

AMTA vs. Counter-Cyclical Payments

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Introduction

The *Federal Agriculture Improvement and Reform Act of 1996 (FAIR)* contained several important changes to U.S. farm policy. Perhaps the most important was the replacement of deficiency payments, which made up the difference between the market price and a target price, with fixed, annual payments for producers of grains and upland cotton. The fixed payments, referred to as Agricultural Market Transition Assistance (AMTA) payments, were to serve as a transition to a lower level of government support for U.S. farmers. Hence, the authorized level of AMTA payments declined from \$5.6 billion in 1996 to \$4.0 billion in 2002.

AMTA payments are based on historical yields and acres of wheat, feedgrains, upland cotton, and rice. They are received whether or not a crop is planted, do not depend on what crop is planted (except that fruit and vegetable acres cannot increase), and are made regardless of the level of farm income. In theory, they are decoupled from a farmer's current production decisions.

Many observers believe AMTA payments should either be replaced or supplemented with

counter-cyclical payments that are high when farm income is low, and low or zero when income is high. The Commission on 21st Century Production Agriculture has endorsed such payments. In this paper, we discuss the counter-cyclical payment issue.

Background

Counter-cyclical payment schemes are not new, and they exist in current farm policy. The *Food Security Act of 1973* authorized counter-cyclical deficiency payments for wheat, feedgrains, upland cotton, and rice. They arrived whenever the U.S. average price was less than a policy-determined target price. Thus, deficiency payments were counter-cyclical with respect to price: the lower the price, the higher the payment.

FAIR eliminated target prices, but did not eliminate counter-cyclical payments based on price. Marketing loan payments and loan deficiency payments, hereafter referred to as LDPs, were authorized. They make up the difference between the market price (approximated by the posted county price or adjusted world price) and the loan rate for wheat, feedgrains, upland cotton, rice, and oilseeds. Loan rates are much lower than traditional target

prices, so LDPs are triggered by a much lower market price than were deficiency payments. Unlike deficiency payments, all production is eligible for LDPs. Thus, LDPs are not at all decoupled from production decisions.

Another farm policy, subsidized crop insurance, provides payments that are counter-cyclical with respect to yield or revenue, depending on the type of insurance bought by the farmer. Crop insurance payments increase as yield or revenue decreases.

The significant counter-cyclical payments provided by current U.S. farm policy are often not recognized. For crop year 1999, such payments totaled more than \$9 billion (\$8 billion of LDPs, plus \$1 billion in crop insurance indemnities, net of producer paid premiums.)

Key Parameters of Counter-Cyclical Revenue Programs

Depending on the decision made with respect to key policy parameters, a new counter-cyclical revenue program could take numerous forms. This section discusses these key parameters as broad concepts. For a discussion of the details of specific counter-cyclical proposals, see the paper, "Counter Cyclical Whole Farm Safety Nets," authored by Richardson, Klose, and Smith.

Counter-cyclical payments can be triggered by a change in gross revenue or by a change in net revenue, which subtracts production expenses from gross revenue. If net revenue is used, an important question becomes what should be included in the measure of expenses. Should only variable production expenses be used? Should a charge for capital be included? Should a charge for land be included? Thus, the definition of revenue on which a counter-cyclical payment is based becomes a key policy parameter.

A second key policy parameter is whether the trigger is national revenue or a more local revenue, such as at the farm or county level. A national trigger will cover low price situations because low prices affect all production. In contrast, low yields typically affect only a small part of the total production area, and low yields in one region typically are offset by high yields in another region.

Furthermore, if a yield shortfall affects all or most of a major production region, such as occurred in the Corn Belt in 1988, it is likely that significant price increases will accompany the yield decline, thus lowering the size of any counter-cyclical payment. In summary, a national counter-cyclical revenue program likely will cover only low price situations.

As noted in the previous paragraph, low yields in most years affect only a small part of the total production area. Thus, as the geographical area on which a counter-cyclical payment is based moves to a more local area, the cost to the federal treasury of a counter-cyclical revenue program increases because payouts will be triggered by both low yields and low prices. For example, Hart and Babcock estimate that a county trigger will be 2 to 10 times more expensive than a national trigger, depending on the percent of gross revenue at which a counter-cyclical payment is triggered.

A third key policy parameter is whether the revenue trigger is specific to an individual crop or if it includes revenue from multiple crops. Just as low yields in one region generally are offset by high yields in another region, so, too, can low revenue from one crop be offset by high revenue from another crop, particularly at the national level. Thus, a multiple-crop revenue trigger will result in lower program costs.

A fourth key policy parameter is the method used to determine the level of revenue that triggers a payment. Currently, guarantees for revenue insurance are based on projected prices (futures prices) as revealed by the market. One alternative is to follow this precedent and base counter-cyclical revenue payments on futures markets prices. However, such a program will not provide a high level of coverage when futures prices are low. A second alternative is to base counter-cyclical revenue payments on a moving average of past revenue over a pre-specified period of time. Tying revenue triggers to a historical moving average permits a more gradual adjustment of programs to changes in market conditions. A third alternative is to set revenue triggers via the political arena and not tie adjustments to changes in market conditions.

Policy Issues and Options

Given the interest in counter-cyclical payments, one policy option is to eliminate AMTA payments and use the money that is saved to increase marketing loan rates or to fund a new counter-cyclical revenue program. A second policy option is to replace the current marketing loan program with a new counter-cyclical revenue program while keeping the current AMTA program. A third policy option is to continue the status quo combination of AMTA payments, automatic LDP counter-cyclical payments, and ad hoc counter-cyclical assistance in years of low income. A fourth policy option is to increase the level of AMTA payments as a replacement for the current marketing loan program, or in place of a new counter-cyclical program.

The fourth option is not discussed much, but counter-cyclical payments, including LDPs, are tied to current production. Thus, they create incentives for farmers to expand or at least maintain farm output. This consequence suggests that questions of conformance with World Trade Organization agreements may need to be considered. This concern may push U.S. farm policy away from counter-cyclical payments.

The issue of counter-cyclical payments likely will be debated in terms of reducing the financial effects of low farm revenue. However, the amount and frequency of such payments will depend on the degree to which Congress and the general public wish to enhance farm income. This observation raises a policy issue as old as farm programs: should the primary objective of farm programs be to reduce risk or raise income?

AMTA payments increase average farm income, but do little to reduce income variability since they are fixed regardless of the farm sector's situation. Counter-cyclical payments reduce at least some income variability, but they also increase average farm income by raising farm income in low-income years. The higher the price or revenue level

at which a counter-cyclical payment is triggered, the more farm income is enhanced and the more costly the program will be for the federal government.

Movement toward a policy of counter-cyclical payments based on farm or county level revenue will raise questions of duplication with crop insurance. Because crop insurance requires producers to bear some of the cost of insurance, a no-cost counter-cyclical revenue program at the farm or county level likely will reduce the demand for crop insurance. A national counter-cyclical revenue program will leave room for current crop yield insurance programs, but it largely will duplicate LDP payments because both are triggered by low prices. Thus, movement toward a new national counter-cyclical revenue program will raise questions of duplication with the marketing loan program.

In addition to questions of overlap and duplication, the alternative policy options will result in different impacts by crop and region. For example, replacing AMTA and/or LDP payments with counter-cyclical revenue payments triggered by farm, county, or state revenue shortfalls will redistribute current farm income payments away from the primary crop production regions. This redistribution will be caused by two factors. First, the primary production regions typically have less yield variability than non-primary regions. Second, when yield shortfalls do hit the primary production regions, a corresponding increase in price is likely; thereby decreasing the size of counter-cyclical payments. Hence, farmers in primary U.S. crop production regions are likely to be wary of counter-cyclical revenue programs based at the farm, county, or state level. In short, discord among regions and commodity groups is likely in the forthcoming farm bill debate.

Last, counter-cyclical revenue payments provide insurance against systematic (i.e., sector-wide) risk caused by declines in price that are, in turn, caused by declines in domestic and/or foreign demand. Thus, counter-cyclical revenue payments, including LDPs, compete directly with futures and options markets. For example, why would a farmer purchase a price hedge on a crop if the government is providing a free hedge against prices below the loan rate?

In summary, if the agricultural policy process is serious about providing an effective and efficient

counter-cyclical program for 21st Century production agriculture, it needs to develop an integrated farm policy that coordinates price and income support programs with crop insurance, as well as futures and options markets.

References and Suggested Readings

- The Commission on 21st Century Production Agriculture. "Directions for Future Farm Policy: The Role of Government in Support of Production Agriculture." Report to the President and Congress. January 2001.
- Hart, Chad E. and Bruce A. Babcock. "Counter-Cyclical Agricultural Program Payments: Is It Time to Look at Revenue." Update of CARD Briefing Paper 99-BP 28. Iowa State University. January 2001.