PolicyPennings by Dr. Daryll E. Ray

ACR: Strong safety net when prices are high but snaps when prices fall

One of the new provisions in the Senate Agriculture Committee's version of the farm bill that will certainly generate some discussion is the Average Crop Revenue (ACR) program whose champion has been Midwest corn growers. In general the program focuses on revenue by guaranteeing producers that their per-acre revenue in a given year will not fall below a percentage (perhaps 90 percent but maybe as much as 100 percent) of the average per-acre revenue received in the previous three years. Producers of other crops are less enthusiastic about the program than corn growers.

Under the provisions now under discussion, farmers would be able to opt into ACR in 2010 for their base acres in exchange for reduced direct payments, the elimination of the Marketing Loan and Counter-Cyclical Payment (CCP) programs, and the switch from nonrecourse loans to recourse loans. It is expected that the program will result in reduced crop insurance rates that would offset a portion of the reduction in direct payments. Once in the program, farmers would be locked into ACR for the duration of the 2007 Farm Bill.

One of the results of the current high price levels for corn, wheat, and soybeans is that producers of these commodities are limited to receiving just their direct payments. Payments would have to fall below the target price—adjusted by the direct payments—for farmers to receive counter-cyclical payments. With the ACR program, these farmers could receive government payments any time per-acre revenue fell below the previous three year's average.

In addition, unlike current programs, ACR would protect farmers against reductions in yield in addition to price.

Given its protection against yield loss and the chance to get payments above the target price, ACR may sound pretty good. But to us it sounds like 1996 all over again.

Why could that be true? Because both Freedom to Farm in 1996 and ACR now are based on the expectation that prices are going to be very good for the foreseeable future and the chance that they would dive off a cliff is very small.

In the case of the 1996 Farm Bill, farmers and policymakers alike expected continuing high prices because of the "double E" disease—Export Exuberance. Prices were expected to remain high in response to booming export demand due to China's growing middle class that would switch to a diet with more corn-fed animal protein and less grains and seeds.

China did not become a net importer of corn and by 1998 corn prices had fallen to below $2.00. Farmers collected massive LDPs (Loan Deficiency Payments) and Congress responded with emergency payments.

In the case of the ACR, farmers and policymakers are expecting continuing high prices because of the "triple E" disease—Ethanol and Export Exuberance. With additional plants coming online, the demand for ethanol is projected to use 3.2 billion bushels of corn. As the result of production problems with feed grains in other countries, US exports are projected to use 2.35 billion bushels of corn. With 2007 crop year projected corn stocks to be at 2 billion bushels, let either of these—exports and ethanol—falter and we have a clear risk of a significant price decline.

How one views the safety net capability of ACR depends on whether—looking ahead—you are a price optimist or price pessimist.

Using corn as an example: If you are of the continuing "triple E" persuasion, you will prefer the ACR to the current program. Why? Because the yearly payment triggers will remain "high" and may increase over the years. That being the case, an occasional year when prices decline or yields falter could generate a generous payment.

If you are a "I-remember-what-happened-after-the-1996-Farm-Bill" person, you may be less enthusiastic about ACR. If prices plummet and stay depressed following successive years at "high" levels, the payments trigger decreases over time. The result would be payment levels that are "excellent" the first year, "good to fair" the second year, "poor" the third year and nonexistent after that. Thus, when revenue for the prior three years is poor, ACR offers little or no protection, just at the time when protection is needed the most.

Proponents of the ACR who assert that the program would provide corn farmers with a revenue floor that is 40 cents a bushel higher than the current counter-cyclical payment are correct—but only if the payment trigger is based on $3.00 per bushel or better corn prices and trendline yields.

On the other hand, if the price were to remain below $2.20 per bushel with trendline yields for three years, the revenue floor would be some 40 cents a bushel below the counter-cyclical payment. Senator Pat Roberts (R-Kan.), who as a Representative shepherded Freedom to Farm through Congress, looked at how ACR would have performed had it been put into place years ago. He says that in 7 of the last 9 crop years, ACR would have paid very little in contrast to the payments actually received by farmers.

Bottom Line: The ACR provides a relatively high income safety net if prices or yields drop from current levels for one year or so. If prices fall and remain low for a string of years, the ACR safety net is quickly lowered to ground level.

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