

WHY THE 2007 FARM BILL WILL BE DIFFERENT

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History suggests that, at this stage in the farm bill debate, the best forecast is that the 2007 Farm Bill will be a slightly modified version of the current (2002) Farm Bill. In my opinion, this forecast is not likely to hold. The reason is the emergence of three largely new principles that will impact this farm bill. Principles are the themes around which policy legislation is organized. The three principles are: (1) inclusion of insurance in the farm bill debate, (2) fairness to landowners, and (3) management of World Trade Organization (WTO) boxes. These principles and their (important) implications are discussed.

INSURANCE INCLUSION: Commonly-stated objectives of farm policy are to support farm income and help manage farm risk. However, insurance, the main risk management instrument, largely has been addressed in separate legislation. Debate over the 2007 Farm Bill will incorporate insurance in a substantive manner for two reasons. First, the 2007 Farm Bill will be the first one in which annual spending on farm insurance programs consistently exceeds \$1 billion per year. In fact, since 2000, spending on farm insurance programs has averaged \$2.3 billion per year. Spending of this magnitude means the program can no longer be sidestepped in farm policy spending decisions. Second, risk management has emerged as a key topic in early discussions, with several groups arguing that this objective should be the primary reason for farm programs.

Implications

- ◆ The role of a powerful lobby is being expanded compared with its involvement in past farm bills.
- ◆ Alternations to existing policy that reduce the role of farm insurance will meet with stiff resistance.
- ◆ Policies options that create synergies between risk management and income support policies will have significant political momentum by generating support from both lobbies.
- ◆ CAVEAT: changes in the portfolio of important actors change the dynamics of policy formation in ways that are difficult to foresee.

LANDOWNER FAIRNESS: Farm bills focus on farmers. Landowners are the invisible partner. When spending on farm income and risk management programs increases, both landowners and farm operators benefit --- landowners through higher land prices and land rents; farm operators through help in managing risk and higher cash flow, at least in the short term. In contrast, when spending on farm programs decreases, landowners are hurt by declining land prices and land rents but farm operators may or may not be hurt because their benefit from paying lower rents may offset other losses.

Implications

- ◆ Farm operators and landowners are political bedfellows when spending on farm programs increases. However, when spending decreases, they can become adversaries.
- ◆ When spending decreases, fairness dictates that this question be asked: "Should the remaining funds be targeted to aid those hurt by the cuts?" In short, if farm program payments are cut, should the remaining payment funds be reconfigured to aid landowners instead of farm operators?
- ◆ The buyout of farm program payments currently is receiving lots of attention. Buyouts already exist for peanut marketing quotas and tobacco production quotas. When implementing a buyout, fairness dictates that buyout payments should be apportioned among recipients according to their share of the damage incurred from reducing or ending a program. Because farm supports are capitalized partly into land prices, landowners should receive part of any buyout. The only question is their share. As an example, the tobacco quota buyout is split 70% for quota owners; 30% for tobacco farm operators.

BOX MANAGEMENT: The 1996 and 2002 farm bills were negotiated with an eye toward compliance with World Trade Organization (WTO) rules. However, WTO's impact on the 2007 Farm Bill will be far greater. Key reasons are the increased spending on farm programs contained in the 2002 Farm Bill and ever-increasing yields. Understanding WTO's constraint on U.S. farm programs requires understanding

the different boxes (degree of trade distortion), different categories (product vs. non-product specific support), and a concept known as *de minimis*.

WTO boxes are color coded. The green box contains programs that minimally distort trade. They include environmental protection and regional development programs, as well as income payments decoupled from (i.e., not related to) current production levels or prices (for example, U.S. direct income payments). The amber box contains programs that distort production and thus trade. The blue box contains programs that distort production (trade) but require farmers to limit production. Production distorting programs include programs that increase price above market equilibrium, such as U.S. sugar and dairy programs, as well as U.S. loan deficiency and counter-cyclical payments.

Support can be non-product specific or product specific. Non-product specific programs are programs for which a producer can qualify without producing a specific crop. Examples are crop insurance and market loss payments. Product specific programs are tied to the production of a specific commodity. Loan deficiency payments are product specific because, for example, receiving a loan deficiency payment for corn depends on producing corn.

De minimis is the level of support that can be provided before support must be counted in the amber box. There are two *de minimis* limits: one for individual commodities and one for overall non-product specific support. The current *de minimis* level is 5% of the value of the product produced in a country in a year. For example, value of the 2003 U.S. soybean crop was \$18 billion. Thus, if support for soybean in 2003 is less than \$0.9 billion, it is not counted in the amber box. The *de minimis* non-product specific level of support is currently 5% of the value of all farm products produced in a country. Once support exceeds the *de minimis* level, all support counts in the amber box.

Probable Present U.S. Classification of Major U.S. Farm Programs under the Current WTO

Program	Box	Product/Non-Product Specific
Loan Deficiency Payments	Amber	Product Specific
Dairy Milk Income Loss Payments	Amber	Product Specific
Price Support Program (milk/sugar)	Amber	Product Specific
Crop Insurance	Amber	Non-Product Specific
Ad Hoc Disaster Assistance	Amber (usually)	Non-Product Specific (usually)
Counter-Cyclical Payments	Amber	Non-Product Specific (??)
Direct (Fixed) (Decoupled) Payments	Green	Does Not Apply
Conservation Payments (CRP, EQIP, FSA, etc.)	Green	Does Not Apply

Uncertainty surrounds classification of counter-cyclical payments. The U.S. has never classified them because we have submitted classifications to WTO only through 2001. Counter-cyclical payments are made regardless of the crop produced. From this perspective, its classification parallels market loss assistance, which was classified as non-product specific amber box. However, many experts consider it likely that the U.S. would lose a challenge to this classification because counter-cyclical payment is tied to price of a specific crop. Under this scenario, they would become product specific amber box.

My best interpretation of the current and proposed WTO box parameters is presented in the table on the next page. It appears to me that a deal can be completed in the current Doha WTO round, assuming the U.S. gains adequate access to agricultural markets in other countries and the European Union gains adequate access to manufacturing markets in other countries. Both assumptions are major unknowns at present. Under either the U.S. or E.U. proposal, U.S. farm policy makers will face the need to reduce U.S. amber box spending by a minimum of one third. The cut in amber box support could double if the U.S. exceeds the *de minimis* value in the non-product specific box (currently since we do not exceed the *de minimis* value of the non-product specific category, none of it counts in the amber box).

But, what if the Doha negotiations collapse? I look for immediate challenges to U.S. ethanol subsidies and soybean program, then a continuing series of challenges. The latter include classifying counter-cyclical payments as non-product specific (if the U.S. so chooses) and classifying crop insurance as non-product specific amber box (reason is that indemnities consistently vary by crop). In short, if Doha collapses, U.S. farm programs will be constantly challenged through WTO. And, the U.S. position seems tenable on many potential challenges. Thus, WTO compliance will constrain U.S. farm policy irrespective of what happens in Doha, although the impact will be more immediate if Doha ends successfully.

Comparison of Current Status and U.S. and E.U. Proposals, U.S. Farm Programs by WTO Category

Category	Current Limit	U.S. Level 2004	U.S. Proposal	E.U. Proposal
Amber Box Product Specific <i>De Minimis</i> Value	\$19.1 Bil. 5%	~\$12 Bil. -----	\$7.6 Bil. 2.5%	\$5.7 1.0%
Amber Box Non-Product Specific	\$12.1	~\$5 Bil.	\$6.0	\$2.4
Blue Box	No Cap	\$0	2.5% Cap	5% Cap
Green Box (fixed payment + conservation programs)	No Cap	\$8.6	No Cap	No Cap

Implications

- ◆ Box management will drive the next farm bill; no other driver is likely to come close in importance.
- ◆ If Doha concludes successfully, it is inappropriate to argue that Congress will not write the next farm bill, but it is plausible to argue that the Administration successfully parameterized the bill.
- ◆ Box management will trump efficiency and fairness considerations. For example, a current proposal is to combine loan deficiency and counter-cyclical payments into a single program (based on price or crop receipt (price time yield)). This proposal makes sense in terms of economic efficiency, but has little chance of being adopted as long as the two programs are classified in different categories. To combine them is to risk reducing total support.
- ◆ Measurement of trade distortion for individual commodities needs revised. The U.S. currently has 36 million acres in the Conservation Reserve Program (CRP), including acres in the general, continuous, and wetland CRP. A 2004 study by the U.S. Department of Agriculture (USDA) estimated that, assuming 50% of CRP general acreage in 2002 returned to production, U.S. farm income would decrease in net by \$4.5 billion in the short run as increased production leads to lower prices (Sullivan, *et al*, 2004). This amount is over one third of U.S. amber box support in 2004. In essence, the production reduction impact of general CRP offsets some of the production expansion aspects of farm income support programs. CRP land can be assigned to specific crops either based on its cropping pattern prior to entering CRP or based on the likely use of the land should it come out of CRP. The figure on page 5 contains USDA's allocation of CRP acres by crop in its long range projections released in early 2005. The acreage allocated to the crops are large enough to offset some, even a non-trivial part, of amber box support, especially for wheat, corn, and soybeans. In short, trade distortion for a particular crop needs to take into account the production reduction impacts of conservation programs when calculating support to individual crops.
- ◆ Currently, WTO blue box programs must restrict production (they also must be based on fixed areas and yields or on 85% or less of the base level of production). The U.S. is proposing to redefine the blue box to remove the production restriction requirement. However, acceptance of this proposal is problematic because it makes the blue box and amber box nearly identical. If the blue box stays as it is and the amber box either stays as it is or is reduced, then the U.S. will need to examine a return a program that many analysts had assumed was a historic artifact: annual production controls. Such a blue box option would seem especially appealing for sugar, rice, cotton, wheat, and potentially even dairy. Reduction in support levels to these commodities will call into question the survival of farms and agribusinesses dependent on these commodities, at least in some production areas. A production set aside, making the program blue box, may be better for the industry than the reduction, even elimination, of production that could occur if amber box programs are reduced to fit under amber box constraints.
- ◆ Crop sector downsizing is occurring in the U.S. Between 1997 and 2005, area harvested of principal crops declined from 318 to 305 million acres, despite \$51 billion in payments to farmers that were tied to production in some way (see appendix discussion). Cuts in spending on farm payments tied to

production will reinforce this trend. Novel approaches to manage downsizing are needed. One such approach is the Cooperative Working Together Program of the U.S. dairy industry. This program is funded by a voluntary assessment of individual dairy farmers. The funds are used in part to buy out existing herds. A similar program could be adopted for crops: a voluntary assessment could fund a buyout of acreage for long term conservation (environmental organizations, private foundations, and maybe even public funds may match farmer contributions). Such a program allows more efficient farmers to buy out less efficient farmers in a way that reduces supply and program expenditures while improving the quality of the environment.

Appendix: Comparison of Farm Program Payment Support for Major Field Crops: Three indicators of this importance are presented in the following table: (1) total program payments from Fiscal Years 1996 through 2005, (2) average farm payments per year per program base acre, and (3) the ratio of per base acre payment to per acre cash cost of production (operating cost + hired labor + taxes and insurance). Using several years of farm payments averages the payments over a variety of supply and demand conditions. Each of the three indicators varies substantively among the various field crops. The level of the annual payment per base acre and of the ratio of per acre payment to cash cost suggest that reducing farm payments will have substantial impacts on farm level decisions, especially for rice.

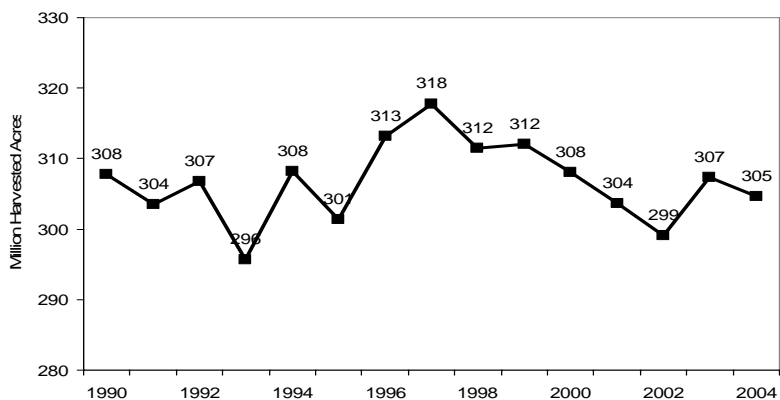
Field Crop	Total Farm Payments FY1996 – FY2005 (Billion \$)	Base Acres 2003 (Million)	Per Year Payment Per Base Acre	Per Acre Cash Production Cost (2004)	Ratio of Per Acre Payment to Per Acre Cash Cost
Corn	\$42.4	87.8	\$48	\$180	27%
Wheat	\$21.9	76.2	\$29	\$76	38%
Cotton	\$21.8	18.8	\$116	\$339	34%
Soybean	\$13.5	53.3	\$25	\$90	28%
Rice	\$9.6	4.5	\$213	\$375	57%
Sorghum	\$3.7	12.1	\$31	\$115	27%
Barley	\$1.7	8.8	\$19	\$92	21%
Oats	\$0.2	3.1	\$7	\$87	8%

Sources: U.S. Department of Agriculture, Economic Research Service, *Agricultural Outlook Statistical Indicators*, October 2005 (<http://www.ers.usda.gov/publications/Agoutlook/aotables/>) and *Commodity Cost & Returns* (<http://www.ers.usda.gov/data/costsandreturns/testpick.htm>). Accessed November 2005.

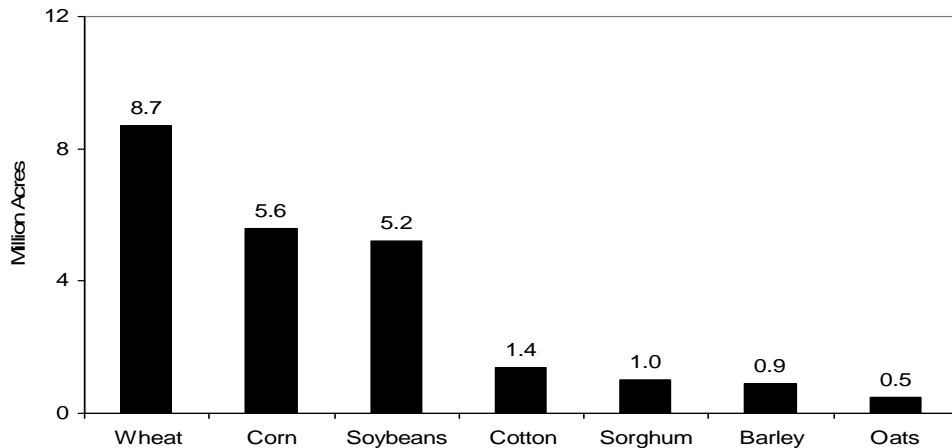
Appendix: The Silent Transformation: Harvested Acres of Principal Crops Since 1990:

Principal crops include all crops except for fruits, nuts, and vegetables. An objective of the 1995 Farm Bill was to unleash U.S. agriculture’s productive capacity by eliminating annual acreage set asides. Farmers could plant crops except fruits and vegetables as market conditions warranted. As hoped, acreage harvested increased from 301 to 318 million between 1995 and 1997. Since then, however, harvested acres have declined back to pre-1995 farm bill levels. This decline has occurred despite \$51 billion in payments to farmers that are tied to production in some way. What does this story imply?

- (1) The 1996 Farm Bill has not increased crop acres.
- (2) Government payments from current farm programs may be less trade distorting than many think.
- (3) Reducing support will likely lead to a further loss of acres in the U.S.



Allocation of Conservation Reserve Program Acreage to Crops, 2003.



Source: U.S. Department of Agriculture, Economic Research Service. *USDA Agricultural Baseline Projections to 2014*. OCE-2005-1. February 2005, page 34.

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