

HAVE FARMING RISKS CHANGED?

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Farm and ranch managers have been informed by many United States Department of Agriculture and university economists that they are now managing their crops in a riskier environment. This suggested change in risk level is attributed to the Federal Agriculture Improvement and Reform Act of 1996 (FAIR Act).

The FAIR Act did provide for substantial changes in the commodity program provisions that had prevailed under the same basic structure but with periodic and important modifications, since the Agriculture and Consumer Protection Act of 1973 was enacted.

Some commodity program provisions were introduced, and others retained and eliminated by the FAIR Act.

FAIR Act provisions Market transition payments for program crops are available to producers who signed production flexibility contracts during the prescribed 1996 sign up period. Market transition payments for the current 1998 crop year are \$0.65 per bushel for wheat and \$0.26 per bushel for barley. Payments will decline in future years. Scheduled payments will be \$0.45 per bushel for wheat and \$0.17 per bushel for barley in the 2002 crop year.

Producers eligible for market transition payments agreed to comply with conservation plans on highly erodible cropland, applicable wetland protection requirements, planting flexibility requirements, and to control weeds at a level equivalent to prior expectations for the management of set-aside acres. They must use their contract acreage for agricultural purposes.

Market transition payments are paid on farm payment yields, which are the same as each farm's ASCS (or more recently FSA) yields for each crop. These yields are the weighted average farm yields for the years 1981, 1982, 1983, 1984, and 1985 after eliminating the high and low year yields.

Market transition payments are paid on 85 percent of contract acres. Contract acres for the 1996 and subsequent crop years covered under the FAIR Act were calculated as the sum of the acreage planted and considered planted to a program crop for the years 1991, 1992, 1993, 1994, and 1995 divided by five. Producers receive no market transition payments on 15 percent of the contract acreage. Producers receive these payments irrespective of crop price levels. For instance, producers with wheat contract acreage and barley contract acreage will receive the associated market transition payments for these acres regardless of the prices of wheat and barley. Producers must comply with their prescribed conservation plans and production flexibility rules. Most crops can be grown on the farm, and producers may hay or graze the contract acreage if they choose. Fruits and vegetables, other than lentils, mung beans and dry peas, are prohibited on contract acreage.

Price supports (loan rate programs) were continued for program crops. Loan rates are set at the smaller of 85 percent of the simple average prices received by producers the previous five

years or the maximum loan rate. The maximum loan rates for wheat and barley are \$2.58 and \$1.55 per bushel, respectively. All loan commodity production on the farm is eligible for a loan. If a farm with 1,800 acres of wheat contract acreage harvests wheat from 2,000 acres, all production from the 2,000 acres of wheat would be eligible for a loan.

The FAIR Act also modified the rules relating to the eligibility of landlords and tenants to receive payments and the distribution of payments. Landlords must assume part of the risk (i.e., a crop-share lease) to be eligible to receive payments. Contract payments are to be shared between tenants and landlords on a fair and equitable basis. Distributions of payments are subject to review by the county-level FSA committees.

So what was eliminated from the commodity provisions of the FAIR Act? Target prices are gone, and as a consequence, deficiency payments were eliminated. Gone also are set-aside requirements. Furthermore, there is now no opportunity to increase contract acreage.

Previous program provisions Commodity programs from 1973 through 1995 operated for two major purposes. The first was to provide income transfers to producers. The second was to provide downside commodity price risk protection through loan rates.

The income transfer mechanism involved target prices, national average prices, crop acreage bases, and ASCS (more recently FSA) yields. Target prices were specified in the political processes that resulted in the successive farm bills becoming legislation.

The difference between the target price and the marketing year national average price for a commodity was the deficiency payment. A producer would receive a total deficiency payment that was the product of: (crop acreage base less set-aside) x (ASCS yield) x (per bushel deficiency payment). To be eligible the producer had to plant with the intent to harvest the subject crop on acreage less than or equal to the crop acreage base adjusted to satisfy set-aside requirements.

Historically a producer could build a crop acreage base for one program crop by staying out of the program and increasing the planted acreage for that crop (the base calculation was a five-year average of acres planted or acres that were considered planted such as set-aside acres). Concurrently the producer could receive a deficiency payment for another crop. Under provisions of the 1985 Food Security Act, however, producers were precluded from the receipt of any deficiency payments if they were building a base. In practice this provision precluded most producers from increasing their crop acreage bases after the 1985 crop year. The 1985 Act also removed any opportunity for producers to increase payment yields. ASCS yields were frozen as the weighted averages of the 1981 through 1985 yields after the high year and the low year yields were removed.

The 1990 Food, Agriculture and Trade Act reduced total deficiency payments by 15 percent by eliminating deficiency payments on the normal flex acres specified as 15 percent of each crop acreage base. Payment acres, at a maximum 85 percent of the base, could be further reduced through set-aside requirements. In addition, producers could choose to forego deficiency payments on an additional 10 percent of their subject crop contract acreage by choosing to plant

other crops on these acres.

Program changes and risk implications The FAIR Act did not change the basic climatic regime of the Northern Great Plains. Production risks associated with producing wheat and barley in this semi-arid region will continue.

Now producers will receive their income transfers from the USDA with complete certainty (excluding producers out of compliance). Per bushel market transition payments are scheduled and contract acreage and farm payment yields are fixed for the duration of the FAIR Act. Producers know prior to the crop year what their total market transition payments will be.

Under previous legislation deficiency payments were never known with certainty at planting unless the producer elected to ensure receipt of 85 percent or 92 percent of the expected deficiency payments through the 0/92 program which became the 0/85 program in later years. These were largely drought relief programs under which producers could be certain they received the expected deficiency payments but could not plant the program crops.

Deficiency payments were uncertain. Some observers considered the deficiency payment program to be an income protection plan without a premium. But did deficiency payments provide income protection? Consider a wheat producer in 1995 who faced an expected deficiency payment of \$0.70 per bushel prior to planting. The producer was in a drought area and harvested no crop. Because of strong world and domestic wheat prices, the national average marketing year U.S. price for wheat exceeded the \$4.00 per bushel target price. No actual deficiency payments were paid. This example illustrates that deficiency payments were not a form of no-premium insurance protection. Rather deficiency payments provided an income subsidy to program crop producers when the marketing year national average price was less than the target price, no matter what the price and quantity of the commodity sold by individual producers. These income subsidies were not known with certainty.

Under commodity program provisions prior to 1990 producers could plant their crop acreage bases less set-aside requirements to a subject crop, receive deficiency payments and be eligible for loans. Starting with the 1991 crop year, producers could plant normal flex acres and optional flex acres to other crops. But did they? Some producers in the Northern Great Plains planted some barley normal flex acres to wheat while most producers planted their wheat normal flex acres to wheat. They didn't make much use of their planting flexibility.

Under the FAIR Act producers have complete planting flexibility. Some suggest that producers will use this planting flexibility, and as a result, increase price volatility. It is not clear that this is the case. For example, 1996 acres planted to wheat in Montana were 21 percent greater than the average acres planted during the five previous years. However, in the same year acres planted to barley were the similar to the average of the three previous years.

In 1996 Montana wheat producers responded to strong cash prices for winter and spring wheat available at planting and also anticipated at harvest. They used their planting flexibility as spring wheat was planted on cropland that usually would have been fallowed. Producers expected

and many realized substantial net returns from these additional planted acres.

When output is able to respond to expected increases in prices, those price increases tend to be moderated by the production response. In 1996 this meant the immediate increase in planted wheat acres in the later-planted spring wheat areas, made possible by the planting flexibility provisions of the FAIR Act, limited the spike in wheat prices. Wheat prices currently expected for the 1998 crop production year are relatively low leading us to expect that less wheat will be produced than in 1996. Few producers will plant wheat on cropland that would otherwise be fallowed in 1998. Such planting decisions are likely to reduce the U.S. supply of wheat. This production response is likely to moderate any further decline in wheat prices.

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