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Farm Bill Options

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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 2001 and 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 The parity index today, of course, is grossly out-of-date since it ignores all the efficiency gains that have occurred since 1910-14.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 bastion 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 '20s, 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 granary, 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 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 the 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,

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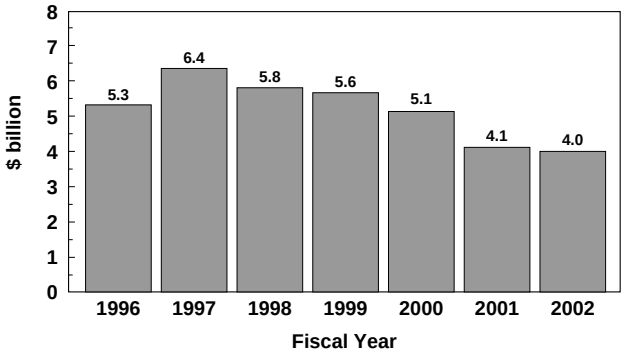
Figure 1. *1996 FAIR Act Authorized Payments*



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. Under budget procedures, expenditures in the current year become the baseline for the next. The widely held myth that farm programs end in 2002 is simply wrong, as is the 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 then it otherwise would have under previous farm bills. Generally, there is less wheat production and more oilseeds and alfalfa. That is what the marketplace indicates. Farm income was excellent in 1996 and 1997, and the new approach to farm programs basked 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 prices dropped. Congress and the administration reacted and appropriated billions in emergency assistance in 1998, 1999, 2000, and 2001 (see Figure 2). In addition, the marketing loan kicked in with loan deficiency payment, resulting in the prevention of a financial crisis similar to the 1980s.

The key to success of continuing this approach is managing risk 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 to $49 billion in 1999 and rebounded to $53.5 billion in 2001. 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 authority for negotiations, insufficient funds for IMF (International Monetary Fund), no permanent normal trade relations with People's Republic of China (Congress passed PNTR with China in 2000), 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, and North Korea. 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? Decoupled payments fit in the "green" box under WTO rules, i.e. no limit. However, the marketing loan benefit are in the "amber" box, which is subject to WTO limits.

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 is 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. In some years, authorized expenditures will be insufficient. 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 safety net for farmers, but at the "expense" of marketplace dynamics. Coupled payments fit in the amber box under WTO rules, i.e. subject to monetary limits.

Revenue insurance. Crop insurance has long been a tool for managing risk, but the bottom line 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 funds be available 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

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

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income in the short run. Currently, loan rates are capped rather than the traditional 5-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 authorized funds 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 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 target could be established. If income fell below that target, the partially decoupled payments would be increased accordingly. Payments would remain decoupled from price and production, but would be coupled to an income index. If the income target is fixed, WTO "green" box status is a possibility.

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 also could add to the farmer's contribution, which could serve as an income supplement. Savings accounts are likely to be WTO "green" box.

Conservation programs. Renewed interest is occurring in conservation programs like CRP and EQIP. A new term has entered the lexicon – conservation security. The debate is likely to center around the question of new funding for conservation or reallocating funds from commodity programs to conservation programs. Such programs are WTO "green" box.

1949 Agriculture Act (which kicks in when the 1996 Act expires in 2002). The 1949 Act was the last permanent farm bill to be 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 an 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 budget baseline funds could be spent on other agricultural projects (such as 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 has not. 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.

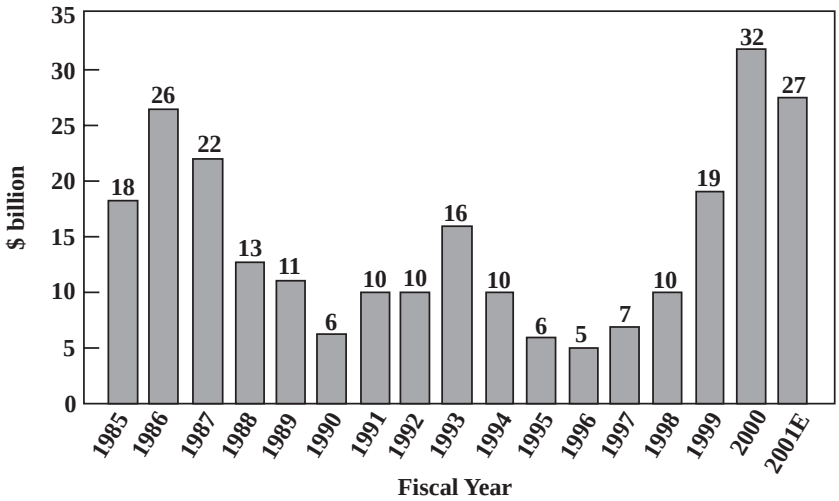
Summary

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 is in power in Washington.

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, conservation to broaden the of support for a farm bill, and a farm savings account to provide longer term stability.

Additional issues likely to surface include: (1) payment limitations and targeting payments to small and medium-size farm operations, (2) agro terrorism, (3) fund availability with a weakening economy and the war against terrorism, and (4) realignment of loan rates between commodities to more accurately reflect market conditions. Perhaps the only sure thing is continuation of planting flexibility. Of course, the possibility exists that a new farm bill could pass prior to the expiration of the 1996 Act.

Figure 2. *USDA CCC Program Net Outlays Fiscal Years 1985 to 2001*



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