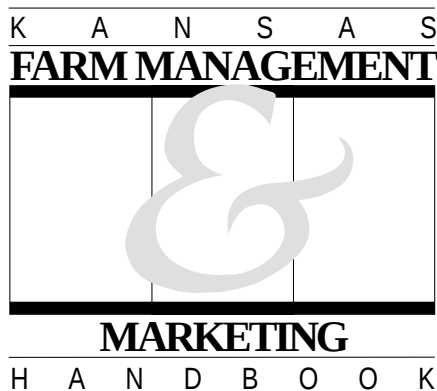




Farm Bill Options

Department of Agricultural Economics



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History Lesson

The 1996 FAIR Act (Federal Agricultural Improvement and Reform Act) expires the end of 2002. What is likely to happen after a spirited debate in 2002? What are the options?

First, a history lesson is in order to put the situation in perspective. The first farm program was a part of the Roosevelt New Deal passed in 1933 (the Agricultural Adjustment Act of 1933). It basically supported prices at 100 percent parity, which was a purchasing power rate indexed to 1910 through 1914 farm prices and expenses. The parity index today, of course, is grossly out-of-date since it ignores all the efficiency gains that have occurred since 1910-14.

Why did the bastions of free enterprise, the American farmer, seek government intervention into the marketplace on their behalf? An actual grain quotation from a South Dakota elevator in 1933 outlines the reasons: #1 yellow shelled corn 3¢ per bushel, #2 yellow shelled corn 2¢ per bushel and #3 yellow shelled corn 1¢ per bushel. Eared corn two cents less, which translates into minus 1¢ per bushel for #3 yellow eared corn. The Great Depression, which began on farms in the early twenties, shook the faith of farmers in the marketplace and the era of farm programs began. When debate began on the 1996 Farm Bill, 63 years of history of government intervention into the marketplace on behalf of farmers had occurred.

Historically, farm programs had four basic elements: land retirement, stored reserves, price supports and income supports. Familiar names come to mind: Soil Bank, CRP, ever normal grainery, farmer-owned-reserve, nonrecourse loan programs, marketing loan, target prices and deficiency payments tied to production controls. With 63 years of history of farming the government, the American farmer became quite proficient at it.

The results of the 63 years of history are clear:

1. The benefits of farm programs have been capitalized into land values.
2. The pain of adjustment to new technology was decreased.

3. The movement off the farm was slowed from what it otherwise would have been.

Traditional farm programs worked in a domestic economy, but high price supports and massive land retirement priced the United States out of world markets and encouraged increased production overseas. This backfired as U.S. agriculture became more and more global. Today, no major sector of the U.S. economy is more export dependent than agriculture. The American farmer idled land, farmed the rest less efficiently, put grain in storage and watched the rest of the world increase production and gain market shares. That's the history lesson to 1996.

1995 through 1996

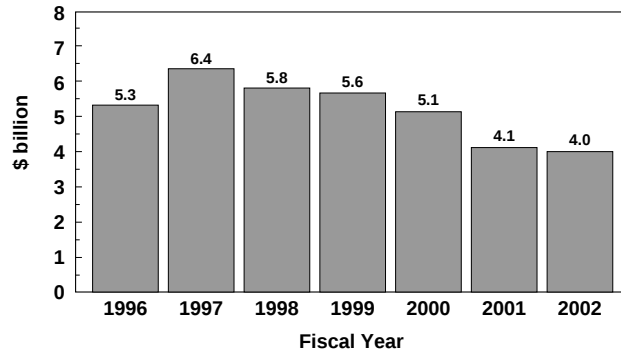
In 1995 through 96, four factors came together to make them watershed years for agricultural policy and 63 years of history was tossed to the winds: huge budget deficits plagued the U.S. government and agriculture had to shoulder its share of budget cuts; program commodity prices were relatively high; the control of Congress changed hands after 40 years of one-party rule and the Kansas connection, i.e. three key players on the Washington scene came from Kansas - Senate Majority Leader Bob Dole, House Agriculture Committee Chair Pat Roberts and Agriculture Secretary Dan Glickman. Thus, Freedom to Farm, a complete overhaul of U. S. agriculture policy, was passed. Myth has it that Freedom to Farm was a Republican farm bill (historically, farm bills have been bipartisan). That argument can be made, but Secretary Glickman supported it and President Clinton signed it.

Freedom to Farm (1996 FAIR Act)

The major difference between Freedom to Farm and previous farm bills is that payments to farmers are no longer coupled to market prices and specific production decisions. Figure 1 lists the total dollars authorized for farm transition payments from 1966 through 2002. Total expenditures for Freedom to Farm decline from \$6.4 billion in 1997 to \$4

Table 1. 1996 FAIR Act Authorized Per Bushel Payments

Fiscal Year	1996	1997	1998	1999	2000	2001	2002
Wheat	\$0.87	\$0.64	\$0.68	\$0.65	\$0.59	\$0.47	\$0.46
Corn	\$0.24	\$0.52	\$0.41	\$0.39	\$0.36	\$0.29	\$0.28
Sorghum	\$0.31	\$0.53	\$0.46	\$0.44	\$0.40	\$0.32	\$0.31

Figure 1. 1996 FAIR Act Authorized Payments

billion in 2002 Table 1 lists the authorized per bushel payments, which shows wheat payments declining from 87¢ to 46¢ and corn payments from 52¢ to 28¢. This schedule was authorized with the passage of 1996 FAIR Act.

Decoupling (Freedom to Farm) transfers the price risk to the farmer. Payments are fixed and not tied to price. Therefore, risk management has increased many fold in importance to the success of a farmer's bottom line. Since the government no longer manages the price risk, success in agriculture requires the development of risk management strategies. There is a multitude of risk management tools available such as futures and options, forward contracting, crop insurance, revenue insurance, diversification (change in crop mix), cost analysis enterprise by enterprise and nonfarm investment. The program has changed such that the American farmer now has the flexibility to farm the marketplace rather than the government program.

Freedom to Farm expires in 2002. There will be \$4 billion in the budget in 2002. Under current budget procedures, this carries over as the baseline from which appropriations are debated for 2003. Thus, the question in the debate on the 2002 Farm Bill is what to do with \$4 billion? The widely held myth that farm programs end in 2002 is just simply wrong. As is the widely held myth that there is no longer a safety net under farm income. The authorized schedule provides for \$36.3 billion of direct Freedom to Farm payments from 1996 through 2002. That is a safety net. The difference is it is fixed and decoupled from market price and what a farmer produces.

Options

Continue Freedom to Farm (status quo). Set up a new schedule of fixed payments. Flexibility is popular and the crop mix is changing more rapidly under Freedom to Farm than it otherwise would have under previous farm bills. Generally, there is less wheat and cotton production and more feed grains, oilseeds and alfalfa. That's what the marketplace is indicating. For example, in 1998, we had 900,000 fewer wheat acres in Kansas and 500,000 more canola acres in North Dakota. Farm income was excellent in 1996 and 1997 and the new approach to farm programs bask in that popularity. In 1998 however, farm income

dropped significantly due to supply and demand fundamentals. The Asian crisis hit and world demand softened. Relatively good weather worldwide increased supplies and so, prices dropped. Congress and the administration reacted and added \$3 billion to the Freedom to Farm payments and another \$3 billion for disaster relief. In addition, the marketing loan kicked in with loan deficiency payments. Another infusion of cash will be necessary in 1999 to avoid a cash flow problem in U.S. agriculture and to prevent a financial crisis until the world economy improves.

The key to success of this new approach is risk management and expanding trade. During the debate on the 1996 FAIR Act, offsetting government payments with trade expansion was clearly viewed as the essential question. How much can exports replace government payments? In 1996, agricultural exports totaled \$60 billion. They dropped \$6 billion in 1998. Trade expansion is essential for Freedom to Farm to work. Yet, almost immediately after passage, the United States embarked on a series of trade retraction policies: no fast track for negotiations, insufficient funds for IMF (International Monetary Fund), no permanent normal trade relations with Peoples of Republic of China and imposition of sanctions (another name for embargoes). Trade policy gets interwoven with foreign policy including human rights, even though scant evidence exists to show that sanctions change behavior in foreign governments. The U.S. wheat farmer has been shut out of Iran, Iraq, Cuba, North Korea, Pakistan and India. Our success in being the moral policeman of the world has failed. Trade ties countries together and produces more civil relations. An interesting question, if the U.S. had not refused to trade with Cuba, would Castro still be in power?

Recouple payments to price and/or production (go back to the old program). The government will then assist in managing price risk; providing protection in low price years and no payments in high price years. Those involved in U.S. agriculture have a price, price, price mentality when it's possible to have lower income in high price years with no farm program payment. Yields and price are obviously correlated. Low yield, high price can equal low income. High yield, low price can equal high income. Recoupled payments are likely to be available when agriculture may not need them and not available when agriculture does need them. Price and yield changes do not always offset each other.

Under this option, Congress loses control of expenditures because producers are entitled to a payment tied to price. \$4 billion will be insufficient in some years. Recoupling to production loses the flexibility to farm the marketplace and reverts back to farming the government. Clearly, this option provides for a more stable protected income for farmers, but at the "expense" of marketplace dynamics.

Revenue insurance. Crop insurance has long been a tool for managing risk, but it is the bottom line which

determines survival and prosperity. Revenue insurance insures the combination of price and yield. If yield or price is high enough (while the other is low) to meet the selection level, no payment is made, but the bottom line is insured. The 1996 FAIR Act does not contain provisions capable of handling weather disasters and disease problems especially if isolated in geographic regions. Revenue insurance investments are available, but not nationwide and across all commodities. The risk pool has been rather narrowly defined and not nationwide in scope. The question, "Will \$4 billion in 2003 be sufficient to replace commodity programs with subsidized revenue insurance with attractive enough premiums to obtain farmer participation?"

Increase loan rates (traditional nonrecourse program and/or marketing loans). This option will bring increased income in the short run, but what about the long run. Currently, loan rates are capped rather than the traditional five year moving average tied to price. Under this option, grain may end up in storage rather than moved out into the marketplace. Stored grain hangs over the marketplace and depresses prices. Also under this option, the Congress loses budget control and \$4 billion may be insufficient to operate the program. The old traditional nonrecourse program with loan prices higher than world prices simply means our competitors "steal" the market, while our grain ends up in government storage. The marketing loan, however, is designed to correct that through the use of a loan deficiency payment rather than forfeiting of the commodity to the government.

Countercyclical income payments. Freedom to Farm was not equipped to handle the severe downturn in the Asian economy and thus, a cash infusion was needed. A countercyclical approach would formalize the process rather than depend on ad hoc appropriations from the Congress. For example, an aggregate U.S. farm income standard could be established. If income fell below that standard, the decoupled payments would be increased accordingly. Payments would remain decoupled from price and production, but would be coupled to an income index.

Farm savings account. The theory behind Freedom to Farm was that farmers would save the decoupled payments

in high income years for use in low income years. This option would formalize the process. (Canada operates a similar program to this approach). Farmers would commit funds to the account which could be withdrawn in low income years. Their funds would draw interest and could be taxed deferred. The government could also add to the farmers contribution which could serve as an income supplement.

1949 Agriculture Act (which kicks in when the 1996 Act expires in 2002). The 1949 Act is the last permanent farm bill that was passed. The 1996 Act simply amends the 1949 Act. The 1949 Act includes: high price supports and referenda on mandatory production controls. It would take the completely opposite approach to current policy. It would work in a domestic market, but it plays right into the hands of our foreign competitors.

Repeal the 1949 Act (required to eliminate farm programs). The \$4 billion in the baseline could be spent on other agricultural projects (like research/education and export enhancement) rather than commodity programs or it could be returned to the U.S. Treasury. U.S. agriculture would operate in an open market with the establishment of rules and regulations as the only government intervention. Theoretically, this will bring more instability, but has the government managed farm programs over the years precisely enough to have actually produced less instability than would occur in open market? The evidence suggests it hasn't. Of course, the success of the open marketplace for U.S. farmers depends heavily on our competitors developing market-oriented policy in cooperation with us.

Summary

What will determine the outcome of the debate over the 2002 Farm Bill? Farm bills reflect the tenor of the times. It depends on the agricultural economy in 2002 and who controls the Congress and the White House.

One possible scenario: farm income is likely to recover at least partially by 2001-02. Therefore, a combination of options could be put in place. A countercyclical income payment to provide a safety net. Revenue insurance to provide a risk management tool and a farm savings account to provide longer term stability. Of course, there is always the possibility the Congress could re-open the farm bill prior to 2002

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