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MARKETING AND POLICY BRIEFING PAPER

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Analysis of Key Non-Dairy Provisions of the Farm Security and Rural Investment Act of 2002

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Abstract

The contentious 2002 Farm Bill has been described by many as the most politicized farm legislation in recent history. Many lawmakers concluded that the 1996 Farm Bill was based on flawed assumptions and that U.S. farmers needed a more dependable safety net. Hence, their support for the 2002 Farm Bill, which represents a partial return to agricultural policies existing prior to the 1996 Freedom to Farm Bill. Many crop producers will see enhanced short-run returns under the new legislation. In addition, the new Farm Bill will remove incentives for expanded soybean production relative to corn in the U.S. Politically popular conservation payments increase under the new legislation. However, trading partners have been angered by the legislation. This will sour the atmosphere for agricultural trade liberalization negotiations in the Doha WTO Round, and may trigger additional complaints to be launched against the U.S. under the WTO dispute settlement mechanisms.

Overview

President Bush signed into law the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill) on May 13, 2002. The Dairy Title of the 2002 Farm Bill was analyzed earlier in Marketing and Policy Briefing Paper No. 76, authored by Ed Jesse and

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Bob Cropp. This paper gives an overview of the Bill and analyzes a few key non-dairy provisions of the new, six-year farm legislation

The 2002 Farm Bill has been described by many as contentious and the most politicized farm legislation in recent history. These traits of the bill are not necessarily evident in the strong votes for the legislation in the House of Representatives and the U.S. Senate. The House of Representatives approved the Farm Bill by a 280-141 vote. The U.S. Senate approved the legislation by a 64-35 vote.

But the degree of controversy surrounding the new Farm Bill is suggested by the splits in the vote in the Wisconsin Congressional delegation. Voting for the legislation in the House of Representatives were Republicans Mark Green, Thomas Petri, and Paul Ryan. Voting against the legislation were Democrats Tammy Baldwin, Thomas Barrett, Ron Kind, Gerald Kleczka, David Obey, and Republican, James Sensenbrenner. U.S. Senator, Herb Kohl voted for the legislation while Russ Feingold voted against it.

Karl Rove, White House political adviser, joked with U.S. senators about the need for a candle-lit ceremony to discourage television coverage during the Farm Bill signing. President Bush didn't resort to a candle light signing but gave the legislation faint praise with the comment, "It is not a perfect bill…no bill ever is." Wall Street Journal writer, David Rogers, described why President Bush was willing to sign the bill in these terms in a May 9, 2002 article,

> "Mr. Bush agreed to the extra spending early last year in a bid to win farm state votes for his tax cut. By the time the legislation began to take shape in the House last August, the administration couldn't afford to complain because it was trying to round-up farm-state votes for the president's Trade Promotion Authority (Fast Track) bill."

The administration also hoped that support of the Farm Bill would help the GOP win key U.S. Senate seats in the 2002 elections in Arkansas, Missouri, South Dakota, Iowa, and Minnesota and regain control of the U.S. Senate.

Opponents' Claims. Opponents of the legislation have described the 2002 Farm Bill variously as "bloated," "budget busting," "a reversion to Great Depression era farm programs," "makes farmers more dependent on government payments," "encourages overproduction of crops," "inflates land rents," and "ignores concerns about equity and payment limits." In a shrill editorial, the Wall Street Journal said that it was "A farm subsidy bill that would embarrass even the (interventionist, protectionist) French." Opponents less given to stinging rhetoric argue that farmers need trade, not aid.

Supporters' Claims. Supporters of the Farm Bill--including many major U.S. farm organizations-- argue that it provides a needed safety net for farmers, adheres to congressional budget guidelines, advances our international trade commitments, and protects fundamental reforms in the 1996 Freedom to Farm legislation.

This paper evaluates key non-dairy provisions of the 2002 Farm Bill using as a framework for part of the analysis the comments of opponents and supporters of the legislation. In the analysis, impacts of the bill on producers of grains and soybeans will be emphasized. It will be evident that strong concerns regarding the legislation relate to its negative impact on U.S. and world agricultural trade. The paper concludes with a discussion of environmental provisions in the new legislation.

Claims of Critics of the Legislation

Budget Busting. Opponents' claims of "budget busting" are rooted partly in memories of the smaller farm program expenditures of 1988 to 1997 when Commodity Credit Corporation (CCC) expenditures averaged only about $10 billion per year. Many politicians thought that these numbers represented the new, lower spending for subsidies for a farm economy stoked by strong agricultural exports. But when commodity prices fell in the late 1990s, the Congress and Administration came forward with emergency funds to shore up farm subsidy payments under the 1996 Freedom to Farm legislation. CCC expenditures (including disaster aid) have averaged near $20.6 billion for the five-year period running through September 30, 2002. Spending under the 2002 Farm Bill is projected to approximately match the expenditure levels of the most recent five years while attempting to reconstruct a more permanent safety net for farmers.

Projected spending under the new Farm Bill is consistent with federal budgeting measures that fit the agricultural legislation into a 10-year budget allocating $73.5 billion in additional, new agriculture-related spending over the next decade. The equivalent number for the six-year life of the 2002 Farm Bill is about $45 billion. Critics of the legislation fear that low farm commodity prices will push expenditures far above those forecast for the new legislation (possibly up by an additional $80 to $100 billion for the 10-year period) at a time when federal budget deficits are forecast to be in the $100 to $200 billion per year range. This is a valid concern but it is difficult to assess how much the additional spending will be. The amount of actual additional outlays will be influenced by the weather, the size of farm exports and other factors. But higher than expected budget outlays put the Congress and Administration in the unpopular business of raising federal debt limits.

A Return to Great Depression Era Farm Programs. While the 2002 Farm Bill retreats from many provisions in the 1996 Freedom to Farm Bill, it is a stretch to claim that that the 2002 Farm Bill is a return to Depression era farm programs. What the new legislation does is resurrect certain farm program provisions that existed prior to the 1996 Farm Bill. In particular, it restores target prices and deficiency payments to grains and cotton. It also extends target prices and deficiency payments to soybean producers, a commodity group that didn't have access to such support prior to the 1996 Farm Bill. The 2002 legislation also raises loan rates for several crops. More details on these changes appear in the discussion of programs for the grains and soybeans.

Architects of the new legislation gave legitimacy to claims of returning to Depression era farm programs when they opted to create new programs for dry peas and lentils and for resurrecting programs for wool, mohair and honey. There also included a $94 million subsidy for apple producers. While political concessions undoubtedly were needed to obtain support for the new Farm Bill, resurrecting dead programs smacks of excess. Critics wonder aloud: Is there no limit to commodities that can be subsidized? Moreover, it may not be good politics to create programs that can be held up to ridicule. People of influence may eventually say, "enough."

What the 2002 Farm Bill didn't do was return to supply control measures such as Acreage Reduction Programs (ARPs) or other land withdrawal measures that existed in pre-1996 Farm Bill legislation. Farmers got a taste of freedom to farm under the 1996 Farm Bill and they liked it. Accordingly, they lobbied successfully to resist a return to supply control. Thus, it could be argued that the 2002 Farm Bill provides relatively high support levels for certain crops without supply restriction--a recipe for high budget outlays for farm subsidies. While there is an element of truth in this argument, the ARPs and land withdrawal measures used in previous programs were not particularly effective for controlling supplies anyway. Thus, the absence of supply controls is not a serious shortcoming in the 2002 Farm Bill.

Makes Farmers More Dependent on Farm Programs, Encourages Over Production, and Raises Land Rents. It is valid to claim that the 2002 Farm Bill makes farmers more dependent on farm programs. Farmers respond to economic incentives. Farmers observed that the Congress and Administration were backing away from the market-oriented 1996 Farm Bill--even before the 2002 Farm Bill was crafted. The new bill will reinforce farmers' belief that they can depend on subsidies for at least the next six years and probably much longer.

The higher loan rates for certain crops under the 2002 Farm Bill will encourage additional production at a time when crop surpluses exist in parts of the world. How much impact the higher loan rates will have on production is uncertain. Developments that raise returns to crop producers over the longer-run such as higher loan rates and deficiency payments presumably will be capitalized into land rents. Moreover, the certainty of the higher returns for at least six years will encourage the capitalization.

Ignores Concerns About Equity and Payment Limits. Senator Richard Lugar, a ranking Republican member of the Senate Agriculture Committee and one architect of the 1996 Freedom to Farm Bill, complained that most of the increase in subsidy payments under the 2002 Farm Bill is earmarked for large farmers who grow primarily corn, soybeans, wheat, rice and cotton. Other congressional critics assert that two-thirds of the increase in subsidies will go to just 10% of farmers. These figures implicitly recognize that farming in the U.S. has become more concentrated and that--absent payment limits--most of the government subsidies go to big farmers. Lugar's complaint and those of other Congressional critics about large transfers of funds from the U.S. Treasury to big farmers raise the equity issue. However, the complaints apparently gained little traction. This is a testimonial to the political power of crop commodity groups. Alternatively, it is implicit recognition that benefits under farm programs are concentrated and costs are diffuse. The latter produces apathy toward farm program spending on the part of the nonfarm population.

Payment limits were controversial in the Farm Bill debate. In part the controversy arose because data placed on the internet showed that some large growers--especially cotton and rice producers--received multi-million dollar annual payments under the 1996 Farm Bill and supplements to the Bill. The Senate version of the 2002 Farm Bill contained a $275,000 annual limit on payments for an individual farmer. The House of Representatives version of the Bill--partly at the insistence of cotton state representatives--contained a larger limit, causing the payment limit in the final bill to be raised to $360,000 per year. And even this larger limit can be legally circumvented.

Claims of Supporters of the 2002 Farm Bill

As is widely known, the 1996 Farm Bill was supposed to wean U.S. farmers away from government subsidies. However, the Congress and Administration heeded calls for additional support when times became tough for farmers. Many Congressional supporters of the 1996 Farm Bill concluded that it did not work and that it was based on flawed assumptions. Many of these same people became persuaded that a more effective farm safety net was needed.

Why Key Provisions of the Market-Oriented 1996 Farm Bill were Abandoned. Important political developments caused the 2002 Farm Bill to bring about a partial U-turn in agricultural policies. But U.S. and world economic developments also conspired to strip the current Farm Bill of many important provisions contained in the 1996 Farm Bill. The 1996 Farm Bill, as indicated earlier, was drafted when U.S. farm exports were large and forecasted to grow larger. Lofty forecasts suggested that U.S. agricultural exports could reach $100 billion by early in the 21st century. But agricultural exports languished in the period following passage of the 1996 Farm Bill (Table 1). In 1999, U.S. farm exports were down about 18% from 1996 levels.

Table 1. U.S. Farm Income and Agricultural Export Figures, 1996-2001.*

Receipts and Export Figures	1996	1997	1998 ($Billion)	1999	2000	2001
Cash Receipts						
Crops	106.3	111.2	101.7	92.6	94.1	95.8
Livestock	92.9	96.5	94.1	95.5	99.5	106.1
Direct Gov't Payments	7.3	7.5	12.4	21.5	22.9	21.1
Net Cash Income	57.7	58.5	54.8	55.7	57.5	59.5
Ag. Exports	59.8	57.3	53.6	49.1	50.8	52.8

*Source: USDA, Agricultural Outlook, various issues, 1996-2002.

U.S. farm cash receipts for crops declined most during 1996 to 2001. Thus, the emphasis on providing a safety net for crop producers in the 2002 Farm Bill is understandable. Livestock receipts actually recorded an increase, particularly in the latter years of the period. Moreover, livestock producers will benefit from the cheap feed generated under the Bill and accordingly may have less need for subsidies than crop producers.

The fall in the value of U.S. agricultural exports in the late 1990s is traceable partly to an increase in the value of the U.S. dollar and other developments. One of the other developments was increased world production of tradable farm products in the five-year period following passage of the 1996 Farm Bill (Table 2). This increase is particularly evident for oilseed crops, partly as a result of expanded soybean production in Brazil and Argentina. Indications of shortages are largely absent from the figures.

Table 2. Annual Average Increase in World Production from Five Years Before (1991/92-1995/96) to Five Years After (1996/97-2000/01) the 1996 Farm Bill, Selected Agricultural Products.*

Product	Five-Year Average Production Increase	Product	Five-Year Average Production Increase
Wheat	8.2%	Rice	9.2%
Coarse Grains	6.3	Cotton	1.7
Oilseeds	21.3	Beef & Pork	8.6
Meal	20.9	Poultry	32.2
Oils	23.3	Milk	1.4

*Source: USDA, Agricultural Outlook, Various issues, 1992 to 2002.

The Needed Safety Net. The 2002 Farm Bill will provide a safety net of sorts since many subsidies under the Bill increase when farm prices are low. Both farmers and farm input suppliers welcome the safety net. Deere, for example, which has recorded depressed farm equipment sales in recent quarters, believes that the new Farm Bill and recovery of the U.S. economy will produce higher sales for the company later in 2002.

There is also logic to supporters' claims that it makes sense to incorporate the larger safety net payments to farmers in legislation rather than make ad hoc supplements to legislation as was done under the 1996 Farm Bill. Why go through the bother of making annual supplements to the subsidies when the supplements are going to be made anyway?

Adherence to Congressional Budget Guidelines. As mentioned earlier, spending under the new Farm Bill is consistent with federal budgeting measures that fit the agricultural legislation into a 10-year budget allocating $73.5 billion for additional, new agriculture-related spending over the next decade. Congressional supporters of farm legislation obtained the $73.5 billion commitment and secured agreement from the Administration for it in 2001. Congressional supporters of the new farm Bill welcomed the early commitment because they feared that the tax cut enacted in 2001 would make less money available for farm programs. The commitment remained acceptable to the Administration despite the additional claims on the federal budget made by the events of 9/11/2001.

Protects Fundamental Reforms in the Freedom to Farm Legislation. This claim is too sweeping to be accepted in full, but there is something to it. The 2002 Farm Bill does not revert to supply control. Moreover, the continued use of marketing loans--which allow domestic prices to fall to market clearing levels--will keep the higher loan rates for some crops under the 2002 Farm Bill from pricing U.S. crops out of foreign markets. Thus, the legislation does not create the problems of the type that emerged under the 1981 Farm Bill when high crop loan rates priced U.S. crops out of foreign markets. It is difficult to find other fundamental reforms that were retained.

Advances U.S. International Trade Commitments. This questionable claim was made by Assistant to the President for Economic Policy, Larry Lindsey. Mr. Lindsey explains the claim as follows in a May 14, 2002 Wall Street Journal editorial:

> "The President believes America must play a leadership role in international trade and that the farm bill must advance this important principle. Not only does the spending in the final bill live within the limits of the World Trade Organization, but the legislation also contains a newly created circuit breaker that requires an automatic reduction in subsidies if we violate our WTO commitments. Thus, we have finally legislated an assurance of our compliance with international trade commitments."

Lindsey's comments are noteworthy. However, whether a country meets its WTO commitments is a complex question. Furthermore, whether the circuit breaker spoken of Lindsey would actually be used to reduce U.S. farm subsidies if the country's WTO commitments were not being met also is unclear. Trade issues raised by the new Farm Bill are discussed in more detail later.

Impact of the Crop Provisions of the New Farm Bill

As noted earlier, the crop provisions in the 2002 Farm Bill are among the most important, contentious, and costly in the legislation. Essentially, the new Farm Bill employs three different types of income support programs for grain, soybean, and minor oilseed producers. These include:

1) a retention of the basic loan provisions, including both market assistance loans and loan deficiency payments contained in the 1996 Farm Bill,
2) the introduction of a direct payment for program crops regardless of whether the crop is planted or not (this provision is very similar to the AMTA payments from the previous Farm Bill), and
3) the introduction of counter-cyclical payments based on identified target prices (very similar to the deficiency payment program from farm legislation prior to 1996).

Loan Program

As with the 1996 farm bill, the program benefits are designed to provide farm level income support without supporting market prices above market clearing levels. In fact, consistent with the 1996 program, the production incentives associated with program benefits will likely result in lower average market prices (in the absence of a production disaster) then would exist in the absence of income support programs.

The new farm legislation retains the basic loan provisions of the 1996 Farm Bill, except that loan rates have been changed. The program allows farmers to place a crop under loan when prices are below the loan rate, but also allows them to simply sell the crop at the current market price and collect a loan deficiency payment (LDP) equal to the difference between the county posted market price and the established crop loan rate. This second option is available to producers who forgo the opportunity to place their crop under loan.

Loan rates for corn, wheat, and soybeans have been adjusted from earlier levels to reduce incentives to expand soybean acres at the expense of grains. The new legislation increases the loan rates on corn and wheat, and reduces the loan rate on soybeans (see Table 3).

The new loan program has been expanded in terms of opportunities available. In addition to LDP's on program crops, and hay and silage from program crops, producers are now eligible for LDP's on grazed wheat, oats, barley, and triticale. Unlike direct payment and counter-cyclical payment benefits, loan program benefits cover all of a farm's production of loan program crops.

Table 3. Loan Rates, Payment Rates, and Target Price for Grains and Oilseeds

	Loan Rate		Direct Payment	Target Price	
	2002-2003	2004-2007		2002-2003	2004-2007
Corn (bu)	$1.98	$1.95	$0.28	$2.60	$2.63
Sorghum (bu)	$1.98	$1.95	$0.35	$2.54	$2.57
Barley (bu)	$1.88	$1.85	$0.24	$2.21	$2.24
Oats (bu)	$1.35	$1.33	$0.024	$1.40	$1.44
Wheat (bu)	$2.80	$2.75	$0.52	$3.86	$3.92
Soybeans (bu)	$5.00	$5.00	$0.44	$5.80	$5.80
Minor Oilseeds (lb)	$0.096	$0.093	$0.008	$0.098	$0.101

Producers who elect to place a program crop under loan face provisions similar to those from the 1996 farm bill. Specifically, the term of a marketing assistance loan is nine months from the month in which the loan is made. Under no circumstances are loan term dates to be extended. In general, marketing loans must be repaid at a rate equal to the loan rate plus interest. However, the Secretary of Agriculture has the authority to lower the rate at which the loan is prepaid to minimize potential loan forfeitures, and thus commodity stocks held by the federal government.

Producers who agree to forgo the loan program can receive an LDP representing the difference between locally posted market prices and loan rates. This is also true for hay or silage derived from a program crop. As currently written, it appears that the 2002 farm bill maintains earlier provisions concerning when a producer becomes eligible for LDP's (this has typically worked to the disadvantage of Upper Midwest grain producers as corn prices have historically recovered to levels above loan rates by the time they were eligible for corn LDP's). However, this may be subject to some revision as USDA considers specific rule implementation under the new farm bill.

Producers who elect to graze wheat, oats, or barley can collect LDP's on those crops if they agree to forgo any harvesting of the grazed crop acres. The payment level is determined by multiplying the loan rate by the number of grazed acres and the payment yield (described below) for which direct payments can be collected.

Direct Payment Benefits

The second income support program for grain producers in the current Farm Bill is direct payments for grain production based on established acreage and yields. The direct payment program is similar to the AMTA payments of the previous Farm Bill, but oilseeds (including soybeans) have been added as a program crop. AMTA payments were introduced in 1996 as a way to transition grain farmers out of government price supports and into an environment where market prices determined the relative rewards associated with producing different crops. However, with grain prices consistently below loan rates in recent years, the AMTA payments were critical to grain farm profitability.

The direct payment program requires the Secretary of Agriculture to make a payment every year for each program crop with established base acres and yields. The total payment is determined by multiplying the payment rate from Table 3 above times a producers payment acres times a producer's payment yield. Payment acres and yields are calculated based on the base acres and yields established by producers with the local FSA office.

While there are a couple of options a producer can use to establish base acres, they basically consist of average acres that were either planted or planned to be planted (but for some reason prevented) from the 1998 through 2001 crop years. Payment acres are 85 percent of the established base for each crop.[1]

Payment yields for direct payment benefits are unchanged from the 1996 Farm Bill (i.e., equal to AMTA yields). For soybeans, there were no established yields under the old farm program because soybeans were not considered a program crop. As such, soybean yields for producers will be established based on the average yield per planted acre from 1998 through 2001, excluding years in which there were no soybeans planted. The 1998-2001 average yields are then adjusted by the ratio of national average yields for soybeans from 1981 through 1985 to the national average yields for soybeans from 1998-2001.

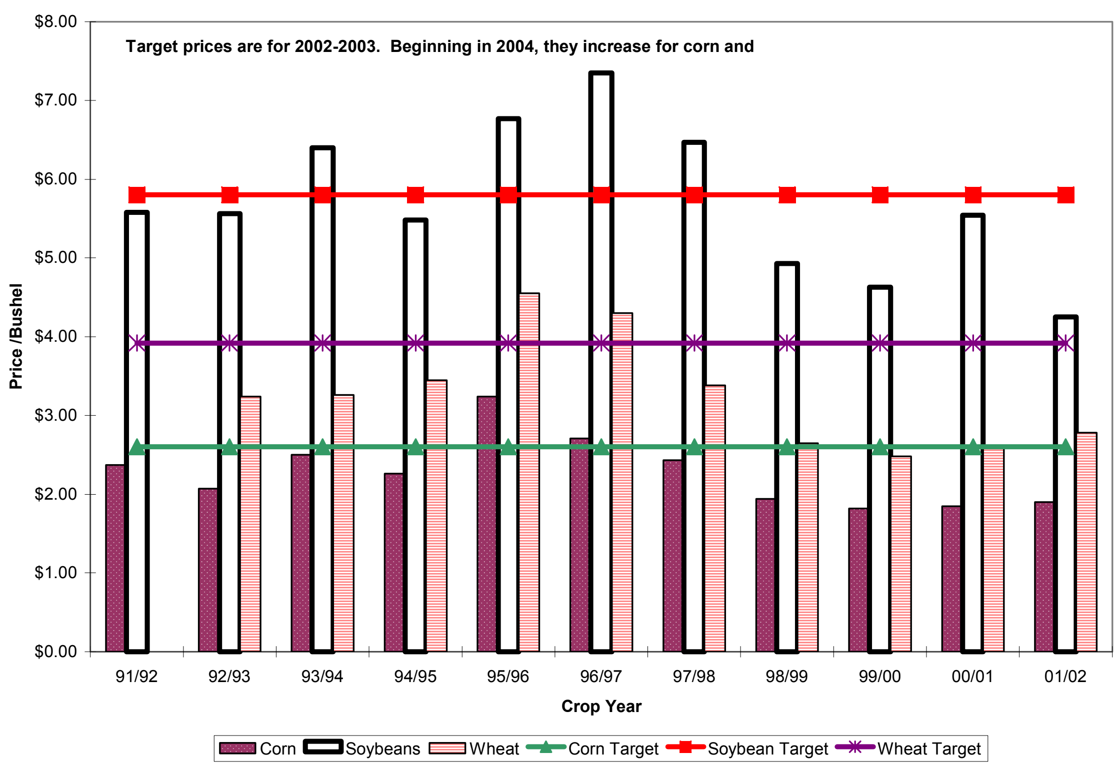
[1] Producers have the option of retaining the current AMTA acreage base from the 1996 Farm Bill and adding to that past oilseed acres, or updating base acres using the average of 1998-2001 planted and prevented planted acres for each program crop.

Producers can elect to receive half of the direct payment beginning December 1 of the year prior to the year the crop is harvested. The other half of the direct payment would be received in October of the year the crop in harvested.

Counter-Cyclical Payments

The third component of income support in the 2002 farm bill is the introduction of counter-cyclical payments. Counter-cyclical payments look much like the deficiency payment program from the 1980's. Essentially, the farm bill identifies a set of target prices for each program crop (Table 3), and authorizes USDA to make counter-cyclical payments to producers who have established payment acres and yields whenever the effective market price for a given commodity is less than the target price. Note from Figure 1 that average farm level prices for both corn and soybeans have been consistently below the newly established target prices for most of the life of the previous farm legislation. Thus, had this program existed in previous years government payments to grain producers would have been significantly higher.

Figure 1. National Average Farm Prices Relative to Target Prices.



The effective market prices used to determine whether counter cyclical payments will be made is defined as the higher of:

1) the national average market price received by grain crop producers in a given marketing year, or

2) the national average loan rate for a commodity.

The combination of the effective market price determination and the LDP program insures that a producer will receive the difference between the target price and the market price even when, market prices are below loan rates, for all eligible payment acres.

Payment acres eligible for counter-cyclical payments are the same as for direct payments. However, payment yields for counter-cyclical payments are determined one off three ways:

1) the same as program yields from the 1996 Farm Bill,
2) program yields are updated by adding 70 percent of the difference between old program yields and actual yields from 1998-2001, or
3) program yields are calculated at 93.5 percent of average yields from 1998-2001.

Producers can elect which of the three methods above are used. Further, if option 2 or 3 is selected, and a producer experienced an actual yield in any year less than the county average yield, 75 percent of the county average yield can be substituted for the actual farm yield.

Note that while loan rates for some program crops decline after the 2003 crop year, target prices for the same crops increase, leaving producers with essentially the same level of coverage on program payment acres (actual coverage declines slightly since LDP's are available for an entire crop and counter-cyclical payments are only available based on payment yields and acres).

In general, the Secretary of Agriculture will determine if counter-cyclical payments are likely to be paid in a given crop year (for winter wheat the crop year begins July 1, and for corn and soybeans September 1). The payment will then be made in three parts: the first by October 31 of the year the crop is to be harvested, the second in February following harvest, and the third at the end of the 12 month marketing year. In general, a producer would receive 35 percent of the expected payments on each of the first two dates, and the remainder on the last payment date. Note, however, that an unexpected rally in prices late in the marketing year could actually result in producers having to re-pay some or all of the early payments. This would happen if actual average prices realized over the 12-month marketing year were higher the forecast the previous October.

<u>Eligibility</u>

To remain eligible for both direct payments and counter-cyclical payments producers must be in compliance with the conservation requirements of the 1985 farm bill, comply with wetland protection requirements fro the 1985 farm bill, control noxious weeds, and comply with the planting flexibility requirements introduced in 2002. These essentially prohibit a producer from planting fruits, vegetables, or wild rice on base acres.

Market Implications

It should be noted that the 2002 farm bill, despite political arguments to the contrary, represents a significant departure from the intent of the 1996 Farm Bill. The 1996 Farm Bill was focused on positioning U.S. agriculture to respond to market price incentives. The new loan program is similar in structure and focus to that from the 1996 legislation, but has been expanded to include additional crops. The direct payment and counter-cyclical payment provisions, however, insulate production agriculture from much market impacts, at least those associated with over-production. The direct payment program, while structurally similar to the AMTA program, has a very different focus. The acronym AMTA from the old farm program stood for Agricultural Market Transition Act. The purpose was to provide producers with gradually decreasing payments over a seven-year period for program crops. At the end of seven years, producers would no longer receive transition payments, and need to make production and marketing decisions based on market prices. The new legislation reverses makes no pretense that a transition to market price incentives will be forthcoming. By referring to the current payments scheme as direct payments, and not offering any language relative to transitioning away from direct payments, the new farm bill reverts to the philosophies of earlier times; namely grain producers should not be exposed to the whims of the market place.

Secretary Veneman has defended the current Farm Bill by arguing that if one takes into account all the emergency legislation enacted over the life of the 1996 Farm Bill, the current program is not much, if any, more expensive than the 1996 Farm Bill. While this may be true (of course this assertion is based on current price projections that may prove to be overly-optimistic), it ignores the fact that the 1996 farm bill was to transition into a market based production environment.

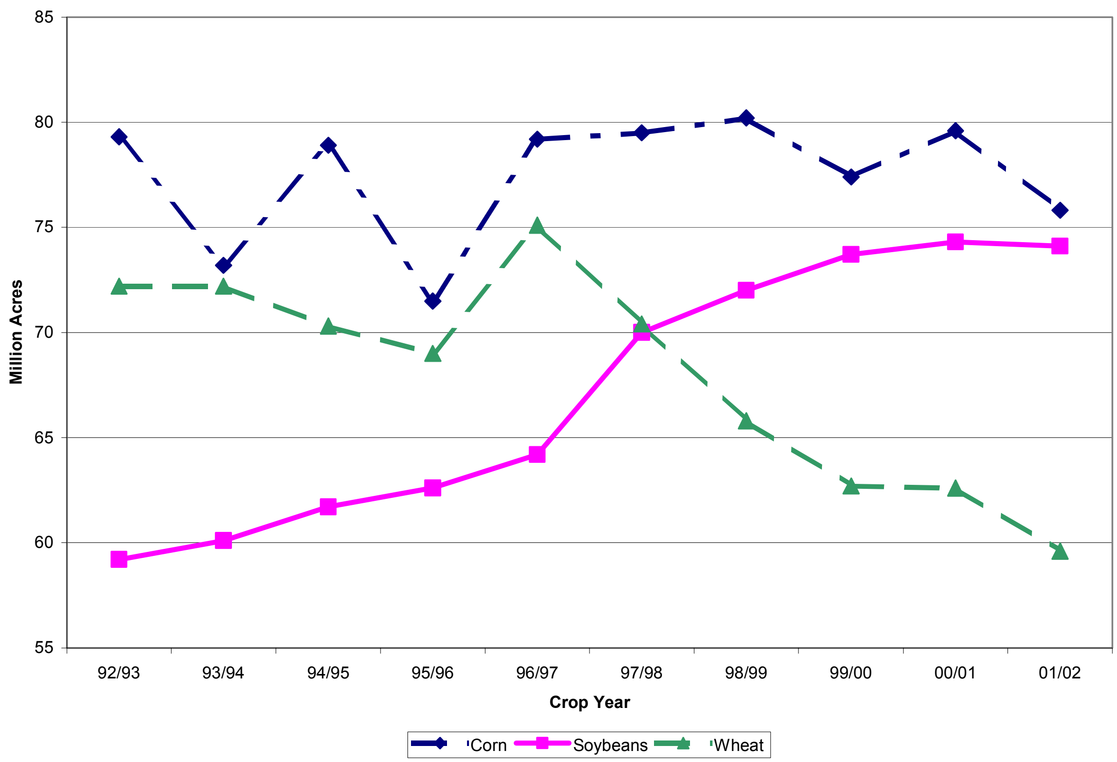
Whether abandoning the move to a market based agriculture is a good or bad idea depends on your perspective. However, it is clear that in the short run grain farmers will be better off than was the case the last several years. In the longer run the production incentives encompassed in current legislation (in the absence of a production disaster) suggest market prices for program commodities will continue to stay low and go lower.

The addition of counter-cyclical payments to the program benefits already in the 1996 Farm Bill increases production incentives at any market price. Given the level of target prices for grains and soybeans relative to market prices in recent years, it can be expected that counter-cyclical payments will be available in all normal production years. The likelihood of average prices going above target levels in the current production environment is very low. However, since grain farm incomes can increase relative to past years even with lower market prices, there is little incentive to reduce production as market prices decline. This incentive structure has and will continue to draw criticism from international trade competitors. Interestingly, the farm legislation of the late 1970's and early 1980's has been sharply criticized because of the impact on international prices.

In the early 1980's, we were the dominant producer and exporter of both feed grains and soybeans. However, domestic policies aimed at supporting farm level prices for program commodities resulted in an international price floor, allowing potential competitors to expand production with limited and known downside price risk. The current program does just the opposite. By maintaining farm incomes at levels that otherwise could only be generated at substantially higher farm prices, producers are encouraged to over-supply the market. Unlike earlier times when over-production was held off the market (the government simply took the perceived excess supply off the market through the loan non-recourse program) the current legislation encourages continued sales at low market prices. This will result in driving world prices for U.S. export crops below levels that would exist in the absence of a U.S. income support program. Further, the higher the level of income support, the greater the expected production, thus the lower the actual market price realized.

A positive aspect of the current target prices for corn, wheat, and soybeans is that they appear to eliminate the program preference for soybeans over row crops. The loan rates contained in the 1996 farm bill encouraged soybean production over corn and wheat production. As a result, U.S. producers expanded soybean acres aggressively at the expense of corn and wheat (see Figure 2). The target prices for corn, wheat, and

Figure 2. U.S. Planted Acres.



soybeans contained in the 2002 farm bill put the relative prices on neutral ground relative to production incentives. For example, the target price for soybeans represents is about

2.2 times the loan rate for corn, a price premium at which farmers are generally indifferent between soybean and corn production. This allows acreage shifts between the two crops to be driven by agronomic decisions, not price incentives. Under the old program, the soybean loan rate was almost 2.8 times the corn loan rate, providing a strong incentive to plant soybeans over corn when loan rates were expected to be equal or higher than market prices.

Impact of the 2002 Farm Bill on Agricultural Trade Negotiations

The 2002 Farm Bill is likely to have chilling effects on agricultural trade negotiations, and ultimately on the amount of world trade in agricultural products. The first relates to the impact of the Bill on the Doha Round trade negotiations under the WTO. The second relates to claims that the U.S. might exceed domestic subsidy reduction commitments agreed to under the Uruguay Round WTO agreement. Brazil's WTO challenges to agricultural trade distortions created by U.S. legislation may represent an important longer-term threat to U.S. domestic agricultural policies.

Impact on the Doha Round of WTO Trade Negotiations. In keeping with earlier declarations, the U.S. vowed to support additional liberalization of agricultural trade under the Doha Round of WTO trade negotiations that began in Doha, Qatar in November 2001. The European Union (EU), which had little desire to further liberalize trade affecting EU farm products, agreed to engage in farm trade negotiations partly because of support from the U.S. and other countries for putting such measures on the negotiating agenda. Long criticized for huge agricultural subsidies, the EU now makes frequent, self-righteous, complaints about U.S. farm policies. For example, EU officials point out that under the 2002 Farm Bill, U.S. farm subsidies on a per farm basis could exceed those of the EU. This is possible in part because the EU has many small farms. The claim also ignores the fact that in the EU farm subsidies, in the aggregate, were nearly 75% larger as a percentage of production than those of the U.S. in 2000. Nonetheless, the 2002 Farm Bill will give the EU a convenient rationale for foot dragging on agricultural trade liberalization.

Politicians from other countries point to the 2002 Farm Bill and claim that the U.S. urges other countries to "do as I say not as I do." In this connection, the 18-nation Cairns Group of farm exporting countries--which has long favored freer agricultural trade-- issued a statement in Mid-May 2002 attacking the larger, trade-distorting subsidies in the 2002 Farm Bill. Foreign politicians also lump the new higher U.S. tariffs on steel and the 2002 Farm Bill together, claiming that the two measures provide evidence that the U.S. is turning protectionist. Trade negotiators from other countries will use these actions to raise questions about the credibility of U.S. positions on trade liberalization in the upcoming WTO round. This will be particularly true if the Bush Administration fails to secure meaningful Trade Promotion (Fast Track) negotiating authority. At a minimum, the new Farm Bill creates an unfavorable atmosphere for agricultural trade negotiations under the Doha Round.

The country of origin labeling provision included in the Bill also might lend credence to claims the U.S. is turning protectionist. This provision, which applies to meat, fruits, vegetables, fish, and peanuts, requires the Secretary of Agriculture to provide guidelines for voluntary labeling by September 30, 2002. For a commodity to be labeled a USA product, it must be produced and processed in the U.S. Products that are ingredients in processed products would not fall under the labeling requirement. Arguing that the provision will substantially increase costs, a number of U.S. importers have vowed to resist full mandatory implementation of the provision. Exporters claim that country of origin labeling represents a nontariff trade barrier.

Complying with WTO Aggregate Measures of Support Commitments. The strong possibility for increases in trade-distorting subsidies under the 2002 Farm Bill raises questions about whether the U.S. can meet Aggregate Measure of Support (AMS) commitments under the WTO. Under the Uruguay Round WTO Agreement, the U.S. and other countries made commitments to reduce trade-distorting domestic subsidies provided to farmers. The implementation period for the commitments was 1995 to 2000.

Domestic farm subsidies under the Uruguay Round Agreement are measured using a specially designed indicator, the AMS. In 1994, 28 countries including the U.S. established ceiling levels for their AMS and agreed to reduce them by 20% by 2000. For 2000, the U.S. AMS ceiling was $19.1 billion and will remain at this level for subsequent years until a new agricultural trade agreement is reached in the Doha negotiations.

In the arcane language of the WTO, domestic support for agriculture is classified into three basic categories for purposes of AMS calculations and WTO notifications: Green Box (least trade-distorting), Blue Box (contains supply-control provisions that partially offset trade-distorting effects), and Amber Box (most trade-distorting effects). The Green Box and Blue Box effects as well as some *de minimis* support expenditures are excluded from the AMS calculations.

The Green Box exclusions are important to the U.S. In recent years, the three largest Green Box exclusions in value terms were decoupled income payments (production flexibility contract payments), resource retirement payments (Conservation Reserve payments), and payments for natural disasters affecting crops and livestock.

With minor exceptions all Amber Box support must be counted in the AMS calculations. Among the largest Amber Box payments made by the U.S. are market price supports for dairy products and sugar and marketing assistance loans, especially loan deficiency payments. In the January-February 2002 issue of Agricultural Outlook, the USDA reported that:

> "The U.S. AMS in 1998 was $10.4 billion, just 50 percent of the $20.7 billion ceiling. Preliminary estimates for 1999 and 2000 indicate that the average AMS during these years was nearly 60 percent higher than in 1998. This means the AMS for these years would now be much closer to the ($19.1 billion) ceiling, perhaps as much as 80 percent (of the ceiling)."

The USDA reported that the increase in AMS for 1999 and 2000, in particular, reflected primarily the larger loan deficiency payments and market loan gains received by producers. There were also increases in AMS stemming from increases in emergency programs for different agricultural products.

Given the increase in potentially trade-distorting (Amber Box) subsidies under the 2002 Farm Bill, it is not clear whether the U.S. will stay within the agreed to AMS ceiling of $19.1 billion. It is difficult to make useful forecasts on this point. However, to qualify for the Green Box exclusion, payments under the 2002 Farm Bill (a) must not involve transfers from consumers, (b) shall not have the effect of providing price support to producers, and (c) shall have no, or at most minimal, trade distorting effects on production. These presumably will be tough standards for certain crop price support provisions to meet under the 2002 legislation. And since supply control measures are absent from the bill, presumably no programs will qualify for the Blue Box exclusion.

But, as noted earlier, if the U.S. does appear likely to exceed the AMS ceiling it can, in theory, reduce subsidy levels to comply with the ceiling. The "in theory" qualification is important. Administration initiatives aimed at reducing support levels to comply with a WTO ceiling are likely to trigger lobbying to prevent such an action. If successful, such lobbying would make trading partners even more cynical about U.S. commitments to agricultural trade liberalization.

Brazil's Challenges to Trade-Distorting U.S. Agricultural Policies. Brazil's strident comments about trade-distorting U.S. agricultural policies fall in the category of "I am mad as h--- and I am not going to take it anymore." The Brazilians argue that U.S. farm programs deprive their soybean and cotton farmers of more than $1.5 billion per year in exports. Brazil and the U.S. also have long-running disputes about orange juice imports. For soybeans, the argument is that U.S. soybean subsidies prevent Brazilian farmers from gaining access to expanded foreign markets. This is an important issue for Brazilian farmers since they have moved aggressively into soybean farming in recent years and exported $5.2 billion of the product last year.

It is not clear whether Brazil can muster a strong case against the U.S. soybean program under the WTO dispute settlement process. Under the Uruguay Round WTO agreement, countries are not generally allowed to challenge one another's farm subsidies until 2004 as long as the subsidies fall within AMS limits agreed to under the WTO. But a country can challenge another's domestic subsidies if subsidies on individual items exceed their 1992 level. U.S. soybean subsidies have risen sharply from almost nothing in 1992 to over $3.0 billion in 2001. Thus, there may be a basis for Brazil to bring the case before the WTO dispute settlement panels.

Particularly if Brazil's case is successful, there is speculation that other countries such as Australia, Canada, or the EU will bring cases against the U.S. to the WTO. This is perhaps the bigger issue raised by the Brazilians' action. If multiple cases are brought against the U.S., at a minimum it would further clog the fragile WTO dispute settlement mechanisms.

Thus, there is considerable uncertainty about the impact of the 2002 Farm Bill on trade negotiations. However, it is clear that the 2002 Farm Bill will sour the atmosphere for negotiations that could lead to freer agricultural trade. The Uruguay Round produced less than expected in terms of agricultural trade liberalization. The recriminations against U.S. regarding the 2002 Farm Bill and the steel tariffs may produce stalemates in trade negotiations or, at worst, trade wars. The negotiating environment that has emerged is not one that promises to expand world agricultural trade.

The Conservation Title

The Conservation Title for the 2002 Farm Bill expands spending for a host of soil, water, wildlife and other conservation measures. Funds allocated for the Conservation title total $17.1 billion for the six-year life of the Farm Bill. The seven programs carrying spending allocations in excess of $500 million during the life of the 2002 Farm Bill are described briefly in Table 4.

The Environmental Quality Incentives Program (EQIP) program accounts for more than half of the spending. EQIP funds will cover expanded programs for defraying costs associated with erosion and sedimentation problems, tillage, and animal waste storage. At this writing the rules for EQIP program were not yet available. Hence, the amount of funds available for the different EQIP programs is not yet known. However, it is clear that substantial increases in funding for EQIP programs will be available for the 2002 fiscal year ending September 30, 2002.

The popular Conservation Reserve Program was, as widely expected, expanded in coverage. With the exception of the expansion of the pilot wetlands program, it is not clear that the nature of the CRP will change much under the 2002 Farm Bill.

Since several of the programs are new or substantially expanded it is difficult to assess how effective they will be for achieving program objectives. The programs listed in Table 4 will be subject to OMB prescribed Cost/Benefit analysis that may provide information for assessing the effectiveness of the programs. Experience with the new programs also will dictate whether actual appropriations for the programs will be as large as indicated in the table.

Table 4. Major Programs Under the Conservation Title of the 2002 Farm Bill.*

Program	Brief Description	Cost
1. Environmental Quality Incentives Program	Expanded to achieve a $1.3 annual funding level. Funds are split 60/40 between livestock and crop producers. Priority areas are eliminated.	$ 9.0 bil.
2. Conservation Security Program	A new national incentive program for maintaining and increasing farm and ranch stewardship practices.	2.0 bil.
3. Conservation Reserve Program	Increases acreage cap from 36.4 million acres to 39.2 million acres. Expands wetlands pilot program to one million acres with all states eligible. Priority areas are retained.	1.52 bil.
4. Wetlands Reserve Program	Increases acreage cap to 2.275 million acres	1.5 bil.
5. Farmland Protection Program	Funding for this program is increased about 20-fold from levels under the 1996 Farm Bill. Protection was provided for 108,000 acres Under the 1996 legislation.	985 mil.
6. Wildlife Habitat Incentives Program	Funding is increased 10-fold from levels under the 1996 Farm Bill. Cost share payments on 1.6 million acres were made under the 1996 Farm Bill.	700 mil.
7. Water Conservation Program	Provides cost share incentives and help for efforts to conserve ground and surface Water.	600 mil.
8. Other Conservation Programs.	Various water, watershed, grasslands, and soil conservation programs.	800 mil.
Total		$17.1 bil.

*Source: Farm Bill Conference Summary, April 30, 2002.