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Farm Bill Options

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The 1996 FAIR Act (Federal Agricultural Improvement and Reform Act) is scheduled to expire at the end of 2002. What are the options that will be debated in 2002, or perhaps even before that if low and volatile prices continue?

Historical Perspective

History may help to put the situation in perspective. The first farm program, as we understand that term today, was part of the Roosevelt New Deal passed in 1933 (the Agricultural Adjustment Act of 1933). It supported prices at a 100 percent parity, which was a purchasing power rate indexed to 1910-14 farm prices and expenses. The parity index today, of course, is grossly out-of-date because it ignores all the productivity gains that have occurred since 1910-14.

Why did independent American farmers seek government intervention in the marketplace on their behalf? An actual grain quotation from a South Dakota elevator in 1933 explains it: "#1 yellow shelled corn 3¢/bushel, #2 yellow shelled corn 2¢/bushel, #3 yellow shelled corn 1¢/bushel, and eared corn two cents less" (which translates into minus 1¢/bushel for #3 yellow eared corn). The Great Depression, which began in the agricultural sector in the Twenties, shook the faith of farmers in the marketplace and the era of farm programs began. When debate began on the 1996 Farm Bill, we had 63 years of experience with government intervention into the marketplace on behalf of farmers.

The results of farm programs are:

- Farm prices and/or incomes likely have been higher than they would have been without these programs.
- The benefits of farm programs have been capitalized into land prices.
- The pain of adjustment to new technology was decreased.
- The movement off the farm was slowed.
- The inherent instability of agriculture was reduced.

Historically, farm programs have had four basic elements: (1) land retirement; (2) stored reserves; (3) price supports; and (4) income supports. Familiar names come to mind: Soil Bank, CRP, ever normal grainery, farmer-owned-reserve, non-recourse loan programs, marketing loan, target prices and deficiency payments tied to production controls.

Traditional farm programs worked in a closed domestic economy, but high price supports and massive land retirement priced the United States out of world markets and encouraged increased production overseas. As U.S. agriculture became more global, policies were adjusted to take advantage of increased world trade. Today, no major sector of the U.S. economy is more dependent on exports than agriculture.

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Freedom to Farm Bill (1996 Farm Bill)

Four factors came together to make 1995-96 watershed years for agricultural policy:

- Huge budget deficits plagued the U.S. government and agriculture was increasingly expected to shoulder its share of budget cuts.
- Farmers and other agribusinesses wanted to be able to plant for the marketplace at full production levels.
- Program commodity prices were relatively high because of low stocks and global demand. Many advisors to the leadership falsely projected that global demand would exceed the world's production capability. Therefore, the relatively high prices in 1995-96 were interpreted as the projected norm for the future.
- The control of Congress changed hands, with the new leadership of farm policy in the hands of three Kansans—Senate Majority Leader Bob Dole, House Agriculture Committee Chair Pat Roberts, and Agriculture Secretary Dan Glickman.

The interaction of these factors led to the passage of the 1996 Farm Bill.

The major difference between Freedom to Farm and previous farm bills is that payments to farmers are no longer directly coupled to market prices and what a farmer produces. Figure 1 indicates the total dollars authorized for production flexibility contract payments from 1966-2002.

Table 1 indicates the authorized per bushel payments for wheat, corn and sorghum from 1996 to 2002. Total authorized expenditures decline from $6.4 billion in 1997 to $4 billion in 2002.

Authorized is the key word. Expenditures were authorized, but not appropriated by the passage of Freedom to Farm. The House and Senate Appropriations Committees have jurisdiction over expenditures, rather than the agricultural committees. No Congress can commit a future Congress to expenditures (unless the program is an entitlement, and even then the entitlement formula can be changed). Thus, the scheduled payments indicated in Figure 1 and Table 1 are subject to annual appropriation. Congress can increase or decrease the payment schedules. For example, in periods of low prices, Congress could add to the transition payments as they did in the 1998 appropriations. However, unlike past programs, these contract payments do not automatically increase when prices decline.

Decoupling (Freedom to Farm) transfers the price risk to the farmer. Payments are fixed and not tied to production or price. Therefore, risk management has become a determinant of farmers' success. There are many risk management tools available: futures and options, forward contracting, crop insurance, revenue insurance, diversification (change in crop mix), cost analysis enterprise by enterprise, and non-farm investment, to name a few. Knowledge of these tools is crucial to farmers' success in the new global environment, regardless of what government policy is in effect.

Figure 1. 1996 Fair Act authorized payments.

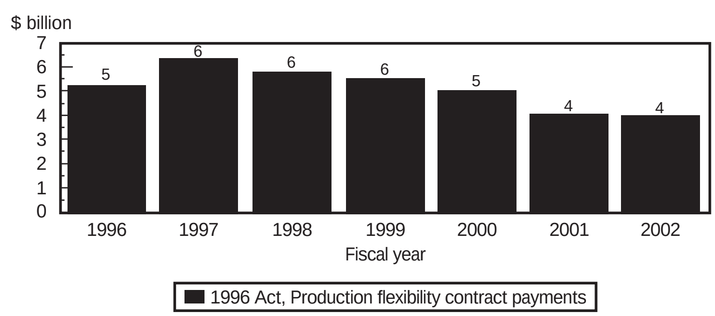

Table 1. 1996 FAIR ACT authorized per bushel payments.

Fiscal Year	1996	1997	1998	1999	2000	2001	2002
Wheat	$.87	$.64	$.68	$.65	$.59	$.47	$.46
Corn	$.24	$.52	$.41	$.39	$.36	$.29	$.28
Sorghum	$.31	$.53	$.46	$.44	$.40	$.32	$.31

Freedom to Farm expires in 2002. If the Congress continues to appropriate according to the authorized schedule, there will be $4 billion in the budget in 2002. Under current budget procedures, this will carry over as the baseline from which appropriations are debated for 2003. Thus, the question in the debate on the 2002 Farm Bill will be what to do with $4 billion?

Options

1. **Continue Freedom to Farm.** Flexibility is popular and the crop mix is changing more rapidly under Freedom to Farm than it otherwise would have. Generally, farmers are producing less wheat, cotton and rice and more feed grains, oilseeds and alfalfa. That is what the marketplace is indicating they should do. For example, in 1998 there were 900,000 fewer wheat acres in Kansas and 500,000 more canola acres in North Dakota. In 1996-97, high farm prices and decoupled payments were favorable for farmers. The real test involves whether Freedom to Farm can survive the Asian downturn, a slowly transitioning Eastern Europe and former Soviet Union, and concerns in South America.

   Can Freedom to Farm survive politically with declining prices and declining payments, or will the payments be increased to partially offset low prices? The key to success of this new approach is risk management and expanding trade. During the debate on the 1996 Farm Bill, offsetting government payments with trade expansion was clearly viewed as the preferred strategy. How much can exports replace government payments? In 1997, agricultural exports totaled $57.4 billion. They dropped by an estimated $3.7 billion in 1998. Trade expansion is essential for Freedom to Farm to work.

   The economic recovery in the former Soviet Union and the Southeast Asian crisis are not the only factors that have reduced U.S. exports. Production was higher in Europe, which is now under the pressure of substantial government-held surpluses as the U.S. was under former price support policies. The U.S. foreign policy environment has not been as favorable to trade, with no fast-track negotiating authority for the president, a lack of timely U.S. support for the International Monetary Fund (IMF), the lack of permanent normal trade relations with China, and the continued use of trade sanctions against countries such as Cuba, Iran, Iraq, North Korea, Pakistan and India.

2. **Recouple payments to price and production.** This option involves reinstituting the old program with target prices, base acres, deficiency payments tied to planting within base acreage, and the non-recourse loan. The government would then assist with managing price risk by providing protection in low price years and making no payments in high price years. Under this option, Congress would lose some control of expenditures because producers would be entitled to a payment tied to price. With a good crop around the world and/or adverse economic conditions in major demand centers, $4 billion would not satisfy the needs and/or political demands of farmers. With below average global production and improved economic conditions worldwide, the $4 billion would exceed program demands.

   Recoupling payments to production would reduce the flexibility of farmers to plan on the basis of the marketplace. This option would give farmers more stable income, but at the expense of marketplace dynamics.

3. **Recouple payments to price.** This option involves raising the loan rate while keeping the marketing loan with the current interpretation of loan deficiency payments. It could be instituted with or without contract payments. Compared to the 1996 Farm Bill, the main consequences of this option would be more price variability (greater price risk), more variable and less predictable government expenditures, and less production response to market forces.

4. **Increase loan rates.** This option retains the non-recourse loan, does away with the marketing loan, and raises the loan rate. Currently, loan rates are capped. Removing the cap would increase the wheat loan rate from $2.58/bushel to approximately $3.21. Under this option, grain may end up in government storage rather than being moved into the marketplace. In the short run the storage decision may be under the

farmer's control, but once forfeited it falls under the control of the Commodity Credit Corporation (CCC). Government-stored grain hangs over the marketplace and tends to keep prices at or near the non-recourse loan rate floor. Also under this option, the Congress loses budget control and $4 billion might be insufficient to operate the program. High non-recourse loan rates tend to keep U.S. prices above world market prices, thus giving our competitors an advantage in global markets while our grain ends up in government storage.

5. **Revenue protection.** This option involves providing a combination of price and yield coverage as a whole farm revenue protection policy. Yield insurance has long been a tool for managing risk. The 1996 Farm Bill can not handle weather disasters and disease problems, especially if isolated in geographic regions in combination with low farm prices. Revenue protection instruments are being piloted but are not available nationwide or for all crops and livestock. One question involves the level of subsidy needed to make revenue protection cost effective and politically acceptable. This is a particularly vexing issue in areas and commodities where weather and biological risks are high.

6. **1949 Agriculture Act.** The 1949 Act is the last permanent farm bill that was passed. The 1996 Bill simply amends the 1949 Act. The 1949 Act includes: (1) high price supports and (2) referenda on mandatory production controls. It would take the completely opposite approach to current policy. It could work in a domestic market, but it plays right into the hands of our foreign competitors. This option would become a law if a farm bill is not enacted in 2002.

7. **Repeal the 1949 Act.** To eliminate farm programs, the 1949 Act would need to be repealed. The $4 billion in the baseline could then be spent on other agricultural projects (such as research, education and export enhancement) rather than commodity programs, or it could be returned to the Treasury. U.S. agriculture would operate in an open market with the establishment of commercial market rules and regulations as the only government intervention. Instability would increase, at least in the short term, as agriculture was restructured geographically and to larger farms. 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, and on farmers' ability to successfully manage risk with conventional tools.

Summary

Today's basic farm policy issue is the nature and level of the safety net needed to protect farmers from economic, political and natural disasters affecting their operations. Farm bills reflect the tenor of the times, and depend on the agricultural economy and who controls the Congress and the White House.

If the world and farm economies recover in the next year, Freedom to Farm may not be changed. Revenue protection, however, will get a close evaluation. If lower income years continue, there will be a strong push to recouple.

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