In Short ■ by Carl Zulauf, Luther Tweeten, and Allan Lines

The Federal Agricultural Improvement and Reform (FAIR) Act: Selected Implications and Unanswered Questions

Although the Federal Agricultural Improvement and Reform Act (FAIR) began as a battle over the budgetary cost of commodity programs, a desire for real change in farm programs became more important as the debate unfolded. High prices for field crops provided a window of opportunity to act on this desire. History teaches us that major policy changes generate substantial consequences, only some of which can be anticipated. In the next section we describe some of the potential implications of FAIR. History also teaches us that major policy changes answer fewer questions than they raise. In the last section, we enumerate some key unanswered questions and discuss them.

Implications

• The farm bill immediately ends supply controls (acreage reduction programs) and presumably will end production flexibility contract (PFC) payments from taxpayers to producers after year 2002. Safety net stabilization (marketing assistance loans and crop insurance) and environmental features (including conservation reserve) are retained and are likely to remain after 2002. The latter observation along with the retention of the permanent legislation of 1938 and 1949 argue that, at present, the bill is best thought of as a buy down to a lower safety net.

• Marketing loans and loan deficiency payments perform like target price deficiency payments, but this bill reduces the income support price on corn, for example, from $2.75 to no more than $1.89 per bushel. Considering only program yield and nonflex program acreage, this decline means that the support received above the loan rate declines from $0.86 per bushel of corn in 1995 ($2.75 – $1.89) to approximately $0.25 per bushel in 2002 based on estimated PFC payments. This is a 70 percent reduction in public support.

• Although the permanent laws remain, the traditional rationales are dead. The farm bill debate rarely mentioned family farms, small farms, food security, and the impact of farm price instability on consumers—traditional rationales for commodity programs. The debate was about commercial agriculture and the bill reflects this.

• Except for the Conservation Reserve Program and a small Emergency Food Security Commodity Reserve, government no longer accumulates buffer stocks nor sets aside acres as a strategic reserve for food security. Nonrecourse loans that resulted in forfeiture of crops to the government are replaced by marketing assistance loans. These changes will add to farm price/quantity variability and magnify the impact of managerial mistakes. Management quality will become even more important for success in the future than in the past.

• Between 1991 and 1995, small farms participated in farm programs less frequently than mid- and large-size farms. Although large farms received more absolute benefits per farm from programs, mid-size farms received more relative benefits (payment per receipt) and hence will be most disadvantaged by the program phase-down.

• Elimination of acreage restriction programs unleashes competition. Farmers can plant or not plant subject to market incentive and the few remaining planting flexibility constraints. Based upon farmers' response to the 15 percent flex-acre provision in the 1990 farm bill, substantial shifting of acres among crops and even the idling of field crop production can be expected. This will be further enhanced by the ability to hay and graze year-round on all contract acreage. States which border the Mississippi and Ohio rivers appear to be the big gainers in the forthcoming regional shifts in field crop production. (See Zulauf and Tweeten, *Choices* First Quarter 1996).

• The bill continues the trend to environmental protection and enhancement as the rationale for farm programs. Over time, the federal government has expanded the concept of environmental protection from soil conservation to water quality to wildlife habitats to protection of farmland from development. The Farms for the Future Program provides $35 million to preserve 170,000 to 540,000 acres of farmland from commercial development. Besides the limit on planting fruits and vegetables, conservation compliance and wetlands protection are the only eligibility criteria that affect contemporary production practices. Thus, PFC payments can be thought of as green payments. In addition, there are many other environmentally related programs, including the Environmental Quality Incentives Program and the purchase of farmland to assist in restoring the Everglades. In short, this is a very pro-environmental bill, especially when viewed

from the perspective of a conservative House of Representatives.

Key unanswered policy questions

• How great will economic instability be? The government will continue to provide risk protection but with less income enhancement to producers. The public buffer reserve of food security provided by acreage reduction programs, farmer-owned reserve, and stocks will be gone. Will the private sector provide sufficient buffer stocks and risk-shifting tools to satisfy the desires of producers and consumers?

• What will be the impact of quantity instability? Without land set-asides and only limited government stocks, quantity instability could become a greater problem for post-farm-gate agribusinesses than price instability. Throughput is critical for these firms, especially given their increasing size and fixed cost. One solution could be greater private stocks held by both elevators and processors. Processors should be thought of as including large livestock farms. Another solution could be production contracts between processors and crop farmers in the surrounding area. Thus, vertical contracting used in fruit and vegetable production could become the norm in field crop production. Quality control and the ability of biotechnology to create designer crops will also stimulate vertical contracting.

• Will farmers overproduce? The optimism associated with the new farm bill and currently favorable crop prices needs to be tempered. At current crop prices, farms have the capacity to produce in excess of what the market can absorb. A concern is that transitory high crop prices coupled with sizable payments in 1996 and 1997 will unduly inflate land prices and cause some farmers to overextend themselves financially, creating conditions for a shake-out in later years. History teaches and economics strongly predicts that, as long as productivity increases continue, real farm commodity prices in the future will be lower than they are today. This observation suggests that farmers should prepare themselves for long-term prices closer to the new marketing loan prices than current target prices, let alone today's high market prices.

• Will low farm prices sometime during the life of the 1996 farm bill cause the government to reestablish crop set asides, stock accumulation, and/or deficiency payments; or raise marketing loan rates? High marketing loan rates create more overproduction than the previous deficiency payments because the loan subsidies are coupled to current output.

• How will including feed grains in the emergency reserve promote food security? The emergency wheat reserve especially benefited poor countries—the only countries unable to purchase food security through imports when world food supplies are tight. The Security Wheat Reserve is now renamed the Food Security Commodity Reserve to reflect that corn, rice, and sorghum are added as eligible commodities. A four million metric ton cap is retained on the reserve.

• Will the sugar, tobacco, and peanut programs survive after the next seven years? These programs exist to enhance farmers' income, but this rationale has not saved other programs. Perhaps if these programs embrace environmental reasons for existence they will avoid joining honey and wool/mohair as historical footnotes.

• Will new arguments emerge for the ethanol tax subsidy? A key argument for this subsidy has been that the subsidy increases demand, which in turn increases price and reduces deficiency payments. With excess production capacity eliminated and the income support rate reduced below current free-market price levels, this argument loses its appeal.

• Will public outlays for food, the environment, and agricultural science and information fall along with outlays for commodity programs? An era of greater exposure to international market forces and a lower economic safety net would seem to warrant greater support for agricultural science, information systems, and environmental enhancement. The answer to the question will depend in part on whether the public views other programs as complements or substitutes for farm programs and/or private sector activities.

• Will PFC payments continue after FAIR expires? Chances for renewal may not be large for several reasons. One is that the same political and economic forces eroding commodity supports since 1985 continue. Another is that America will be on the threshold of a major fiscal drain from retiring baby boomers. A third is that, as budget balancing progresses and interest on the debt increases, taxpayers will perceive a decline in government services received per dollar of taxes paid. This perception may energize further budget cutting.

• Is it politically feasible to take a program historically designed to raise commercial farm income and efficiently target it to environmental needs? The strongest intellectual argument for continued government involvement in agriculture is to protect the environment from nonpoint source externalities. Society has already determined that farmers will be regulated on environmental practices. Farmers can determine by their collective decisions and actions whether or not they are paid for this regulation. The challenge will be to design programs which meet environmental needs, yet are targeted, effective, efficient, and administratively feasible. If these challenges are met and farmers accept the environmental rationale, PFC payments may continue after 2002 as incentives to use environmentally friendly practices.

The last three questions are part of a much larger question: What is the appropriate long-term role of government in agriculture? FAIR authorizes an eleven-member Commission on 21st Century Agriculture. This commission will monitor the impact of PFCs and by January 1, 2001, will make recommendations regarding the appropriate role of the federal government in agriculture. ■

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