

May 6, 2002

FEFO 02-10

Brief Highlights of the 2002 Farm Bill

The Conference Report for the 2002 Farm Bill offered few surprises, representing a collection of compromises between the House Bill and the Senate Bill. It is now a six-year farm bill, entitled “Farm Security and Rural Investment Act of 2002.”

Below are some highlights of the Conference Report’s Commodity Title and Conservation Title. The other titles of the omnibus bill are on trade, nutrition, credit, rural development, research, forestry, energy, and miscellaneous items. The Conference Report passed in the House yesterday (May 4) and is expected to pass in the Senate early next week.

Commodity Title

In general, the commodity title offers the same type and level of income support that has been provided during the past four years by establishing (1) a loan rate program that increases the loan rate for corn and decreases the rate for soybeans, (2) the continued use of AMTA payments, and (3) a counter cyclical program that replaces the oilseed and Market Loss Assistance (MLA) payments.

Loan Rate Program. The national average loan rate for corn was increased from its current level of \$1.89 per bushel to \$1.98 for the 2002 and 2003 crops. The soybean rate was lowered from \$5.26 to \$5.00, while the wheat rate increased from \$2.58 to \$2.80. For 2004-07, the soybean rate remains at \$5.00 while the corn rate drops to \$1.95 and the wheat rate drops to \$2.75.

Inherent in the “safety net” feature of the loan program is the possibility of creating non-market price signals. In recognition of this, both the House and Senate Bills adjusted the relationship between the 1996 Farm Bill soybean and grain rates to

more closely reflect the relative costs of production between the crops. The House Bill made this adjustment in relative rates by maintaining the corn rate at the current level and lowering the soybean rate by 34 cents per bushel.. The Senate Bill's adjustment was made by decreasing the soybean rate by 6 cents and increasing the corn rate by 19 cents. The resulting compromise between the two bills increased the corn rate by 9 cents per bushel for 2002-03 (6 cents for 2004-07), while decreasing the soybean rate by 26 cents.

The rough calculus using average Illinois costs and yields suggests that the relative loan rates offered by the House Bill between corn and soybeans more accurately reflects a "market equilibrium" between the two crops than those offered by either the Senate or Conference Bills. Consider, for example, the case where average variable cost of production in Illinois is \$170 per acre for corn and \$106 for soybeans, coupled with average yields of 136 bushels and 39 bushels. If the corn loan rate is \$1.89, the corresponding soybean rate that provides the same return per acre is \$4.95. (The House Bill's loan rates were \$1.89 and \$4.92.) If the corn rate is increased to \$1.95 (the 2004-07 rate), the corresponding equilibrium soybean rates – using the above cost and yield assumptions – is \$5.16. Thus, when using average Illinois costs and yields, the adjustment from the 5.26/1.89 soybean/corn relationship of the 1996 farm bill to the 5.00/1.95 relationship of the 2002 bill may have moved us from a point where the soybean rate was too high – relative to the corn rate – to one where the soybean rate is too low – relative to the corn rate. However, this type of rough calculation does not take into account the difference in production and pricing risks between the two crops.

Nevertheless, it should be emphasized that, from an economic efficiency standpoint, the new relative rate structure between corn and soybeans is probably a better reflection of costs than that which has been used during the past six years.

Counter Cyclical Program. The counter-cyclical (CC) program of the 2002 Bill, in effect, institutionalizes the MLA (second AMTA payment) and oilseed payments that have been made each fall since 1998. These payments have been made on program bushels, in response to low commodity prices. The new CC payments will also be on the basis of program bushels when the national average price falls below levels specified in the 2002 Bill.

For the 2002 and 2003 crops, CC payments for corn will be triggered when the 12-month average price falls below \$2.32. For the 2004 - 07 crops, the price trigger increases by three cents per bushel (matching the three cent drop in loan rate) to \$2.35. For soybeans, the national average price below which CC payments are

triggered is \$5.36. For wheat, it is \$3.34 for 2002 - 04 and \$3.40 for 2004 -07. If the 12 month national average price is below the trigger price then the payment is equal to the difference between the trigger price and average price times program bushels. The maximum payment is the difference between the trigger price and loan rate times program bushels.

To determine program bushels for CC payments, producers have the option of either (1) keeping their current AMTA base acres and adding oilseed acres or (2) using the average 1998-2001 planted acres as the base. Payments are made on 85% of the base. If a producer updates base acres, he/she can either (1) keep the current program yield (and establish the program soybean yield) or (2) update yields with either one of two formulas.

Like the loan program, the general purpose of the CC program is to provide an income “safety net” to producers. However, an important difference between the loan and CC programs is that the loan rate applies to current production, while the CC rate applies to a fixed quantity determined on the basis of past production. This quantity is independent of what is being currently produced. Consequently, the primary “pricing signal” that faces the producer is provided by the market price and the loan rate. Since the CC trigger price does not apply to what is produced, it’s effect on production decisions is through an “insurance effect” that is triggered by price.

Direct Payment Program. Fixed payments, like AMTA payments, are made on traditional program crops, plus soybeans. Program bushels for direct payments are those that have been used for AMTA payments in conjunction with the establishment of program bushels for soybean. The direct payment rate is 28 cents per bushel for corn; 44 cents for soybeans; and 52 cents for wheat.

The support provided through direct payments does not vary depending on price, income, or other economic variables. Thus it is difficult to find “safety net” features in such a program unless it is in a long term context where the government is providing support during the current (and presumably short term) period of low prices. However, even in this context, fixed payments are bid directly into land rents, reducing if not eliminating any increase in the expected profit per rented acre caused by the payment. The impact of such payments, then, depends on the farmer’s tenure (land ownership) situation.

Income Support Level to Illinois Producers. The 2002 Farm Bill maintains or increases the level of income support that has been provided during the past three

years to Illinois corn and soybean producers. Under a “typical” scenario where recent support has been \$60 to \$70 per acre, it is estimated that the new bill is would provide \$5 to \$10 more per acre.

Payment Caps. Limits per individual producer are \$40,000 for direct payments; \$65,000 for counter-cyclical payments; and \$75,000 for LDP’s and MLG’s. The total limit of \$180,000 is effectively increased twofold to \$360,000 through the 3-entity rule, and because there is no limit on the use generic certificates (allowing unlimited LDP and MLG payments) \$360,000 is not an effective cap.

Other Provisions. A few of the other features of the commodity title include:

1. A new 42 month “target price” program for milk which is in addition to the current price support program. Payments are capped on production beyond that which is typically produced by about 140 cows.
2. A peanut production quota buyout over five years is established, and a target price program and loan rate program are introduced.
3. Marketing loan programs are established for wool/mohair and for honey. Support programs for these commodities were dropped in 1996.
4. New marketing loan programs were established for small chickpeas, lentils, and dry peas.

Conservation Title

Base line expenditures for the Farm Bill are expressed in terms of a 10 year budget, even though it is a six year bill. The total baseline expenditure for conservation programs – mostly for the CRP – over 10 years is \$21.5 billion. The 2002 Farm Bill provides for a \$17.1 billion increase over this baseline. This increase is close to that proposed by the House (\$17.5 billion) but less than the Senate’s proposed increase of \$22.5 billion. These ten-year expenditure estimates, however, do not reveal the annual outlays which are not necessarily (indeed rarely) equal across years.

A 10-year cost of \$9 billion is budgeted for the Environmental Quality Incentives Program (EQIP). Introduced in the 1996 Farm Bill, EQIP has assisted farmers in meeting environmental laws, particularly those associated with livestock waste management. The 2002 Bill allocates 60% of the EQIP funding to livestock practices and 40% to practices related to crops. A producer can receive no more

than \$450,000 of EQIP funding over the life of the Farm Bill.

The crop security program (CSP) is a new incentives program aimed at conservation practices on working lands. The CSP, authored by Senator Harkin, was passed in Conference at \$2 billion or more, depending on participation. The CSP offers three tiers of conservation contracts providing different levels of assistance, depending on whether the producer is using basic management practices, practices that address additional priority resource concerns, or practices that address all resource concerns of the operation.

Some other highlights of the of the Conservation Title include: (1) an increase of the CRP cap from 36.4 million acres to 39.2, and an increase in the WRP cap from 975,000 acres to 2.275 million acres; (2) relatively large increases in funding for the farmland protection program and the wildlife habitat incentives program; and (3) the introduction of a grasslands reserve program that can enroll up to 2 million acres of pastureland.

Summary

In sum, the commodity title of the Farm Security and Rural Investment Act of 2002 provides the same type and level of support to Illinois crop producers as that which has been provided since 1998. It does so by maintaining the loan-rate and AMTA programs, coupled with rules that determine when the second AMTA payments are made. The conservation title will provide several opportunities for Illinois producers of both livestock and crops to adopt conservation practices assisted by the Conservation Security Program and the Environmental Quality Incentives Program.

Issued by: Robert J. Hauser, Department of Agricultural and Consumer Economics