any yield that is less than 75% of the average yield for the county in those crop years.

In instances that a farm owner would not elect to update yields, the countercyclical program yield (under the 2008 farm bill) would be used. Numerous farm trade/industry publications have suggested that farm owners should update payment yields even if they decide to enroll crops in the ARC program. The base acre reallocation decision is independent of the payment yield update decision, with both choices at the discretion of the farm owner. Base acres can be reallocated without updating payment yield, and vice versa.

Recall that the decision to reallocate or retain base acres is important as program payments are made to a percentage of the base acres enrolled for each covered commodity. For covered commodities that are enrolled in the ARC (county option) and PLC programs, farm program payments are made on 85% of the base acres for each covered commodity. For the individual ARC coverage option (e.g. a whole farm revenue program), payment acres are reduced to 65% of the base acres for all of the covered commodities on the farm(s).

Election is required on behalf of the producers on a farm for participation in either of the ARC or the PLC programs. This enrollment decision is made on a FSA serial number farm-by-FSA serial number farm and a covered commodity-by-covered commodity basis. To stress the importance of this consent requirement, all producers on a farm must unanimously select whether to receive ARC payments based on county-level coverage (CO) applicable on a covered commodity-by-covered commodity basis or individual coverage (IC) applicable to all of the covered commodities on the farm. One distinguishing factor on program contrast is that the ARC-CO is a revenue program based on county-level yields. Meaning that each covered commodity has a separate revenue guarantee. Whereas ARC-IC is a revenue program based on actual farm-level yields. ARC-IC is a whole-farm program for all covered commodities on the farm.

The PLC program is a 'modified' version of the countercyclical price program (target price program) contained in the 2008 farm bill. Like the target price program, the PLC program has reference prices set by Congress for the entire length of the farm bill, making payments when the U.S. marketing year average (MYA) price is below this statutorily established reference price. The operational mechanics of the PLC program can be defined as that in any of the 2014-18 crop years if the effective price for the covered commodity (for the specific crop year) is less than the reference price for the covered commodity, a PLC payment is made. The effective price is the higher of the national MYA price or the national average loan rate in effect for the crop year. The PLC payment rate is the difference between the reference price for a covered commodity and the effect price. The PLC payment amount is equal to the PLC payment rate multiplied by the PLC payment yield for the covered commodity multiplied by the payment acres (85% of base acres) for the covered commodity.

ARC-CO and PLC can be elected by on a crop-specific basis, unless ARC-IC is selected, in which case the option applies to all crops produced on the farm. This implies that producers may choose ARC for some covered crops produced on their farm and PLC for other covered crops produced on that same farm. Producers should consider two points in weighing their program election. The first point is whether the expected national MYA price will be above/below the reference price. If a producer expects that the MYA price for a particular covered commodity will be above the reference price, the PLC program will not produce a payment that year as the program only produces a payment will MYA price is below the reference price. Under this scenario, the ARC program may look attractive. The ARC-CO should also be considered relative to not only price but the relationship between farm and county yield correlation. If the opposite anticipation is held by the producer and the MYA price is expected to be below the reference price, the PLC program may look attractive in providing downside price protection foe the enrolled commodity. A second point to consider is to ask the question of what does the forecasted MYA price look like over the upcoming crop years in deciding which program will provide long-term risk protection relative to the producer's risk strategy. This decision should not be made in a vacuum, it will rest upon more factors than expectations about projected price trends. Farm trade publications have advised that it may be useful to wait until near the end of the sign-up period to see where prices for the 2015 are heading. If program election is not made by the March 31, 2015 deadline, the farm will be placed in default and will be automatically enrolled in PLC program starting with the 2015 crop year. Any potential payments will be forfeited for the 2014 crop year.

There are advantages and disadvantages of using individual farm data opposed to relying on county averages when comparing the ARC versus PLC programs. Given the recent years of high prices that are used in the ARC payment calculations, it is likely that ARC payments will begin at higher price levels than the relatively low reference price (used in PLC payment calculations) for corn, soybeans, and wheat- which can be viewed as an advantage for the ARC program. This is easily observed in the corn, soybean markets three years ago. Since the ARC program uses a five year Olympic average of prices and yields, high prices from the 2011and 2012 crop years are included in the benchmark revenue calculation. A disadvantage is that ARC payments are capped to 10% of the benchmark revenue. This means that if a significant and substantial price decline occurs, maximum payment is reached with the ARC program providing no additional protection with any further price declines. In contrast and keeping with the above policy scenario, PLC payments continue to grow until prices move down to the loan rate levels. These evaluations point to the fact that will be important to make a program decision based on the individual producer's five-year price outlook. The more optimistic they are about the price of a crop, the more likely they are to favor ARC. If a producer believes low, or very low prices could occur, they may look more favorably toward PLC. Producers will also need to consider how their government program choice integrates with their crop insurance program and how these programs combine to provide a financial safety net.

Payment limitations can be described as both a technical and legal issue. The total amount of payments (for covered commodities) received by a person or legal entity for any crop under sections 116 (PLC) and 117 (ARC) and as marketing loan gains or loan deficiency payments may not exceed $125,000. In a general sense, the payment limit for a person and a spouse is $125,000 each, provided both are actively engaged in the farming operation. A person or legal entity shall not be eligible to receive any program benefit during a crop, fiscal, or program (as appropriate) if the average AGI of the person or legal entity exceeds $900,000.

A unique, somewhat complex feature of the 2014 farm bill, is the interaction between Title I commodity programs and Title XI crop insurance products- most notably the SCO policy endorsement. ARC and PLC commodity programs are tied to historical base acres, while traditional crop insurance policies- to include the SCO-are tied to planted acres. Covered commodities that are enrolled in the ARC-CO or ARC-IC are not eligible to receive coverage from the SCO insurance program. Whereas, covered commodities enrolled in the PLC program remain eligible to participate in the SCO insurance program. Note, that the ARC and PLC program payments are paid on the base acres of the enrolled covered commodity. In the event that insurance indemnities are triggered, payments (SCO and STAX) are made on a planted acre basis. SCO and STAX programs are similar to the preexisting Area Risk Protection Insurance (ARPI) policy. Coverage under these programs is based on the experience of the county rather than an individual farm.

SCO is a new insurance product for the 2015 crop year that provides county-level coverage from an 86% to the coverage level of the underlying insurance policy. Indemnities are triggered based on county losses in excess of 14% (100% - 86%), which means the entire county must suffer at least a 14% loss in order for any individual's SCO policy to pay an indemnity. However, the actual indemnity received by any individual producer will be tied to their individual deductible value. The size of the county level loss results in a payment factor which is applied to the individual producer's insurance deductible to determine the actual indemnity payment. SCO has important implications for producers as they evaluate commodity program options (i.e. PLC versus ARC) and risk management decisions (i.e. individual insurance coverage levels). Because SCO is limited by the statute to the deductible range of the underlying policy, it will operate as individual-based coverage, but the indemnity is triggered and scaled by area-wide (county) losses. The premium cost of the SCO policy will be subsidized by 65%.

With the SCO endorsement, an underlying insurance policy is required for the crop. SCO is only available to commodities enrolled in the PLC program; although enrollment in the PLC program is not a prerequisite. The choice of either ARC option will make the producer ineligible to purchase SCO. Producers should consider the purchase of an SCO policy in future crop years when making the choice between the PLC and ARC commodity program decisions. Since SCO is an RMA-administered program it acts like other 'traditional' insurance products in that is can be purchased on a year-to-year basis. This annual insurance policy duration complicates alternative farm bill commodity program decision making in that commodity program selection is irrevocable for the five-year life of the farm bill. Linking the decision farm program and crop insurance suite of products can complicate crop insurance delivery, as commodity program choice (beginning with the 2014 crop year) will have to made prior to offering SCO (beginning in 2015).

As an added component to pairing commodity program to crop insurance, there is potential overlap can exist between crop insurance and the PLC program option. An overlap can exist between target price payments and declines in crop insurance price between the pre-plant and the harvest price discovery periods. The exact degrees of the overlap expected between PLC and crop insurance is difficult to calculate because PLC pays on 85% of the farm's base acres while insurance pays on 100% of are planted on the insured unit. Producers should consider this insurance/PLC overlap when making their farm program election. Overlapping payments would provide additional assistance if prices decline and remains below the reference price established by statute. A producer is not required to buy crop insurance to enroll in either the ARC or PLC commodity program for covered commodities produced on their farming operations.

The new farm bill brings fundamental changes in the safety net for cotton producers. The majority of cotton support will be contained in Title XI of the new farm bill, as cotton transitions away from traditional commodity price and income support programs. STAX is another new insurance product for the 2015 crop year administered by the RMA. The major feature of this product that sets it apart from other insurance products, like SCO, is that STAX is only available to producers of upland cotton. The new income safety net for cotton will be the RMA-administered STAX product. STAX will be a county area-based revenue insurance plan that will cover losses between 10% (100% - 90% coverage) and 30% (100% - 70% coverage) of expected county revenue. STAX is designed to cover shallow losses and supplement the farms existing yield or revenue policy. STAX may be purchased as a supplement to an existing crop insurance policy or may be purchased as a stand-alone policy. The premium cost of the STAX policy will be subsidized by 80%.

Cotton producers can select STAX or SCO but cannot have STAX and SCO on the same cotton acres (double coverage of the same acreage is prohibited). STAX and SCO are very similar in terms of operational mechanics and the way in which indemnities are calculated. Ultimately, both are revenue products like the ARC program for covered commodities, in that they are shallow loss programs. While STAX coverage is based on revenue experience, SCO indemnities can be triggered by either county yield or revenue experiences.

The farm program decision is a multi-year management decision. ARC and PLC can provide assistance with multiple year losses. ARC-CO is an integrated shallow multiple year loss program. PLC paired with the SCO is not integrated. In further detail to the above-mentioned point, there are two sets of calculations must be combined, one for shallow losses (SCO) and one for multiple year price losses (PLC).

A key consideration with the SCO is a loss at the county level may or may not align with loss experienced on the individual farm. ARC-CO and PLC can influence the crop insurance choices for certain covered commodity that are produced on a farm. Therefore, the farm program/crop insurance selection decision question can be separated such that the crop insurance components (to include SCO) of the decision are examined. If a commodity's price is expected to be below the reference price, producers may elect the PLC program to provide downside price protection and possibly reduce their yield insurance protection to cover yield risk. A strength of the ARC-CO is the assistance for shallow multiple year losses. However, ARC-CO also provides some disaster price assistance since it has a minimum price built into its policy design as the inclusion of the PLC reference price. Strength of the PLC program is its assistance for multiple years of declining and stagnant prices, coupled with SCO (or high individual farm insurance coverage) can provide assistance with cumulative shallow losses.

In conclusion, this farm bill allows producers to tailor the coverage options for the next five years to their individual farming operations and the commodities that are produced on their farms. To briefly summarize the farm program options, PLC is intended to cover against the risk of lower commodity prices. It is a traditional income support policy utilizing price floors for commodities to help with market uncertainties such as sustained low prices. ARC is intended to cover against lower revenues caused by either lower prices or by lower yields relative to recent averages. ARC provides benefit to producers when price declines relative to recent averages. ARC provides assistance in the deductible range of crop insurance utilizing indications of actual losses and an emphasis on multi-year price risk. There may be times in the future when one program produces a payment and the other program does not. A heavily emphasized point at many extension meetings is that producers should evaluate the average payment in future crop years given multiple price and yield scenarios for each farm program alternative.

This information is presented for educational purposes only and is not an endorsement for one farm program or insurance product over another. Consultation should be sought from a certified crop insurance agent regarding insurance options for a commodity produced in a particular geographical area. Additional information can be obtained on farm programs at the LSU Agricultural Center's Department of Agricultural Economics and Agribusiness farm bill webpage at: http://www.lsuagcenter.com/en/our_offices/departments/Ag_Economics_Agribusiness/extension_outreach/2014-Farm-Bill-Information/

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