



Domestic Farm Policy for 2007: Forces for Change

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The fundamental political rationale of U.S. farm policy, to support and stabilize the incomes of family farmers, has been embodied in farm bills since the early 1930s. U.S. agriculture has changed dramatically since the Great Depression in ways that matter from the perspective of policy makers. In the 1930s, farm household incomes and wealth were lower on average than nonfarm household incomes and wealth. In 2006, that situation has reversed. In the 1930s, the average farm size was much smaller than in 2006, both in land area and value of sales. The types of products being produced were also far less diverse. In the 1930s, more than 75% of all farms raised commodity program crops such as corn and wheat. Today, only about a quarter of all farms grow such crops. In the 1930s, agricultural resource policy was focused on enhancing farmland productivity. In 2006, preserving natural resource attributes of that farmland is also a major policy concern.

These changes in structure and focus have created substantive policy issues. Some ideas, such as imposing tighter limitations on government payments to individual farms and proposals to target assistance more towards low income households, have been sources of controversy for several decades. Other issues, such as expanding the scope of government support to be provided to other commodities, including fruits and vegetables and livestock, are relatively new concerns. All are in play in the context of current debate over the likely shape of the 2007 Farm Bill. In addition, since 1994, U.S. farm policy has been constrained to some degree by the U.S. Government's commitments under the Uruguay Round Agreement on Agriculture (URAA), as implemented through the World Trade Organization (WTO). Further, funding for farm programs, and therefore the scope and structure of those programs, are contingent on the status of the federal bud-

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get during the period in which a new farm bill is debated. The next farm bill is also likely to reflect broader societal interests, with particular attention paid to the environmental and energy impact of farm policy.

Budget Issues

When legislators have been faced with substantial federal budget deficits, as in the 1990s, many farm programs have been cut back or eliminated. In contrast, the 2002 Farm Bill was developed in a brief era of budget surpluses when funding was much less constrained. The March 2001 budget baseline released by the Congressional Budget Office (CBO) projected a \$5.7 trillion budget surplus in the federal budget over the period 2002-2011. In this environment, farm state members of Congress were able to obtain \$73.5 billion of additional funding for the 2002 Farm Bill. The August 2006 CBO baseline assessment paints a very different picture, projecting a ten-year cumulative deficit of \$1.8 trillion.

Moreover, this official or 'status quo' CBO baseline projection does not account for the potential extension of expiring tax cuts after 2010, changes in the Alternative Minimum Tax to reduce its adverse tax impacts on middle-class Americans, and the cost of a continuing military role in Afghanistan and Iraq. A separate CBO analysis, which accounted for these impacts, results in annual bud-

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get deficits averaging more than \$500 billion over the next ten years. In addition, the increase in the national debt implied by these deficits will raise federal debt service interest costs. In this fiscal environment, framers of the next farm bill are likely to have to work with no more than current baseline funding, and conceivably less (Figure 1).

Under the budget resolution for fiscal 2006, the House and Senate Agriculture Committees were required to cut spending by \$3 billion over five years, along with similar cuts required for other Congressional Committees. For agriculture, the largest cuts were in commodity and conservation programs and agricultural research funding. For reconciliation, CBO projected that spending for all mandatory farm programs (including food stamps) over the five-year period 2006-2010 would be \$278 billion. Since the effort to make cuts in the fiscal 2006 budget was successful, Congress is more likely to repeat the exercise in the future, further reducing funding for the 2007 Farm Bill.

The Farm Security and Rural Investment Act of 2002 consisted of ten separate titles. These included commodity and conservation programs, trade (including food aid), nutrition, farm credit, rural development, agricultural research, forestry, renewable energy, and miscellaneous issues. Under the August 2006 CBO baseline, spending on farm bill programs (other than nutrition programs) is expected to be about \$195 billion over the ten-year period beginning in 2008.¹ Proposals for new programs or modifications to current programs in the 2007 Farm Bill will likely have to fit within the baseline funding level to be projected by CBO in March 2007.

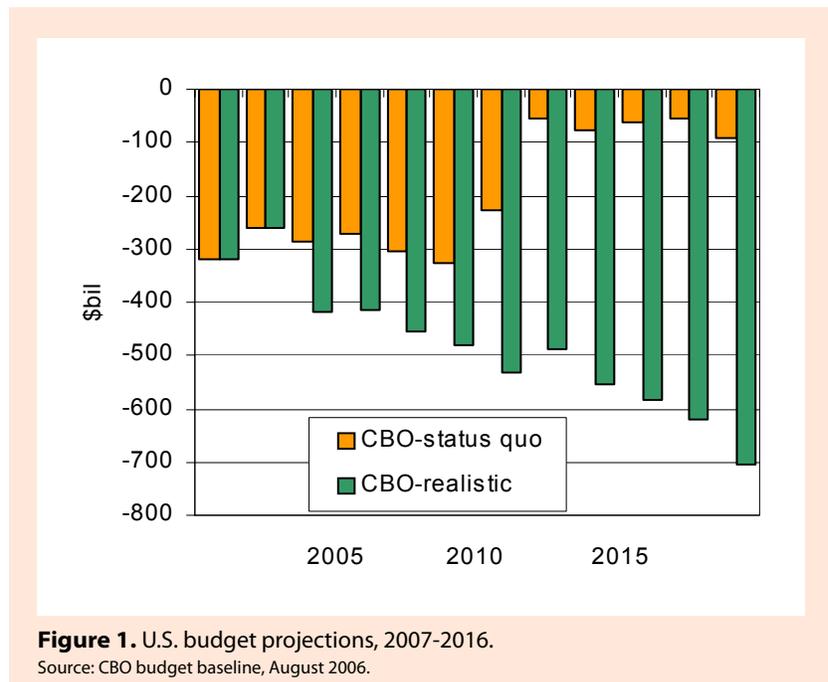


Figure 1. U.S. budget projections, 2007-2016.

Source: CBO budget baseline, August 2006.

Changing Demographics

Farm bills are not written in a vacuum. Although farmers and rural communities are the direct beneficiaries of farm programs, the interests of other groups also matter in the current political environment. In the U.S. House of Representatives, agricultural interests are not the force they once were. Every decade, seats are reallocated to states on the basis of new Census population estimates and Congressional District reapportioned by state legislatures. Over the last 50 years, the regions in which agriculture is economically important have shrunk significantly. An analysis by USDA's Economic Research Service (ERS) shows changes in farming-dependent counties between 1950 and 2000.² In 1950, farming-dependent counties were located in

nearly every state. By 2000, these counties had dwindled in number and had become concentrated in a belt 1-2 states wide stretching from eastern Montana to the Texas panhandle.

The political implications of this demographic shift are important. Data from the 2002 Census of Agriculture indicate that among all Congressional District (representing an average of 646,000 residents), fewer than half contain more than 1,500 farmers. Thus, only a minority of members in Congress have substantial farm-based constituencies that are committed to maintaining funding for federal farm programs. Moreover, the proportion of families in the United States directly involved in farming has become very small, about 2% of the population. Most Americans have no, or only distant, connections with agriculture as a source of income and a way of life.

1. *The current CBO baseline runs for 2007-2016. The \$195 billion figure extrapolates spending trends for 2017, the last year of a ten-year baseline for a 2007 Farm Bill, excluding food stamp spending.*

2. *ERS defines farming-dependent counties as those with at least 15% of income from farming.*

Many members of the general public who do hold opinions on U.S. farm policy base their views on information from the mass media, which is often critical of the distribution of farm program funds. For example, in 2001, data on farm program payment recipients disseminated by the Environmental Working Group sparked public interest and debate about whether wealthy farmers with large operations should receive substantial annual government payments. An amendment to sharply limit payments was added to the Senate version of the 2002 Farm Bill, but dropped from the final legislation at the insistence of conferees from the House Agriculture Committee. This issue has already resurfaced in discussions about the 2007 Farm Bill, but faces opposition from commodity groups, especially rice and cotton producers in California and the South, which include most recipients of large payments because of the structure of their farms.

The Evolving Structure of Political Interest Groups

The politics of agricultural policy have generally become more complicated over the past two decades. Arguably, the major commodity policy elements of the 1985 Farm Bill were framed to address the concerns of feed grains, cotton, rice, soybean, sugar, wool and mohair and wheat producers along with environmental interest groups concerned about conservation. Among livestock producers, dairy operators with a price support program to preserve were probably the most active participants in the policy process. Players in the current debate over the future of farm programs are more numerous. In the last Farm Bill, along with the producers of traditional program

commodities and sugar and dairy, growers of minor oil seeds and pulse crops sought and acquired loan rates for their crops. They too have a stake in maintaining loan rate programs or negotiating other means of support if loan rate benefits were to be reduced.

In addition, producers of fruits and vegetables have become actively engaged in the 2007 policy debate. This is partly because of the increased importance of the federal crop insurance program as a source of subsidies and risk management for these commodities. Beef cattle producers also have recently become involved in crop insurance debates as new policies covering grazing land and livestock price risks have been introduced.

Advocates for low income household programs such as food stamps and school lunches and breakfasts are also participants in farm bill debates, although child nutrition programs are usually handled in separate legislation. Further, in addition to environmental interest groups, advocates for renewable energy production are now active advocates for certain farm bill programs. Given the recent sharp increases in oil prices and the resulting expansion of interest in renewable fuels, lobbyists for the ethanol and biodiesel industries may be effective voices in the writing of the next farm bill. These groups seek energy-related incentives or mandates aimed at increasing domestic demand for major commodities such as corn and oilseeds and reducing exportable surpluses. Energy programs that increase domestic consumption of grains may also be viewed benignly by other countries and could therefore resonate with legislators.

Other groups without a direct stake in agriculture are also seeking to be heard in the policy process. Humanitarian groups such as Oxfam

America are raising questions about the adverse impact of U.S. farm programs on farmers in developing countries. Some conservative or libertarian groups, such as the Cato Institute and Heritage Foundation, assert that farm programs represent corporate welfare and should be ended.

Inertia is also an important factor in policy formation. Gary Becker pointed out that major policy shifts tend to occur only when the economic and political benefits of change outweigh the costs. The increased income flow from farmland resulting from most U.S. commodity policies has led to an increase in the value of U.S. farmland over time. Ending some of these programs or reducing the subsidies they provide will inevitably lower land values, with concomitant impacts on farm wealth. By some estimates, for example, abandoning loan rate programs and direct payments could reduce prices for agricultural land in several states by 20% or more. Farm interest groups are deeply concerned about such effects, and policy makers, therefore, have to be conscious of the impacts of proposed policy changes on land prices in evaluating the 2007 Farm Bill.

Implications of the WTO Agreements for the 2007 Farm Bill

For the first time, under the terms of the 1994 URAA, agricultural policies that affect trade were to be subject to an agreed set of international rules. The URAA also introduced new and binding procedures to resolve disputes between member countries over whether specific trade policies were consistent with WTO obligations. Previously, individual member countries had been able to block the implementation of panel findings.

In September 2002, the government of Brazil filed a landmark case against the U.S. Government's cotton support programs, the first in which one country claimed that another country's domestic support programs were incompatible with that country's WTO obligations. Several important elements of Brazil's claims were supported by a WTO panel's rulings in August 2004 and were subsequently upheld by the WTO appellate body in March 2005. The WTO panel found that the United States had forfeited protection under the peace clause of the URAA by spending more each year on domestic support for cotton between 1999 and 2002 than in 1992, the benchmark year.³ Further, U.S. price-related support programs had depressed prices in the world cotton market. The WTO panel therefore determined that the U.S. government must modify or eliminate those programs. The panel also found that the Step 2 cotton program and U.S. export credit guarantees were export subsidy programs, and should be modified or eliminated.

In response, the U.S. Government took some steps to bring the relevant programs into compliance. USDA modified the operation of the export credit program by issuing new regulations, basing fees that countries must pay on the risk of nonrepayment of loans made under the program. The Step 2 cotton program was terminated August 1, 2006,

3. *The peace clause is contained in Article XIII of the URAA, and exempted countries from actions against their domestic agricultural policies under other Agreements if support remained below the level provided in 1992. It expired in 2004.*

Congress having let the program complete the 2005 marketing year.

The WTO panel report offered no further guidance on U.S. compliance. However, Congress may also need to make changes to domestic price-related programs, chiefly the marketing assistance loan and countercyclical payments (CCPs), to comply with the panel's findings. In addition, current limits on the use of land for the production of fruits and vegetables associated with the direct payment program may have to be modified. Within policy circles, Congress is expected to incorporate any changes it deems necessary into the 2007 Farm Bill and, for reasons of political balance, will likely make similar changes to programs for all crops, not just cotton.

Since November 2001, WTO member countries have also been engaged in agricultural negotiations in the Doha Round, aimed at further reductions in domestic support, improved market access, and elimination of export subsidy programs, in addition to reforms in trade in services and market access for manufactured goods. However, in July 2006 negotiations appeared to collapse, mainly over gaping differences between the United States and other countries such as India and the European Union with respect to agricultural provisions, and negotiations were formally suspended. There is widespread agreement that Trade Promotion Authority (TPA) for the President is a necessary prerequisite for any new WTO agreement to insulate legislation to implement the agreement from Congressional amendments. Current TPA legislation expires July 1, 2007, and there is no guarantee it will be renewed beyond that date. Thus, the Doha Round of WTO negotiations may have very few implications for the

2007 Farm Bill. However, some farm groups are advocating an extension of the 2002 Farm Bill for a few years until the Doha Round can be completed. Under those circumstances, the 2007 Farm Bill could have a very short lifetime, and significant policy change could come in response to a delayed Doha Round Agreement.

U.S. negotiators did submit a substantive proposal to the WTO on agricultural reform in October 2005, whereby the United States would reduce the ceiling for its trade-distorting domestic programs from \$19.1 billion annually under the URAA by 60%, to a maximum of \$7.6 billion annually. Had the U.S. proposal been adopted, the U.S. Government would have obligated itself to make changes in many of the programs that make up the farm safety net. Congress could respond to such constraints in three ways: 1) simply cut program spending, 2) transfer a portion of spending into direct payments while maintaining a reduced farm safety net within the new caps, or 3) undertake a fundamental shift from price-related support to decoupled, 'green box' programs, including those which address broader societal objectives such as conservation and rural development. Whether these policy reform proposals will now receive much attention in the 2007 Farm Bill debate is much less clear, although budgetary pressures may be an important driving force for some changes in these areas.

In the current policy mix, the U.S. Government provides a portion of support to farmers through green box programs that are deemed to be minimally trade-distorting, including direct payments and conservation payments. Other U.S. green box programs support development of infrastructure or improved economic opportunities through rural develop-

ment initiatives and agricultural research programs. To compensate for potential reductions in price-related subsidies resulting from the Brazil cotton case or a resuscitated Doha Round, the United States could choose to expand funding for these programs, while phasing out or substantially reducing domestic subsidies provided by the marketing loan and countercyclical payments programs. Concerns have been raised about the use of decoupled direct payments by some farm groups. These groups have argued that a substantial proportion of all direct payments accrue to 'absentee' land owners who are not involved in farming. Second, such payments drive up land values and land rents. Finally, because direct payments are not linked to production—the very characteristic that makes them tenable under current WTO rules—many legislators and the general public could perceive them to be analogous to welfare checks. This perspective, some farm groups suggest, could make direct payments vulnerable to Congressional reduction in periods of fiscal constraint.

Other Free Trade Agreements

While the Bush Administration has undertaken the negotiation of 11 free trade agreements (FTAs)—six in force and five still underway—no FTA has directly obligated the U.S. Government to make changes in domestic farm programs. In fact, U.S. trade negotiators have steadfastly resisted such commitments, reserving domestic policy issues for multilateral negotiations within the WTO. However, providing increases in market access for FTA partners for products that are protected by the use of tariff-rate quotas incrementally reduces the effectiveness of U.S. price support

programs for commodities such as sugar and dairy. These indirect effects led the U.S. sugar industry to unsuccessfully oppose the Central American FTA in 2005, fearing a long-term degradation in their support system if more market access is provided in future FTAs.

Conclusions

The 2007 Farm Bill will be developed in a very different political environment than the 2002 Farm Bill. In 2002, Congress and the Administration were enjoying the flexibility in policy making provided by substantial federal budget surpluses. The 2007 Farm Bill will be developed in the context of official federal budget deficits on the order of \$300 billion per year, or about 2% of current Gross Domestic Product. Past budget proposals indicate the Administration is willing to support some reduction in funding for agricultural commodity programs; this perspective resonates with many members of Congress.

Federal budgetary constraints are also being reinforced by some recent developments with respect to the obligations of the United States under its WTO commitments. Specifically, the recent WTO Dispute Resolution determination in the Brazil cotton case, that several elements of U.S. cotton programs violate U.S. commitments under the 1994 Uruguay Round Agreement, raises similar questions about U.S. programs for other commodities such as corn, oilseeds, and wheat. Price supports and the level of funding for subsidies derived from marketing loan programs and CCPs have all been brought into question. The Brazil case findings have even raised questions about the validity of direct payments to producers of program com-

modities under the WTO. The U.S. responses to the Brazil Cotton Case findings, including actions already taken and those that may yet occur, and the U.S. WTO proposal in 2005 to cut amber box payments by 60%, reflect both the domestic budgetary and WTO-related pressures for changes in the structure and funding of farm programs.

Other pressures may also come into play. Domestic agricultural commodity groups may resist changes in the funding and structure of farm programs that adversely affect farm incomes, farm household wealth, and farmland values. Changes in farm programs that fail to largely maintain the benefits currently accruing to the agricultural sector would be resisted by most farm groups. Within the agricultural sector, however, a broader array of interest groups is likely to be involved in the policy process because livestock producers and growers of fruits and vegetables now have a more direct stake in a range of federal programs, including conservation, crop insurance, trade promotion, and agricultural research. Environmental and wildlife groups will also seek to maintain and expand conservation programs that improve environmental amenities in rural areas. In the face of recent spikes in energy prices, a wide range of groups seeking to reduce reliance on imported petroleum may seek additional incentives or research funding for processing agricultural commodities or new dedicated energy crops into biofuels.

This mix of budgetary concerns, political commitments under the WTO, and the broadening of issues to be encompassed in agricultural policy raise an intriguing possibility. While funding for agricultural commodity programs is almost certainly not going to be expanded and most

likely will be somewhat reduced, the potential for substantial changes in the structure of U.S. farm programs genuinely exists. Major changes could be made to the marketing assistance loan programs and other programs that are linked to domestic production. However, farm state members of Congress will be reluctant to approve substantial reductions in funding for programs that support farm incomes. Therefore, major reductions in existing programs are likely to be offset by expansions of other existing programs or introduction of new programs that fall into the WTO green box cate-

gory of agricultural support programs. The results of all of these factors, some of them with pressures moving in opposite directions, could make for a very lively 2007 Farm Bill debate.

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What Happens if You Try to Run Current Farm Programs on a Tighter Budget?

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Congress gave the committees writing the 2002 Farm Bill permission to increase farm program spending by billions of dollars per year. The committees writing the next farm bill are unlikely to have the same luxury.

Since the beginning of the 2002 Farm Bill debate, the federal budget has gone from surplus to deficit. In early 2006, Congress passed a deficit reduction bill that reduced estimated U.S. Department of Agriculture spending by \$2.7 billion over the next five years. Unless the budget picture significantly improves, Congress could face pressure to make further cuts in spending on farm and other programs.

Trade agreements are also a factor in writing future farm legislation. Under existing World Trade Organization (WTO) rules, Brazil successfully challenged particular aspects of U.S. cotton programs. In the Doha Round of WTO negotiations, there was general agreement that certain types of producer support should face tighter limits. Those talks were suspended in 2006, in part because of a dispute over just how tight the limits on domestic support should be.

Current Farm Programs with Less Money

Budgetary and WTO considerations are certain to be important in the next farm bill debate, but it is too early to predict the precise shape of new legislation. Congress could examine a wide variety of options, including some radical departures from current programs. The one option Congress seems almost certain to consider is a simple extension of current farm programs, perhaps with minor changes required to address budgetary or WTO concerns.

What might such a “status quo minus” approach mean for U.S. agriculture? We examine three policy options to reduce government farm program spending:

1. a 22.2% reduction in direct payments (DPs),
2. a 47.1% reduction in countercyclical payments (CCPs), and
3. a 38.0% reduction in marketing loan benefits (MLBs—loan deficiency payments and marketing loan gains).

Assuming that changes are implemented effective with the crop harvested in 2008, we estimate that each of these options would reduce government farm program spending by a total of \$5 billion over fiscal years 2008–2012.

Baselines and Analysis Approach

The point of comparison for the analysis is the 10-year stochastic baseline prepared by the Food and Agricultural Policy Research Institute (FAPRI) based on information available in January 2006 (FAPRI, 2006a). The stochastic baseline is a set of 500 possible outcomes for U.S. agricultural commodity markets. These outcomes share the common assumption that current farm policies remain in place, but make different assumptions about the weather and other factors affecting supply and demand.

DPs are fixed and total \$5.3 billion per year. In contrast, CCPs and MLBs depend on market prices—the lower the market price, the greater the payments. Based on Farm Service Agency reports, FAPRI estimates that annual CCPs averaged \$2.9 billion, and MLBs averaged \$3.5 billion over the 2002–2005 period.

The stochastic baseline projects modest increases in prices for most major crops that reduce average spending on CCPs and MLBs. For example, average corn prices in the stochastic baseline rise from less than \$2.00 per bushel in the 2005/06 marketing year to over \$2.40 per bushel by 2010/11. Across the 500 baseline outcomes for the 2008–2012 crop years, baseline CCPs average \$2.7 billion per

year, and MLBs average \$2.5 billion per year. In many of the stochastic outcomes, prices are high enough that there are no MLBs or CCPs; in other outcomes, low prices result in very large payments.

Some suggest that rapid growth in production of ethanol is likely to result in strong growth in prices for corn and other commodities. A short-term baseline update, prepared in July 2006 (FAPRI 2006b), projected higher prices than in the stochastic baseline used for this analysis. All else equal, higher average market prices would reduce estimated CCPs and MLBs—and would suggest that larger proportional cuts would be required to achieve a certain level of budgetary savings relative to the baseline.

One way to achieve the assumed reductions in payments would be to make appropriate adjustments to target prices, loan rates, and direct payment rates. Instead, this analysis assumes that those measures remain unchanged at 2002 Farm Bill levels, but that USDA would be instructed to withhold a proportion of each payment otherwise due to producers. This approach could raise implementation issues ignored in the analysis. For example, producers could choose to forfeit on commodity loans if marketing loan benefits are insufficient to compensate producers for market prices below the loan rate.

Government Spending by Commodity

By design, each of the three options would reduce average government farm program spending by \$5 billion over a five-year period (fiscal years 2008-2012). In each scenario, the proportional cut in a particular type of payment is the same across all commodities. As shown in Table 1,

Table 1. Impacts on government outlay.

	Cut Direct Payments	Cut Counter-Cyclical Payments	Cut Marketing Loan Benefits
(billion dollars, 2008-2012 total)			
Corn	-2.00	-1.68	-1.24
Wheat	-1.08	-0.44	-0.11
Soybeans	-0.58	-0.36	-1.38
Upland cotton	-0.58	-1.92	-1.40
Rice	-0.40	-0.22	-0.37
All other	-0.36	-0.38	-0.52
Total outlays	-5.00	-5.00	-5.00

however, the impacts on government spending on each commodity differ greatly across the options.

In the case of direct payments, the results are fairly simple. Corn accounts for approximately 40% of total direct payments in the baseline. Reducing direct payments has only very limited effects on market prices, countercyclical payments, and marketing loan benefits. Corn, therefore, accounts for about 40% of the overall estimated savings, or about \$2 billion over the five-year period. Wheat cost savings exceed \$1 billion over the same period, with soybeans, rice, cotton, and all the other program crops sharing the remaining \$2 billion in cuts.

The picture is more complicated in the scenarios that cut countercyclical payments and marketing loan benefits. First, the baseline level of spending on each commodity is sensitive to market price projections. Second, changes in CCPs and MLBs have larger effects on commodity production and prices than changes in DPs. For example, if reduced MLBs result in acreage shifting out of cotton and into wheat, the resulting changes in prices will affect MLBs and CCPs for both commodities.

The three scenarios have very different impacts on spending for par-

ticular commodities. Consistent with differences in baseline spending, wheat outlays are far more sensitive to proportional cuts in DPs than to the corresponding reductions in CCPs and MLBs. Cotton spending is particularly affected by cuts in CCPs, and soybean spending is most affected by changes in MLBs. For both corn and rice, proportional cuts in DPs have slightly larger average impacts than proportional cuts in other payments.

Producer Returns

Reducing government payments reduces estimated per-acre returns (Table 2). For corn, a 22.2% reduction in DPs would reduce annual government payments per base acre of corn by more than \$5. Changes in direct payments have only minimal effects on corn production and prices, so the market value of corn production, CCPs, and MLBs are all largely unaffected. For a producer with one acre of corn base for every acre of corn harvested, annual per-acre income would be reduced by a little over \$5 per acre.

Limiting CCPs and MLBs would have no effect on payments if prices are high, but could have very large impacts if prices are low. If CCPs are

Table 2. Impacts on producer returns.

	Cut Direct Payments	Cut Counter-cyclical Payments	Cut Marketing Loan Benefits
(dollars/acre, 2008-2012 average)			
Corn			
Market value	0.18	0.39	0.17
Payments	-5.49	-5.05	-3.59
Sum	-5.31	-4.66	-3.41
Soybeans			
Market value	0.15	0.01	0.42
Payments	-2.63	-1.96	-4.74
Sum	-2.48	-1.95	-4.32
Wheat			
Market value	0.13	0.14	-0.12
Payments	-3.42	-1.35	-0.46
Sum	-3.29	-1.22	-0.58
Upland cotton			
Market value	0.07	1.78	3.80
Payments	-7.65	-30.29	-20.61
Sum	-7.58	-28.51	-16.81

Notes: Market value and loan benefits are reported per harvested acre. Direct and countercyclical payments are reported per base acre. Total payments and the sum of payments and market value are reported per harvested base acre. For individual producers and the country as a whole, base area and harvested area differ significantly.

reduced by 47.1%, annual corn CCPs are reduced by approximately \$5 per corn base acre, averaging across the 500 stochastic outcomes. The reduction in CCPs would cause a slight reduction in corn production and increase in corn prices, and these changes would result in a very slight increase in the value of corn production and an even smaller reduction in loan program benefits. The net effect of these changes is to leave average corn producer returns down relative to the baseline by slightly under \$5 per harvested base acre.

Reducing MLBs by 38.0% reduces corn MLBs and has modest effects on the market value of corn production and CCPs. Overall, corn

producer returns decline relative to the baseline by a little over \$3 per harvested base acre. Note that these producer return estimates for corn are consistent with the estimates of government spending—reducing DPs has the largest effect on corn producers, followed closely by reductions in CCPs, with reductions in MLBs having the smallest effects.

The patterns for other crops are also consistent with the government expenditure results. For soybeans, restrictions on MLBs have the largest net effects on producer income, while limitations on DPs are of greatest importance to wheat producer income, and reductions in CCPs have the largest impacts on cotton

producer income. In all cases, changes in the market value of production are small relative to the changes in government payments.

An important note of caution is in order: for sake of simplicity, the reported calculations of per-acre returns assume producers have one base acre of the commodity in question for every acre they harvest. This is not the norm. For the country as a whole, base acreage for wheat, corn, and upland cotton exceeds harvested area, while the reverse is true for soybeans. On particular farms, there may be little or no correlation between the current crop mix and the base acreage used to determine DPs and CCPs.

Market Impacts

Reducing government payments has important impacts on producer income, but has only modest impacts on crop production and prices (Table 3). Market effects are especially small when DPs are reduced. DPs do not require production of any particular crop, or even of any crop at all, and the payments are unaffected by changes in market prices. One minor restriction is that DPs are not available if base acreage is used to produce fruits, vegetables, or dry beans. Economists differ in their estimates of just how much such largely “decoupled” payments affect production choices, but most would agree that any production effects of such payments are likely to be smaller, on a dollar-for-dollar basis, than effects of payments that are more closely tied to production or prices.

Reducing CCPs has only slightly larger impacts on production and prices. Like DPs, CCPs are not tied to production of particular crops or even of any crop at all. However, CCPs are affected by changes in mar-

ket prices—within certain ranges, lower season-average prices translate into larger CCPs. As a result, CCPs may play a price insurance role not played by DPs, and thus might be expected to have slightly larger impacts on production. Only in the case of cotton (the crop most dependent on CCPs) does estimated acreage change as much as 1% when CCPs are reduced by 47.1%.

MLBs, in contrast, are only available on actual production. Because producers have to harvest the crop to get MLBs, it seems reasonable to expect that changes in MLBs would have larger impacts on crop production patterns than changes in DPs or CCPs. When MLBs are reduced, estimated acreage declines for crops most dependent on MLBs in the baseline—cotton and soybeans—but actually increases slightly for wheat, the major crop least dependent on MLBs in the baseline. Note that even though cotton producers are more dependent on CCPs than MLBs, estimated effects of reductions in MLBs on cotton acreage are larger than the estimated effects of reductions in CCPs.

Even in the case of reduced MLBs, the main effect of reduced payments is to encourage producers to shift production from one crop to another, rather than to reduce the overall amount of land used for crop production. Total acreage devoted to production of 12 major crops only declines by a little over 0.1% when MLBs are reduced by 38.0%.

Net Farm Income

Policy changes that reduce government spending by \$5.0 billion over fiscal years 2008-2012 are estimated to reduce net farm income by \$3.3 billion to \$3.9 billion over calendar years 2008-2012 (Table 4).

Table 3. Impacts on acreage and prices.

	Cut Direct Payments	Cut Counter-Cyclical Payments (2008-2012 average)	Cut Marketing Loan Benefits
Corn			
Acreage	-0.01%	-0.07%	-0.02%
Prices	0.05%	0.11%	0.05%
Soybeans			
Acreage	-0.03%	0.04%	-0.08%
Prices	0.06%	0.00%	0.18%
Wheat			
Acreage	-0.13%	-0.10%	0.27%
Prices	0.08%	0.09%	-0.08%
Upland cotton			
Acreage	-0.04%	-1.00%	-2.18%
Prices	0.01%	0.38%	0.82%
12 crops*			
Acreage	-0.06%	-0.11%	-0.12%

*Corn, soybeans, wheat, upland cotton, rice, sorghum, barley, oats, sunflowers, peanuts, sugar beets, and sugarcane.

As discussed, the three options to reduce government spending have only small impacts on crop production and prices, so it should not be surprising that crop and livestock receipts are largely unaffected. What may be surprising is that the reported changes in government payments significantly exceed the \$5 billion change in government outlays. This occurs primarily because of differences between the fiscal years used to measure farm program spending and the calendar years used to report net farm income. Payments made between October 1 and December 31, 2012 would affect net farm income for calendar years 2008-2012, but not farm program spending for fiscal years 2008-2012, a period which ends on September 30,

2012. This seemingly arcane point may be more important than it seems, as budgetary rules require Congress to stay within spending limits over a specified period of fiscal years, not calendar years.

Reductions in payments do not have a dollar-for-dollar effect on net farm income. Smaller government payments reduce the value to producers of rented farmland, so over time one would expect rental payments to nonoperator landlords to adjust. In other words, at least part of the impact of lower government payments is absorbed by landlords. Other production expenses also decline in response to lower payments.

Table 4. Impacts on net farm income.

	Cut Direct Payments	Cut Counter- Cyclical Payments	Cut Marketing Loan Benefits
(billion dollars, 2008-2012 totals)			
Crop receipts	0.04	-0.06	-0.19
Livestock receipts	0.02	0.03	0.07
Gov't payments	-5.33	-5.68	-5.11
Sum of above	-5.27	-5.70	-5.24
Rental payments	-1.44	-1.42	-1.29
Other expenses	-0.36	-0.58	-0.90
Total expenses	-1.80	-2.00	-2.19
All other net income	-0.17	-0.16	-0.23
Net farm income	-3.64	-3.86	-3.27

WTO Considerations

WTO considerations could also have important impacts on the design of new farm legislation. In response to a WTO ruling on a case brought by Brazil, the United States has already eliminated a program subsidizing the use of U.S. cotton and modified its export credit program. Brazil has argued that further changes in other U.S. farm programs are also required by existing WTO rules.

Before negotiations for a new WTO agreement were suspended, the United States tabled a proposal in October 2005 that would place limits on certain types of producer support programs. The U.S. proposal would have reduced the allowed level of “amber box” support from \$19.1 billion per year to \$7.6 billion per year. Based on past U.S. reports to the WTO and discussions with U.S. officials, we assume that U.S. amber box support would include government spending on the marketing loan program for grains, oilseed, and cotton, as well as the imputed value to producers of the dairy and sugar

price support programs (these values are set by a formula tied to current support prices and past world prices, and generally far exceed actual budgetary expenditures on the dairy and sugar programs).

Whether the United States would have to make changes in farm programs to comply with its proposed limits on amber support is a matter of contention. If market prices are high, marketing loan expenditures are low, and it is conceivable that total U.S. amber box support could fall below the proposed limit with no changes in current policies. However, low prices could translate into large marketing loan benefits that would cause measured levels of U.S. amber box support to balloon.

In 53% of the stochastic outcomes for 2012, the baseline level of U.S. amber box support would exceed the proposed \$7.6 billion limit. Reducing DPs or CCPs would have only minimal impacts on this proportion. Reducing marketing loan benefits by 38%, however, would reduce the proportion of out-

comes exceeding the U.S.-proposed limit to 37%. One reason the proportion does not decline even more sharply is that imputed support from the dairy and sugar programs makes up a very large share (approximately \$6.4 billion) of the total, and the assumed policy changes would have no effect on that estimate.

The U.S. proposal would also redefine “blue box” support to include CCPs, and limit such support to \$4.8 billion per year. In 11% of the baseline stochastic outcomes for 2012, CCPs would exceed this proposed limit. Reducing DPs or MLBs would have little or no impact on this proportion, but reducing CCPs by 47.1% would eliminate any possibility of exceeding the proposed cap on blue box support.

If the U.S. proposal were adopted, there could be pressure to place limits on MLBs and CCPs and to make changes in the sugar and dairy price support programs. One practical question could be how one goes about deciding what probability of exceeding support limits is acceptable? If policies would result in support exceeding proposed limits 37% (or 20% or 10% or 5%) of the time given normal variation in market prices, is that sufficient, or are further reductions in support levels necessary?

Other countries have sought deeper cuts in U.S. supports than in the October 2005 U.S. proposal. If the negotiations resume, there is likely to be continued pressure on the United States to put in place strict limits on producer support measures. MLBs and CCPs are especially likely to be under close scrutiny, and even in the case of DPs, some policy changes may be needed to ensure that payments qualify for the “green box” designation that would make them exempt from limits.

Other Scenarios

The discussion here has focused on simple modifications to current farm programs. The last two farm bills have made significant shifts in policy, and it is very possible that the next farm bill may also result in a change in direction.

WTO concerns may encourage at least some consideration of alternative policy directions. The variability in spending on marketing loan and CCP programs complicates efforts to stay within the types of limits on amber and blue box subsidies that have been proposed. Our results suggest, for example, that with a scaled-back version of current policies, the average level of support provided to producers would have to be well below the proposed limits in order to make sure that the limits are not exceeded when prices are lower than anticipated. Likewise, some might examine the sugar and dairy programs to see if there might be a way to provide a similar level of support to producers without such a large

charge in terms of amber box support measures.

Purely domestic concerns could also encourage examination of other policy options. For example, some have suggested examining policies that make payments tied to producer revenue shortfalls rather than to market prices. Other groups important in the farm bill debate—ranging from environmental groups to bio-fuel advocates to budget hawks—are also likely to recommend other policy options. While many options will be considered, current programs are likely to serve as a benchmark, and budgetary and WTO concerns are likely to receive considerable attention in choosing among the alternatives.

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The Evolution of the Rationale for Government Involvement in Agriculture

by Otto Doering and Joe L. Outlaw

JEL Classification Codes: Q18, Q10

Before change can be introduced successfully, we have to know *why* we are where we are today. This is as true of policy as it is of individual behavior. There are a number of suggestions for substantial change in our agricultural policy. Few address up front the issue of whether government should be involved in agriculture. Thinking about the evolution of today's policy may encourage us to dig a little deeper into our objectives for agricultural policy and ask whether we are attempting to reach these most effectively.

Background

The Jeffersonian notion of agricultural fundamentalism was more a rationale for a kind of democratic society rather than a rationale for government involvement in agriculture. This prescribed the maintenance of a population of yeoman farmers who would be the backbone of democracy as small, independent-propertied individuals. The Louisiana Purchase extended the opportunity for the expansion (geographically and in numbers) of this citizenry, while shutting out the British and the Spanish. Government's involvement in agriculture for the first hundred years was largely land policy (Northwest Territories Act and Lewis & Clark expedition, for example) to create a property survey and rights system and settle the central expanse of the country and the land west of the Mississippi. The creation of the extensive public domain through expansion also involved moving these lands into private hands through veterans' programs and homestead acts.

Government also helped create infrastructure – the most notable early example being the Erie Canal, which opened up the middle of the country to export markets in Europe and set the future for New York as the commercial center of the nation. Agricultural interests agitated for

public infrastructure that would ease the transport of goods to market. Later came support for railroads, and ultimately the regulation of rail rates to prevent monopoly charges for transport of agricultural inputs and commodities.

In the 1860s, the Department of Agriculture was established and both the Homestead Act and the Morrill Act were passed. All three were critical to the development of agriculture and all three brought benefits to the farmer, providing resources and infrastructure, but not proscribing production. The rationale for these actions was one of helping agriculture prosper and with it the economic development of the country. Monetary policy and trade also became key issues for agriculture.

One early major role of the Department of Agriculture had been seed distribution. However, under Secretary of Agriculture, Wilson (in the early 1900s), the Department became a scientific establishment capable of leading agricultural research. The early 1900s were a golden age for agriculture. From the Civil War, agriculture had suffered through both the nation's business cycles and the extension of agricultural lands and production that constantly drove down prices. In the early 1900s, the frontier closed and industrialization and immigrant population growth surged and increased net demand for agricultural commodities. It is no accident that farmers chose 1909 to 1914 as the base for parity.

Yet, rural agriculture was still disadvantaged relative to urban industry. Teddy Roosevelt's Country Life Commission (1908) looked into the deficiencies of agriculture and country life and the means by which they might be remedied. From this report came rural free mail delivery, the Smith Lever Act and the state experiment stations, and improvements in rural health and education. Whatever

the rationale, the tradition of government involvement in agriculture was still indirect, helping stimulate settlement, defining boundaries and property rights, building transportation and infrastructure, and improving communications, technology, and education. It was not until the great agricultural collapse after the First World War that government, with a rationale born of prolonged depression, began to enter directly into agricultural markets, production, and the livelihood of farmers.

Agricultural prices broke around the world in the summer of 1920. This was a quick end to the bubble of land prices and input costs that had been occurring since the First World War. A national agricultural conference assembled in 1923 that called for economic equality for agriculture (a fair share of the national income) and adjustment of farm production to demand. From 1923 on, farm groups lobbied for government action to relieve rural distress. The McNary-Haugen Bill became the central vehicle for a policy to help agriculture. This policy would allocate a reduced portion of the crop to domestic demand and raise domestic prices, while the “surplus” would go to the export market. Now government is seen in a price and supply determining role. The Agricultural Marketing Act of 1929 put the government in the role of influencing markets with a Federal Farm Board administering a revolving fund of 500 million dollars to loan to cooperatives to store and withhold commodities. This proved to be futile (Benedict, 1953).

By 1933, the exchange value of farm products to industrial goods was 50% of the pre-war average (Davis, 1940, p. 313). The cash economy in rural areas had ground to a halt. When the Roosevelt Adminis-

tration came to Washington, there was fear that there would be revolution in the countryside if something were not done.

The New Deal prescribed a new role for government involving direct intervention into markets and individual production decisions by farmers. Much of the discussion of the period was about raising rural standards of living to be more comparable to urban standards. This was different from the earlier concept of purchasing parity based on the 1909-1914 relative industrial and agricultural costs and prices.

Chester Davis, in the *1940 Agricultural Yearbook*, set forth a broad view of the range of government actions that affected agriculture in contrast to the narrow view that only Farm Bills affected the sector

“A nation’s agricultural policy is not set forth in a single law, or even in a system of laws dealing directly with current farm problems. It is expressed in a complexity of laws and attitudes which, in the importance of their influence on agriculture, shade off from direct measures like the Agricultural Adjustment Act through the almost infinite fields of taxation, tariffs, international trade, and labor, money, credit, and banking policy” (Davis, p. 325).

Today we can add environmental policy, food safety, and more. These things now set the larger environment for agriculture, and like Paul Volker’s decision to stop inflation in the early 1980s, can be the overriding government influence on the sector.

Where does this leave us? The broadening of interests and policy impacts works both ways. Policies that are not thought of as agricultural

can have a determining impact on agriculture. In addition, what are thought of as agricultural policies (the “Farm Bill”) can exert strong influence on areas beyond the narrow scope of agriculture. As such, these broad aspects become part of the fabric of what happens in agriculture and beyond.

Reviewing the Legislation

A review of the preambles to 14 major pieces of agricultural legislation from 1933 to 2002 (generally those we now refer to as Farm Bills) provides another characterization of the evolution of the rationale for government involvement agriculture. These broadly defined categories of goals – both explicitly stated and/or implicitly implied reflecting programmatic intent as determined by the authors – are portrayed in Figure 1. Generally, the goals (as indicated in Figure 1) are the perceived problems that the programs provided for in the legislation attempted to alleviate. A few broad conclusions can be made from reviewing the goals. First, many of the goals have been consistently addressed over time. Second, there have been very few recent changes in direction other than making agricultural programs more responsive to market forces and promoting agriculture as an alternative source of energy.

Asking Questions about the Rationale

There has only been one attempt in recent decades to determine some national rationale for agricultural policy. In 1994, the staff of the Senate Committee on Agriculture, Nutrition and Forestry prepared for Senator Richard Lugar a set of questions on prospective farm policy that were circulated around the country

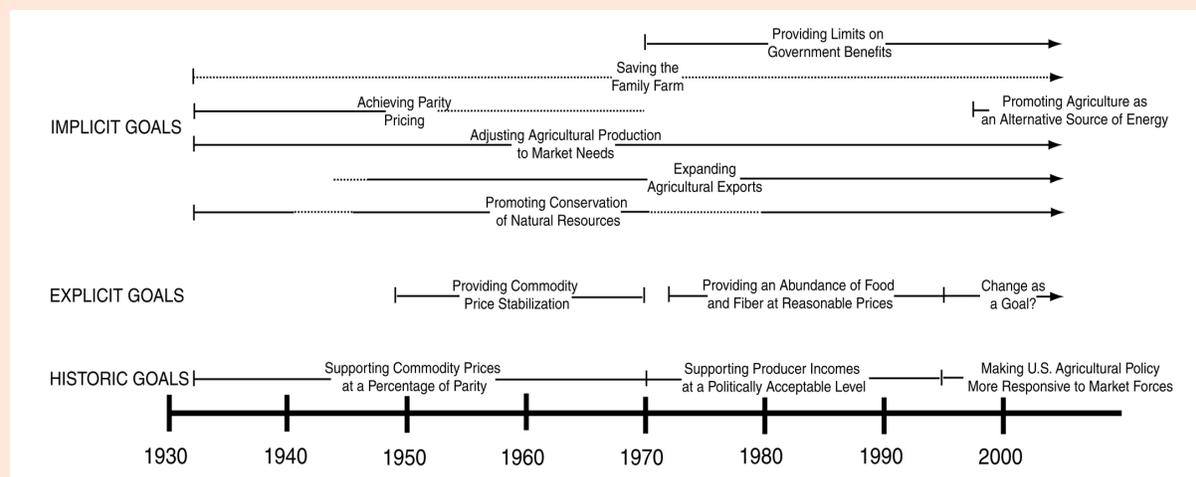


Figure 1. Agricultural policy goals: 1933-present.
Sources: Flinchbaugh and Knutson (2004); The National Agricultural Law Center (2007).

(Schertz & Doering, 1999). Questions were asked about commodity, conservation, export, nutrition, and rural development programs. A summary of these indicates that the attempt was made to ask the question, why do we have the farm policy we do? (i.e., what is the rationale, and are the programs effective in terms of what they purport to do?) The answers the committee received relative to the request were very broad and at least to some degree reflective of the conditions in agriculture at the time. The answers would certainly have been much different if the question had been asked at the height of the record prices in 1995 or at the very low prices realized less than two years later.

The Broad Response to Rationale for Involvement in Agriculture

If one were asked 20 years ago, what is the rationale for U.S. Government involvement in agriculture, a response might have been to increase farm incomes to the levels of urban incomes. Admitting the complication of off-farm income, this objective has been achieved. In addition, “farmers”

have more accumulated wealth than their urban cousins, usually in the form of land.

Another response might be a strategic one, i.e., that the nation needs to be self-sufficient in food. Without government involvement, would there still be an abundant food supply, would agricultural exports drop, and would less acres be cultivated? Few seem to be concerned that not enough food would be grown for domestic consumption. However, government involvement of some sort might be justified if food self-sufficiency were a national concern (in spite of the fact we wish other countries to do otherwise so we can increase our exports to them).

There is a strong rationale for government involvement in agriculture to reduce risk from natural causes – drought and flood. We accomplish this partially through subsidized crop insurance and partially through ad hoc disaster payments. There is a rationale for involvement and we are doing it, though probably less cost effectively than we might.

One broad rationale for government involvement under the “reduc-

ing risk” heading is the desire to have a stable industry over time. Investments in machinery, buildings, and human capital are relatively large in U.S. agriculture. It would be costly to the sector and to the public, through higher food prices, if there were cycles of capitalization and de-capitalization of these assets over time. This is different from decreases in land values, which the producer (or landowner) bears directly (decreases which farm groups fight to prevent). The banking community also has a large stake in this rationale, especially during times when loans have been based on asset values rather than on the ability to repay, as in the farm financial crisis of the late 1980s.

Price stability is another leg of the “reducing risk” rationale. Traditional farm programs after the 1930s used a “price stability” rationale to boost farm incomes by setting loan rates and later target prices above long-term average prices (contrary to Wallace’s “ever-normal granary” concept). Fred Waugh’s concern with the use of price stability as a vehicle for increasing farm incomes and the ensuing treasury exposure led him to write an article attempting to show

that price stability was not always best for the consumer (Waugh, 1994). The protection from risk, whether through price supports, direct payments, or insurance, for natural disasters involves a number of rationales for government involvement depending upon where one's interests are – helping beginning farmers, ensuring an inexpensive food supply, keeping farmers on the land, etc. Most have some credence as being in the national interest.

In some ways, agricultural policy and the rationale for it is becoming more closely tied to conservation of the land and the sustainability of agriculture than ever before. While conservation during the dust bowls of the 1930s was a rationale that could stand alone, it also became the vehicle for moving cash into rural areas to meet income needs through payments to farmers for adopting conserving practices and setting land aside. Today, conservation is a strong independent rationale for agricultural policy. The 1985 Farm Bill's cross compliance provision was to enforce basic national conservation standards on those farmers wishing to obtain the risk and income protection of commodity programs. The compliance standards have been reduced and enforcement has proved unpopular so this device has less impact. However, we see that the newer programs for conservation on working lands, EQIP, CSP, etc., reflect a public concern that conservation be a primary rationale for government involvement in agriculture. Programs like the Conservation Reserve Program have brought new supportive constituencies to agricultural conservation – in this case sportsmen and others interested in wildlife habitat, as well as improved water quality.

Nutrition programs are out of the inner circle of what is considered essential to government's involvement in agriculture. If these programs are to remain within the Department of Agriculture, they may have to become more closely linked to the traditional agricultural programs – if for no other reason than their political importance to these programs. The photos in most Congressional offices show the Congressman involved in the school lunch program, not in production agriculture. Food safety is in the same political situation. While nutrition and food safety largely stand on their own, other efforts, like export enhancement and trade liberalization, are intended to increase and/or stabilize the incomes of farmers.

While rural development and things like the FMHA programs remain part of government's involvement, they have not been of major importance since the Great Society. Given the current availability of credit from a variety of sources, there is less argument that a government credit role is as essential as it was in the 1930s. For example, Farmer Mac has not played the role that was envisioned for it and does not appear to be a least cost way to provide a function that may not be essential for government today.

Conclusion

The rationale for government involvement in agriculture has evolved from indirect involvement in the early years of the United States and income parity and the credit availability of the 1930s. Currently, the central remaining issues are risk reduction and the public's willingness to continue to provide income transfers and other assistance to this sector based on its strategic importance or

uniqueness. Senator Lugar's questions focused on whether government needed to continue to be involved, and what the most cost effective way to be involved would be if that is required. Few today ask if government involvement is needed, what the rationale is for the involvement, and then what the best way is to provide support. This may change as agriculture becomes viewed as a producer of biofuels and other bio-products in competition with food and at a potentially higher cost to the environment from more intensive and/or extensive production.

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