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Changing Farm Policies for Changing Times

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CORNHUSKER ECONOMICS

Changing Farm Policies for Changing Times

Market Report	Yr Ago	4 Wks Ago	10/14/11
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	\$95.36	\$116.80	\$119.49
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	120.85	150.26	153.01
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	114.79	137.46	146.62
Choice Boxed Beef, 600-750 lb. Carcass.	153.18	184.27	185.39
Western Corn Belt Base Hog Price Carcass, Negotiated.	64.00	88.62	90.59
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean.	81.96	95.09	97.33
Slaughter Lambs, Ch. & Pr., Heavy, Woolled, South Dakota, Direct.	142.50	183.50	170.00
National Carcass Lamb Cutout, FOB.	336.98	404.92	406.82
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu.	5.76	6.71	6.02
Corn, No. 2, Yellow Omaha, bu.	5.10	6.82	6.32
Soybeans, No. 1, Yellow Omaha, bu.	11.08	13.09	12.18
Grain Sorghum, No. 2, Yellow Dorchester, cwt.	8.89	11.20	10.68
Oats, No. 2, Heavy Minneapolis, MN, bu.	3.65	3.60	3.57
<u>Feed</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	*	185.00	190.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	75.00	117.50	127.50
Grass Hay, Large Rounds, Good Nebraska, ton.	*	92.50	92.50
Dried Distillers Grains, 10% Moisture, Nebraska Average.	144.00	204.50	222.00
Wet Distillers Grains, 65-70% Moisture, Nebraska Average.	50.75	75.00	73.50
*No Market			

It has long been said that farm policy and farm bills are much more evolutionary than revolutionary. Policy changes tend to occur rather slowly and gradually, unless some economic or policy shock creates an opportunity or urgent need for a change in policy direction.

The current debate in Washington could provide just that shock to point federal farm policy in a new direction. Farm legislation authorized in the 2008 Farm Bill expires in 2012, and the initial debate over re-authorization was already well underway when the Federal Debt Ceiling/Deficit Reduction Compromise legislation was passed in August. That legislation created a “Super Committee,” charged with preparing a plan to reduce the federal budget deficit to be voted on by Congress before Christmas, highlighting the potential for significant cuts in farm programs along with other federal spending.

As the Super Committee began its deliberations, it has been taking input from the various committees in Congress, including Agriculture, on recommended spending cuts. And in turn, the Agriculture Committees have received substantial input and recommendations from interest groups as to the preferred direction for United States farm policy, particularly farm income safety net programs.

Potential Farm Policy Changes

Given the broad portfolio of current farm income safety net programs, it is no surprise that the recommendations from ag interest groups varied widely. But, it is informative to note that almost all of the recommendations include two major elements:

- 1) The proposals almost all acknowledge that the Direct Payment (DP) Program first established in the 1996 Farm Bill seems relegated to elimination. DPs were popular in 1996 because they were fixed and decoupled from production. They maintained supports to producers, while allowing planting flexibility and

better compliance with then-new WTO support limits. But the fixed, decoupled nature of DPs has also made them a target in 2011. Fixed payments paid regardless of price or income are difficult to defend politically in times of record farm income and record budget deficits. Furthermore, fixed payments tied to production history naturally accrue to larger farms, continually feeding the payment limit debate between large and small farms. And perhaps most significant, the \$5 billion per year cost of DPs makes them the single largest budget item in the farm income safety net, and an obvious target for budget cutters.

- 2) The proposals also focus on new or improved risk management programs as the fundamental core of the farm income safety net. Federal farm programs have evolved over almost 80 years from an initial focus on supply control and price support, to a focus on income support, to an emerging focus on risk management. The current federally-supported crop insurance programs resulting from modern legislation in 1980, 1994 and 2000 provide a foundation of risk management support for producers. The 2008 Farm Bill provided a revenue-based risk management safety net in the form of the Average Crop Revenue Election (ACRE) Program and the Supplemental Revenue (SURE) Assistance Program. Now, most of the interest group proposals suggest using some of the budget savings from cutting DPs to fund improved protection in new programs, either revising ACRE or combining elements of ACRE, SURE and crop insurance together in an integrated program.

On Friday, October 14 the leadership of both the Senate and House Agriculture Committees forwarded to the Super Committee a recommendation of \$23 billion in total ag spending cuts, with \$15 billion coming from commodity programs. The details of the proposed cuts were not released, and are not expected until November 1, but the size of the cut suggests that the Agriculture Committees may, in fact, be developing a plan consistent with the two principles outlined above. Cutting DPs alone would reduce spending by \$5 billion per year for a total of \$50 billion over ten-years, but the net savings would not be that big. If there were no DPs, participation would increase in the current ACRE program, and the trigger price for Counter-Cyclical Payments (CCPs) would also increase, both leading to an increase in expected payments for a net spending reduction of about \$32 billion, based on recent reported estimates. The Agriculture Committees' reported recommendation of \$15 billion in cuts suggests that the committees propose to use at least half of the savings from cutting DPs to enhance other parts of the safety net, perhaps as part of a revised revenue safety net.

Potential Impacts

In Nebraska, farm commodity support payments have averaged about \$643 million dollars per year over the past

decade, although higher crop prices have translated into lower support payments in recent years, with an average of \$428 million per year over the 2006-2010 period. The fixed DPs have been by far the largest component of that support at about \$321 million, or 81 percent of total commodity support payments. If the DPs are cut or eliminated while the risk management safety net is enhanced, the impact could be substantial for Nebraska producers in terms of total expected payments and optimal risk management decisions.

To analyze the impact of potential changes in farm policy on crop revenue and on optimal risk management decisions, the authors developed a comprehensive model of crop revenue for key Nebraska crops as a core component of a research project funded by the Nebraska Soybean Board. The model simulates crop prices for soybeans, corn and wheat simultaneously, with yields at the national, state, district, county and farm level. The model includes a total of 95 different price and yield variables that are simulated simultaneously to incorporate the inherent correlation between changes in yields and/or prices (e.g. soybean yields and soybean prices or soybean yields at the state and crop district level). The simulation is run 500 times to provide probabilistic estimates of yield and price that translate into probabilistic estimates of crop revenue, farm program payments, crop insurance payments and other risk management outcomes.

This model allows for comparison of policy alternatives, including the current proposed changes to the revenue safety net. As a refresher, remember that the current revenue safety net is the ACRE program that protects producers from revenue losses if crop revenue falls below guarantees at both the state and farm level. The guarantee at the state level is equal to the two-year average price times the five-year Olympic average yield times 90 percent, and the maximum ACRE payment is limited to 25 percent of the guarantee. Many of the interest groups propose changes in the ACRE program to improve the expected risk protection provided by the program. One of the common changes suggested is to shift the state-level guarantee to a crop district-level guarantee to make the protection more relevant to local growing conditions. Along with the shift in geography, the proposals consider a shift in the level of coverage from the current 90 percent guarantee to a rate between 70 and 90 percent, and a shift in the size of the maximum payment.

By modeling these proposed changes in the geography and the level of the ACRE guarantee, we can begin to see the potential impacts of a change in the revenue safety net. While results are calculated separately for key crops in each of the state's eight crop districts, the following summary tables provide insight on the implication for expected payments and expected program costs under various policy alternatives.

Table 1 provides statewide-average estimates of expected 2011 payments under the ACRE program, given price and yield expectations going into the growing season. The first column of data shows expected payments under the current 90 percent state-level guarantee, while each succeeding column shows expected payments under alternative guarantee levels at the crop district level. The first thing to note is the expectation of no payments for irrigated crops and only marginal payments for non-irrigated crops when using the current 90 percent state-level guarantee. With price expectations at the beginning of the crop production year far above the two-year average price used for the ACRE guarantee (for example, \$13.49 per bushel vs. \$11.35 per bushel for soybeans), the simulation did not produce large enough revenue losses to trigger substantial ACRE payments.

term trends, leading to a higher effective yield protection level if ACRE had been switched to a crop district-level guarantee in 2011.

While these results are certainly relevant to the 2011 crop production year, they may not accurately reflect long-run expectations, given that the ACRE guarantee moves over time with changes in yields and prices. To compare alternative ACRE guarantee levels under a representative long-run scenario, the simulation was repeated using price expectations for 2011 equal to the two-year average price and yield guarantees consistent with yield expectations for 2011. The results in Table 2 (on next page) show the implications of changing the ACRE guarantee and guarantee level under representative long-run expectations. Not surprisingly, the expected payments under this alter-

Table 1. Summarized Expected Base* Scenario ACRE Payments and Aggregated Payments

Expected Average Payments Per Acre						
Crop/Trigger	State 90%	District 90%	District 85%	District 80%	District 75%	District 70%
Corn Irrigated	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Corn Dryland	0.17	3.94	2.74	1.86	1.26	0.84
Soybeans Irrigated	0.00	0.00	0.00	0.00	0.00	0.00
Soybeans Dryland	0.23	0.30	0.12	0.06	0.04	0.03
Winter Wheat	0.29	0.61	0.33	0.17	0.06	0.01
Expected Aggregated Payments						
Crop/Trigger	State 90%	District 90%	District 85%	District 80%	District 75%	District 70%
Corn Irrigated	\$0.00	\$19,885	\$0.00	\$0.00	\$0.00	\$0.00
Corn Dryland	590,775	13,798,116	9,592,610	6,502,677	4,425,925	2,949,496
Soybeans Irrigated	0.00	1,046	0.00	0.00	0.00	0.00
Soybeans Dryland	593,627	799,067	324,533	152,097	107,729	78,045
Winter Wheat	458,072	966,455	519,602	262,249	99,610	20,270
Total	\$1,642,473	\$15,584,567	\$10,436,745	\$6,917,024	\$4,633,264	\$3,047,811

* Base scenario simulation prices are 2011 spring planting values on a per bushel basis for corn, soybeans and wheat, of \$6.01, \$13.49 and \$7.15.

If the ACRE program were changed to a crop district-level guarantee, it could substantially change the level of expected payments. For example, the estimated payment per acre in dryland corn goes from \$0.17 per acre under the 90 percent state-level guarantee, to \$3.94 per acre under the 90 percent district-level guarantee. Even with price expectations far above the two-year average, the yield expectations and yield variability at the district level produced substantial losses that showed up in average expected payments. A closer look at district-by-district results would show greater payments in central and western Nebraska districts, due to the greater yield variability in these districts. In addition, strong yield results in recent years could raise the ACRE yield guarantee relative to the expected yield based on longer-

native scenario are substantially higher than the base scenario, given the increased price protection provided by ACRE against assumed lower price expectations. In addition, simulating the policy alternatives under these more representative assumptions demonstrates the increased payments that would generally be expected in shifting a state-level guarantee to a crop district-level guarantee. As producers have argued, the crop district-level guarantee should be more reflective of local production conditions, and thus offer more protection to local producers. The data suggest this is the case, as a 90 percent crop district-level guarantee pays more on average than the 90 percent state-level guarantee. (Of note, some crop districts are actually less variable than the state as a whole and would not pay as much, but some crop districts

are substantially more variable than the state as a whole, and would pay significantly more.)

As the guarantee level is reduced, the expected payments obviously also fall. A comparison of the data generally shows that a crop district-level guarantee between 85 and 90 percent would pay out equivalent to the state-level guarantee of 90 percent. Given the policy proposals that presume to use some savings from cutting DPs to pay for strengthening the revenue safety net, the analysis suggests that a district-level guarantee would need to be maintained at 90 percent (or even increased to 95 percent, as suggested in some proposals), to actually strengthen the protection provided by the ACRE program.

Finally, the expected aggregated payments in either scenario are calculated from the average payments per acre multiplied by the total crop acreage for each crop in the state, assuming 100 percent participation in ACRE. The aggregate results show that even under the 90 percent state-level or 90 percent crop district-level guarantees, the expected payments are less than \$100,000,000 in Nebraska. While this may provide substantial support to Nebraska crop producers, it is less than one-third of the current fixed payments received each year under the DP program.

Given the presumed cuts to DPs, it appears that Nebraska crop producers will face greater challenges in the coming years with less total government support, and greater needs for sound risk management strategies and decision-making.

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Table 2. Summarized Expected Alternative* Scenario ACRE Payments and Aggregated Payments

Expected Average Payments Per Acre						
Crop/Trigger	State 90%	District 90%	District 85%	District 80%	District 75%	District 70%
Corn Irrigated	\$7.44	\$8.46	\$3.76	\$1.36	\$0.46	\$0.14
Corn Dryland	3.68	6.18	3.77	2.36	1.52	0.95
Soybeans Irrigated	3.62	3.96	1.77	0.69	0.30	0.16
Soybeans Dryland	4.44	5.08	2.97	1.68	0.93	0.48
Winter Wheat	3.35	3.18	1.91	1.05	0.50	0.21
Expected Aggregated Payments						
Crop/Trigger	State 90%	District 90%	District 85%	District 80%	District 75%	District 70%
Corn Irrigated	\$39,047,772	\$44,394,642	\$19,711,294	\$7,113,282	\$2,399,754	\$721,476
Corn Dryland	12,891,992	21,632,362	13,208,829	8,265,157	5,312,672	3,313,696
Soybeans Irrigated	8,216,922	9,004,065	4,026,440	1,570,953	685,539	372,454
Soybeans Dryland	11,696,707	13,378,759	7,810,186	4,431,505	2,439,384	1,268,054
Winter Wheat	5,308,167	5,043,454	3,029,434	1,670,739	785,781	331,845
Total	\$77,161,560	\$93,453,282	\$47,786,183	\$23,051,637	\$11,623,130	\$6,007,524

* Alternative scenario simulation prices are two-year national marketing year average values on a per bushel basis for corn, soybeans and wheat of \$4.378, \$10.294 and \$5.621.