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The Next Farm Bill

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INTRODUCTION

It is important to examine factors that will influence the next US farm bill in thinking about the stresses on further integration of the North American agrifood economy. No free trade agreement can function smoothly if one or another country is subsidizing its producers of any specific commodity more than the other member countries. When the North American Free Trade Agreement (NAFTA) was negotiated, agriculture was more difficult than many other sectors, but commitments to significant convergence of policies and market opening did occur. During the period from the mid-1980s to the mid-1990s, the US was also exercising global leadership in agricultural trade liberalization and policy reform. However, the 2002 farm bill reversed this course, increasing intervention levels and spending on farm subsidies.

This chapter first assesses the extent to which convergence among US, Canadian, and Mexican agricultural support has occurred. It then turns to a brief, historical review of US agricultural policy and discusses the changes resulting from the 2002 farm bill. The main section of this chapter reviews a number of factors that will affect the composition of the 2007 farm bill on which debate is beginning already.

DOMESTIC SUPPORT CONVERGENCE?

In examining the overall agricultural producer support estimates (PSEs)[1] calculated by the Organization for Economic Cooperation and

[1] The Producer Support Estimate (PSE) is the percentage of gross farm receipts attributable to government policy, including budgetary transfer financed by taxpayers, as well as the implicit tax on consumers that arises from interventions such as border protection that raises farm prices above the levels that would otherwise prevail.

Figure 7.1: Producer support estimates, United States, Canada, and Mexico, 2004.

Commodity	United States	Canada	Mexico
Wheat	32	13	24
Maize	27	24	25
Barley	33	7	16
Soybeans	24	21	20
Milk	39	52	29
Pork	4	8	2
Eggs	4	21	2
Overall	18	21	17

Source: OECD PSE database.

Development (OECD) for 2004, the most recent year for which estimates are available, substantial convergence appears to have occurred. In all three NAFTA countries, 17 to 21 percent of farmers' incomes were coming from government programs. However, as Table 7.1 illustrates, there are great differences in the relative levels of support received by producers of each commodity. And it is the differences in relative support levels among commodities in each country which distort the patterns of production and induce larger production of commodities in less efficient producing areas. The levels of assistance provided to maize, soybean, and pork producers are similar in the three countries, but the relative assistance to other commodities varies widely.

A BRIEF HISTORY OF US AGRICULTURAL POLICY[2]

American agriculture prospered during World War I, but when European agriculture recovered after the war, exports collapsed, leaving US farm production capacity well in excess of domestic demand. American agriculture went into depression in 1921, almost a decade earlier than the rest of the economy. After several halting attempts to shore up farmers' income in the late 1920s, Congress passed the Agricultural Adjustment Act of 1933, which laid the foundation for farm policy for more than half a century. To raise the prices farmers received for their products, various acreage restrictions and marketing controls were used to constrain supply. However, agricultural productivity rose faster than domestic demand grew, making the surpluses even larger. Because US commodity prices were being supported at levels above world market levels, exports were possible only when subsidized or given away as food aid.

After the US dollar was devalued in 1971 and 1973, US farm products became once again internationally competitive, and exports grew rapidly

[2] For a more detailed history, see Gardner.

through the 1970s until they were providing the market for about one third of production. Weakness of the dollar in the late 1970s further facilitated these exports. However, in 1981, the dollar appreciated significantly, while Congress wrote a new farm bill which prescribed minimum levels at which US prices would be supported (loan rates). Once again, US farm policy undercut the international competitiveness of its farm products. Agricultural exports fell by 40 percent in five years. This precipitated the worst financial crisis in rural America since the 1930s, exactly 60 years after US agriculture went into depression when exports collapsed with the recovery of Western European agriculture.
The 1985 farm bill had to deal with the financial crisis while restoring the international competitiveness of US products. To transfer income to farmers, the bill provided deficiency payments equal to the difference between a politically determined target price and the market price or the loan rate (price support), whichever was higher. To restore international competitiveness, the loan rates were reduced to 85 percent of a moving average world market price. "Marketing loans" were created for cotton and rice, in which the Commodity Credit Corporation (CCC) of the United States Department of Agriculture (USDA) would pay farmers the difference (loan deficiency payment) between the loan rate and what it determined the world market price to be.

To prevent deficiency payments from inducing larger production than would otherwise have occurred, the 1985 farm bill began decoupling payments from current production. Deficiency payments were no longer based on actual production, but rather on a fixed historical average yield and the number of acres planted to each program crop. The 1990 farm bill completed the decoupling of payments from production by fixing also the acreage base for each crop at historical levels. Since current planting and input decisions could no longer influence the deficiency payment a farmer received, the payment was now fully decoupled from production decisions.

The 1996 farm bill gave farmers yet greater planting flexibility by doing away with target prices, deficiency payments, and acreage reduction programs. The bill eliminated any link between income support payments and market prices. To compensate for giving up deficiency payments farmers were granted production flexibility contract payments also known as Agricultural Market Transition Act (AMTA) payments, which were to be phased down to zero over the seven year life of the bill (Young and Shields).

US ADVOCACY FOR AGRICULTURAL TRADE LIBERALIZATION

At the same time, in the Uruguay Round of multilateral trade negotiations the United States and the Cairns Group, under the leadership of Australia, were advocating freer and more open international markets for agricultural products. At the instigation of the United States, domestic agricultural policies were considered for the first time in trade negotiations. In previous negotiations, domestic policies could not be discussed because they were not border measures such as tariffs and quotas. This was a significant breakthrough because it is domestic policies, not border measures, which often cause the greatest distortions in the determination of what farm products get produced where. Border measures are often put in place merely to accommodate the domestic policies, as when a government attempts to support the domestic price of an importable commodity at a level higher than the world market price.

While acknowledging that there will always be occasions when a government for political reasons has to provide support to its farmers, the United States sold the notion that not all payments to farmers are equally distorting of agricultural production and trade. Support that is linked to the volume of production or sales of specific commodities distorts farmers' production decisions more than direct payments. These led to the categorization of agricultural support into three boxes. Support that is clearly linked to production was categorized in the amber box. Each country accepted a maximum aggregate measurement of support (AMS) below which it agreed to keep its total amber box support.

Countries were encouraged to decouple support from production of specific commodities by also creating a green box category, on which there would be no cap. The green box includes direct payments that are not linked to present or future production of any specific product. These payments might be for doing something, like conserving the soil or protecting the landscape for tourism, or they could be direct income transfers to farmers calculated on some fixed historical base. Investments in public goods like agricultural research, extension, and teaching; and collecting and diffusing agricultural statistics and market information were also included in the green box.

A third category of agricultural subsidies was created, known as the blue box. Policies were categorized in the blue box if, while they would otherwise induce larger production, there was some constraint on the volume of production or sales of that product, such as a land set-aside program or a marketing quota.

In the Uruguay Round agricultural negotiations, the US also advocated the conversion of all nontariff barriers to agricultural imports to tariffs, which would then be reduced by an agreed upon percentage over the implementation period. This was important because it is much harder for potential suppliers to compete for a country's purchases when imports are constrained by a quota than by tariffs.

There is a more important economic argument for tariffication, as this conversion came to be known. A quota or other nontariff barrier (NTB) to imports, such as a variable import levy, cuts the link between the world market price and domestic price of a product so that the domestic price no longer moves up and down with the world market price, and domestic producers and consumers get no signal to adjust. All the adjusting has to be done by the producers and consumers in countries whose domestic prices are linked to the world price (even when distorted by a tariff). When fewer producers and consumers participate in the adjustment to any shock in the world market, the world market price has to adjust more than it would if all shared in the adjustment. This causes world commodity prices to be more volatile than they would otherwise be, increasing price risk to producers and consumers in the rest of the world. If all countries reconnected domestic prices to world prices, the swings in world commodity prices would be dampened, *ceteris paribus*.

The US and the Cairns Group both sought a ban on agricultural export subsidies. Export subsidies have been banned in nonagricultural goods trade since the General Agreement on Tariffs and Trade (GATT). In the Uruguay Round Agreement on Agriculture (URAA), agricultural export subsidies (both value and volume) were frozen and reduced, but not banned, and no country could start subsidizing exports of a commodity not previously subsidized.

THE 2002 FARM BILL

Congress passed the 2002 farm bill early. The days of budget surpluses were coming to an end, however, the budget baseline[3] within which Congress had to bring the bill, had not yet been revised. A few years earlier, the Uruguay Round negotiators had agreed to a $19.1 billion ceiling (AMS) on amber box subsidies to US farmers. There was widespread subsidy envy among American farmers over the fact that the European Union (EU) had negotiated an AMS of $67 billion, more than three times larger than theirs. Congress was in a mood for spending and looked at the US AMS more as a target to be attained than as an upper bound on farm programs. Out of fairness to the Congress, they tried to design programs which would not exceed the AMS, but they didn't want actual subsidies to fall very far short of it either. The net result was to increase budget authority for its farm programs at a time when the United States had been telling everybody else to cut theirs.

[3] The budget baseline is a projection of federal expenditures and revenues into future years, assuming that all current laws and policies remain unchanged. It provides a benchmark against which the budgetary effects of proposed changes in law or policies can be compared.

The 2002 farm bill raised loan rates on grains and lowered them on soybeans (Wescott, Young, and Price). The 1996 farm bill had provided excessive incentive to produce soybeans relative to alternative crops that could be grown in the same places, and the 2002 bill corrected this market distortion. The 2002 farm bill reestablished a target price system and created a new counter-cyclical payment (CCP). The CCP program institutionalized $2 billion of ad hoc "emergency payments" that had been made each year on top of what was authorized under the 1996 farm bill. The 2002 bill watered down payment limitations, allowing each farmer to get a larger total payment, and authorized updating the historical bases, meaning payments were no longer decoupled from production decisions. The bill also institutionalized fixed direct payments in place of the AMTA payments, which had been designed as transitional compensation that would be phased down. The 2002 farm bill created new farm programs for commodities that had never before had them (small legumes); resurrected previously killed programs for wool, mohair, and honey; increased benefits to sugar producers; and created another dairy program. It bought out the quotas in the old peanut support program, and replaced it with a new support program.
When viewed from abroad, the 2002 farm bill was seen as an abdication of US leadership in reforming farm policy and liberalizing agricultural trade. The United States, which had led the global effort to reduce agricultural subsidies, appeared two-faced, telling the rest of the world to cut their farm subsidies while increasing its own. By allowing direct payment bases to be updated, this farm bill was seen as a retreat from decoupling by its author and strongest advocate, the United States.

The United States had also been advocating that the prices to which farmers respond in making their production decisions should be linked to world market prices so that farmers everywhere adjust their planting decisions up and down to changing world market price signals. Counter-cyclical payments violate this principle. They reduce American farmers' responsiveness to declining prices, but not to increasing prices. Furthermore, marketing loans, which were created originally for cotton and rice in the 1985 farm bill, were effectively export subsidies. While the US negotiators argued against export subsidies, the 2002 farm bill broadened the role of marketing loans in US agricultural policy.

TOWARDS THE 2007 FARM BILL

There are several things to keep in mind when identifying factors likely to influence the writing of the 2007 farm bill. First, a farm bill is much more than commodity programs. The 2002 farm bill had ten titles:

1. Commodity Programs
2. Conservation
3. Agricultural Trade and Aid
4. Nutrition Programs
5. Farm Credit
6. Rural Development
7. Research
8. Forestry
9. Energy
10. Miscellaneous

While two-thirds of American agriculture is not affected by commodity programs, most is affected by programs authorized under one or more titles.

Another important thing to keep in mind about farm bills is that they are authorizing legislation; implementation of most programs authorized in a farm bill (even when the authorization specifies an annual expenditure level) requires an appropriation each year. There is an important exception, however, unique to the USDA. Many of the farm commodity programs are authorized in farm bills as entitlements which can be run independent of annual appropriations. The Commodity Credit Corporation (CCC) has a standing line of credit at the United States Treasury of $30 billion against which USDA draws. Periodically, after enough money has been paid out to farmers, USDA goes to Congress for a replenishment of its line of credit.

STATE OF THE AGRICULTURAL ECONOMY

Every farm bill is influenced disproportionately by the current economic conditions in the farm sector and agricultural commodity markets *at the time* the farm bill is written. While no one can predict how crop conditions here and around the world will evolve between now and 2007, we can predict with some assurance that whatever they are will affect the content of the 2007 farm bill.

The role government payments are playing in farmers' incomes will also affect the outcome, but the direction of its influence is difficult to predict. If government programs are supplying a significant fraction of net farm income, farm organizations will lobby hard to keep what they have. On the other hand, if there is another big jump in the magnitude of payments from 2005 to 2006 in addition to the large anticipated increase from $14.5 billion in 2004 to $24.1 billion in 2005 (USDA 2005a), budget hawks are likely to attack, demanding reductions.

MISPERCEPTIONS ABOUT MODERN FARMING

The most common arguments for government support to agriculture are low farm family income and excessive variability of income. Two-thirds of American farmers receive no farm program benefits because they do not grow program crops. There is no evidence that these farms are less profitable than those receiving Federal farm program benefits. Most program payments are distributed in proportion to past or present sales of the program commodities, so the largest producers of those commodities get the largest benefits. Because most program payments get capitalized into the value of farm land, most of the benefits accrue ultimately to the largest farm land owners, a group whose average wealth exceeds the national average.

One source of misperceptions about modern farming is the very out-of-date definition of a farm used in official statistics on American agriculture: any place that sells over $1,000 worth of agricultural product(s) per year. The USDA's Economic Research Service (ERS) disaggregates these data into three broad groups: rural residence farms, intermediate farms, and commercial farms (USDA 2000). Over 1.2 million of the 2.1 million "farms," so defined, sell less than $10,000 worth of product per year (USDA 2000). In no sense are these farms commercially viable businesses capable of supporting a family. They are rural residence farms, or hobby farms, or both. In fact, 77 percent of the farms in the United States by the official definition collectively contribute only 14 percent of the nation's production of food and fiber. On average, they earn more than the median family income from nonagricultural sources and lose money on their farming operations. The only group whose income averages less than the median US household income is intermediate farms, and they receive very little from farm programs (MacDonald, Hoppe and Banker).

Another misperception is that corporate agribusiness has taken over American farming and receives most of the farm program benefits. This is false. Most commercially viable farms today are incorporated for tax and estate planning and ease of transfer of ownership between generations. Agribusiness accounts for less than ten percent of farm output, and much of that is in the production of nonprogram commodities. The popular perception that corporate agribusiness receives a lot of farm program payments is erroneous.

To stabilize their incomes, farmers can buy commercial price insurance (put options) and federally subsidized crop insurance. Farmers also have two other ways to smooth their incomes which are not available to other forms of business. Farmers are allowed to use cash accounting, which facilitates shifting income and expenses between two tax years, and farms are the only businesses allowed to use income averaging (over four years) when calculating their income tax. When one penetrates most stabilization arguments for farm programs, what farmers are really seeking is stabilization around a higher average. Therefore, it is difficult to justify farm programs on the basis of either low farm family incomes or income volatility.

The Environmental Working Group has posted on its website data obtained through Freedom of Information Act requests on how much each individual farmer (by name) receives from USDA programs. The ready availability of this information spawned a flurry of anti-farm program editorials in newspapers throughout the country. The transparency which publicly posting these data has brought to farm programs has forever changed discussions of the justification for and benefits of farm programs. The argument that farm programs help low income family farmers will no longer be persuasive.

FEDERAL BUDGET DEFICIT

The 2002 farm bill was passed by Congress using a budget baseline projection that everyone involved knew was wrong. That farm bill was rushed through Congress early in order to get as much money committed to farm programs as possible before the baseline was updated. The Federal deficit returned and has run about $400 billion per year since 2003. Despite frequent calls to do something about the budget deficit, neither the White House nor the Congress appears to be very concerned. Both candidates for President talked about reducing the annual deficit to $200 billion. Many observers have argued that agriculture must participate in deficit reduction, particularly since there never would have been as much money available for farm programs if the 2002 farm bill had not been taken up ahead of schedule.

In the Administration's Fiscal Year (FY) 2006 budget proposal transmitted to Congress in February 2005, a modest reduction in farm programs was proposed – $5 billion over five fiscal years. Farm organizations and commodity groups responded angrily, arguing that the government was breaking faith (if not a legal contract) with farmers, who had made their five-year business plans assuming that the full anticipated benefits of the 2002 farm bill would remain intact for the full five-year life of the bill. Some members of Congressional agriculture committees even proposed that the cuts should be taken out of food stamps, a form of welfare assistance to low income people, instead of from farm programs.

The budget resolution Congress passed on 28 April 2005, authorized a $2.6 trillion Federal budget for FY 2006. The largest savings or cuts from the budget baseline (not real reductions) came out of Medicaid, another welfare program for low income Americans. Despite many anti-farm subsidy editorials in major newspapers, agricultural spending was cut little – $3 billion over five years, with all but $173 million put off until 2007, when the next farm bill is to be written, and beyond. In principle, this leaves over $2.8 billion in cuts from this year's budget cycle to be made under the 2007 farm bill.

US farm programs have never been subjected to an effectively binding budget constraint. Even in 1985, a year in which Congress mandated across-the-board reductions in Federal outlays to reduce the deficit (Gramm-Rudman-Hollings bill) it passed a farm bill which authorized the largest farm program benefits ever. It remains to be seen whether the environment in 2007 will be any different from the past.

Many budgetary commitments get made in the heat of Presidential election campaigns. For example, in the 2004 campaign in Wisconsin both candidates pledged to continue the Milk Income Loss Contract (MILC) program, a temporary additional dairy program created in the 2002 farm bill, which was slated to expire. The President's FY 2006 budget proposal contained funds to continue this program for two more years. When all such commitments are added up, they too make it more difficult to reduce the Federal budget deficit.

ELECTION POLITICS AND THE HIGH COST OF ELECTIONS

It is important not to forget that rural America reelected George Bush in 2004. If one overlays a map showing the red (Republican majority) and blue (Democratic majority) counties in the 2004 presidential election (Gastner, Shalizi, and Newman) with a map showing where farm program payments are sent (USDA 2005b), the correlation is striking. One can understand that the President's FY 2006 budget proposal did not push very hard to reduce farm program payments going to counties that so recently voted so strongly for his reelection.

Congressional and Presidential elections are extremely expensive in the United States, and little real campaign reform has been achieved. Campaign contributions do buy access to get a firm's or interest group's position heard by the Executive Branch and by members of Congress involved in writing legislation of interest. Food and agribusiness groups are generous contributors to both Congressional and Presidential campaigns. Recently released data on Political Action Committee (PAC) contributions to Federal candidates in the 2004 election cycle list $12.3 million in contributions from farm and commodity organizations and from food and agribusiness companies (Center for Responsive Politics). When the data for agricultural commodity PAC contributions are broken out, one observes a positive correlation between the magnitude of campaign contributions and the producer support for that crop. The four highest agricultural campaign contributors – sugar, dairy, cotton, and rice – are also the commodities with the highest producer support.

Despite the shrunken size of the US farm sector and its work force relative to the US economy and population, respectively, its interest groups have effectively managed their campaign contributions and political influence to give them political clout far in excess of their numbers. Many more Americans are concerned about issues like Social Security reform, Alternative Minimum Tax relief, funding of local schools, and prescription drugs under Medicare than farm programs. There is little public goodwill towards farm programs that give most of the benefits to the largest producers and farm land owners. Nevertheless, there is sufficient political support that farm programs almost completely avoided reductions in this year's budget process.

Three final points related to political influences on the 2007 farm bill merit mention here. The Congress and the White House are now extremely politicized. There is virtually no bipartisan cooperation among either the agriculture committee members or their staffs. This is very different from the traditional behavior of the agriculture committees of Congress. Today, each party is attempting to make the other look as bad as possible – even if it means Congressional paralysis. Second, we will not know the Republican-Democrat split in the Senate or the House of Representatives that will write the next farm bill until November 2006. Finally, the State of Iowa has the first Presidential primary, and no aspirant to the Presidency of the United States will utter a word against any farm program while campaigning in Iowa for fear of being an early casualty in the campaign. By the time a candidate is elected President, he has made so many commitments that it is hard to exercise leadership to change farm programs.

INTER-COMMODITY SOLIDARITY

US agriculture's political clout has been enhanced over the years by solidarity and formation of effective coalitions among commodities. For many years dairy and tobacco interests formed a very effective coalition that resulted in each securing more farm program benefits than either could have if they had worked independently. Cotton has the most vertically integrated program of any commodity. Every phase of the industry gets something from the cotton program – from those who grow cotton, to those who gin, ship, store, export, or use it domestically. This has ensured cotton industry solidarity in support of the program.

Agricultural commodity organizations have traditionally deferred to one another's interests, as have individual commodities within the general farm organizations. There has always been enough money to go around. Even when certain commodities or regions seemed to always get more benefits than others, amity and solidarity have generally prevailed.

In 2005, one observes cracks in this historical solidarity. Farm and commodity organization leaders are beginning to acknowledge that 2007 may be different, that Congress really is going to have to do something about the Federal budget deficit and that agriculture will be forced to participate in deficit reduction. One hears suggestions that the historical inter-commodity and inter-region solidarity may break down in the face of a tight budget constraint. The large differences among commodities and among regions in PSEs and in payments per farmer are starting to bring demands for greater equity. For example, groups that previously deferred to sugar are angry at sugar's attempts to defeat the Central American Free Trade Agreement (CAFTA), which is generally viewed as good for the agricultural sector as a whole.

Farm program legislation bans production of fruits and vegetables on land benefiting from commodity programs. However, a recent WTO dispute settlement panel decision (the Brazil cotton case, discussed in more detail below) ruled that this exclusion has to be removed if the US wants to continue claiming its direct payments as green box support, not subject to a cap. Otherwise, those payments must be reported as amber box support. Changing this exclusion could bring land that previously grew program commodities into fruit and vegetable production in competition with existing growers. This would certainly cause fragmentation between fruit and vegetable interests and the program commodities. On the other hand, if the US does not remove the exclusion, it will violate its AMS cap.

WHAT ROLE WILL ENVIRONMENTAL GROUPS PLAY?

The first time that environmental groups played an active role in writing a US farm bill was in 1985. That farm bill created the long-term conservation reserve program (CRP), under which farmers bid for annual compensation for idling erosion-prone land for ten years. The CRP was created by a coalition of environmental groups concerned about conservation and farm organizations that sought more government supply control. In addition, the 1985 farm bill gave us the so-called sod-buster and swamp-buster provisions and created conservation compliance, which requires any farmer who receives benefits from any USDA program to have a farm conservation plan that meets certain environmental standards. Failure to do so would cause that farmer to lose all USDA program benefits. To add these measures to US agricultural legislation required an unprecedented degree of cooperation between agricultural and environmental groups.

I would characterize the relationship over the last 20 years between these two groups as wary of one another. Farmers see many environmental regulations as overly restrictive, increasing their costs more than the expected benefits are worth. They see environmental organizations as too prone to use the stick instead of the carrot. Most farm organizations have not forgiven the Environmental Working Group for bringing transparency to how much each farmer receives in farm program payments.

Since 2002, every time Congress has authorized disaster payments, agricultural interests have successfully lobbied to have their cost subtracted from appropriations for conservation measures, not from commodity programs. Furthermore, neither the farm lobby nor the Bush Administration has supported funding of a new Environmental Conservation Security (ECS) program that was authorized in the 2002 farm bill, but has remained unfunded and unimplemented. Such actions have led the environmental organizations to doubt the sincerity of farm organizations' support for conservation programs. This behavior by farm groups, however, is not unique to environmental measures. They support funding research, conservation, trade promotion, and the like as long as the appropriations are additional to commodity programs. The organizations have been unwilling to reduce near-term commodity program benefits in exchange for Federal investments in measures that would have longer-term payoffs for the sector as a whole.

In the Doha Round of trade negotiations, European farm groups, who foresee lower traditional farm program benefits, would like to see more direct payments to underwrite the cost of soil conservation, protection of the landscape, and investments in other measures beneficial to the environment. It is likely to be easy to get agreement with the EU for this kind of doubly green[4] payments to be exempted from any binding or cap in the Doha Round Agreement on Agriculture (DRAA). The payments are doubly green in the sense that they are environmentally beneficial and would be categorized as green box payments, on which there are no limits.

AGRICULTURE AS ENERGY SUPPLIER?

The Uruguay Round Agreement on Agriculture was oversold to American farmers. Agricultural economists did a great deal of analysis which showed large potential gains from agricultural policy reform and

[4] To paraphrase Gordon Conway's "doubly green revolution."

moving to free trade in agricultural products. In reality, despite some conceptual advances in the URAA, virtually no real agricultural trade liberalization resulted. When the anticipated gains failed to materialize and Brazil captured most of the growth in the world markets, many farmers became disenchanted with the WTO and with their ability to compete in the export market. They started casting about for alternative market growth possibilities.

At the same time as corn growers were looking for new markets, there was increasing concern about the growing dependence of the United States on imported oil. The resulting interest in renewable sources of energy sparked interest in using corn to make ethanol to blend with gasoline and, more recently, soybean oil to produce biodiesel. Even with the price of oil well above $50 per barrel, this industry seems to be economically viable only with construction subsidies, mandated minimum use in gasoline/diesel blends, and protection against imports from lower-cost suppliers such as ethanol from sugar cane and biodiesel from palm oil. An energy bill was passed by Congress in July 2005, which doubles the mandated use of ethanol in fuel blends. The petroleum companies, that control access to the service station pumps and have deeper pockets to make political campaign contributions, oppose such mandates. Nevertheless, corn and other renewable energy interests had the political clout to beat the petroleum industry this time. Farm organizations can be counted on to advocate an ever larger role for agriculture in producing renewable fuels in the 2007 farm bill. In fact, most farm organizations are currently more interested in this than in agricultural trade liberalization.

THE WORLD TRADE ORGANIZATION

There are two channels via which the WTO may affect the 2007 farm bill: the Doha Round of multilateral trade negotiations (officially, the Doha Development Agenda or DDA) and the loss in a case brought by Brazil against the US cotton program.

Before addressing either of these specifically, it is useful to review what the WTO is and what the WTO is not. There is such a vast amount of misinformation swirling through the media that we need to have a clear understanding of the institution before taking up how it may affect the 2007 farm bill.

The World Trade Organization is a voluntary association of 148 countries which meet periodically (rounds) to review and revise the rules of the road on international trade. Decisions are taken by consensus of all participants. The WTO has a Secretariat, located in Geneva, Switzerland, which organizes and staffs the negotiating meetings, as well as a dispute settlement process to resolve differences among members over whether these mutually agreed rules are being broken.

When a case is brought by one country against another, a dispute settlement panel is appointed, which functions as the court of first appeal in trade disputes. If any party to a case is dissatisfied with the panel's ruling, it can appeal the decision to the WTO's Appellate Body, which, in effect, serves as the supreme court of international trade. The panels and the Appellate Body build up a body of case law which interprets and clarifies trade agreements. In past rounds, negotiators have often found it necessary to use fuzzy language to reach closure and allow each party to declare victory after returning home. The cost of this is that panels and the Appellate Body may reach interpretations at odds with what the negotiators themselves thought they had agreed to.

Perhaps the most widespread misunderstanding about the WTO is the fact that it cannot make any country change its policies. However, if a country which loses a case refuses to change the policy found to be in violation of the existing trade agreement, then the WTO can authorize the victims of the violation (i.e., the country which won the case) to collect a specified amount of compensation by levying import duties on the violator's exports to that country. The goods on which the duties are levied need have no relationship to the sector found to have been hurt by the violation. This often leads to targeting with duties, goods produced by politically powerful nonagricultural sectors to get them to bring pressure on their governments to change the offending agricultural policy.

The WTO Cotton Case

In February 2003, Brazil filed a case with the WTO against the United States, alleging that the US cotton program violated the Uruguay Round Agreement on Agriculture, of which, parenthetically, the US was not only a signatory, but a principal author. Brazil also brought a successful case against the other principal author of the URAA, the European Union, alleging that its sugar program violated that agreement.

Brazil alleged that the various subsidies in US cotton policy stimulated larger production and exports of cotton than would have been the case in the absence of those subsidies. Brazil further alleged that the additional exports depressed the world price of cotton, reducing the earnings of Brazilian cotton producers, who get their entire income from the marketplace. Brazil demanded that the US change its cotton program to remove the offending subsidies or pay it damages.

The United States lost the case on most counts at both the panel and the Appellate Body levels. They ruled that certain US policies had depressed the world price of cotton sufficiently to cause serious prejudice to the interests of other cotton exporters. The offending policies included marketing loans, loan deficiency payments, countercyclical payments, and Step Two payments (an export and domestic use subsidy specific to cotton). However, the panel and Appellate Body ruled that certain other US policies had not had the world price depressing effect that Brazil alleged, specifically direct payments, crop insurance subsidies, and AMTA payments.

When each country filed its new tariff schedule with the WTO following the Uruguay Round, it was required to itemize those commodities for which export subsidies were being provided, and no previously unsubsidized commodity could be added to the list. The United States' filing did not list cotton (or soybeans). Therefore, the ruling mandated that the Step Two cotton payments, as well as export credit guarantees in excess of normal commercial terms, which it found to also be export subsidies, should be changed by 1 July 2005.

No date was specified by which the United States should change the other offending policies. Whether the fix can wait until the 2007 farm bill or the outcome of the Doha Round will be decided in negotiations between Brazil and the United States. It should be noted, however, that the US cannot claim any credit in the Doha Round negotiations for changes it makes in policies that a WTO panel found to be in violation of the existing URAA.

Fruit and Vegetable Exclusion

The WTO panel and Appellate Body made one other quite unanticipated ruling in the cotton case. When set-aside programs were designed, the fruit and vegetable industry (especially California and Florida growers) lobbied successfully for a ban on subsidy recipients growing fruits and vegetables on set-aside land. They argued that, if producers of program commodities planted set-aside land to fruits and vegetables, this would likely depress the prices of fruits and vegetables to the primary growers of those commodities who get their entire income from the marketplace. This fruit and vegetable exclusion rolled forward into the direct payment rules.

The WTO cotton panel, which ruled that the US direct payments had not contributed to the larger production and exports which had depressed the world cotton price, found that those direct payments did not meet the definition of decoupled payments in the URAA. To be decoupled, the definition, which the US substantially wrote, requires that there be no restrictions on what the payment-receiving producer grows (or does not grow). The fruit and vegetable exclusion violates the definition. The panel concluded that the direct payments, therefore, should have been included in the total trade-distorting (amber box) subsidies reported by the US to the WTO, and, if they had been, the US would also have been in violation of the cap on such support that it had agreed to in the URAA.

The Doha Round of Agricultural Trade Negotiations

In July 2002, the United States submitted to the WTO an ambitious proposal for agricultural trade reform in this round of trade negotiations. The proposal stated that the US is prepared to undertake significant reform of its domestic agricultural policies in exchange for significant increases in market access for US agricultural products abroad.

After more than two years of little progress, on 31 July 2004, a Framework Agreement was struck which moved the process forward (International Centre for Trade and Sustainable Development). This agreement was substantially less ambitious than the original US proposal, however it contained many provisions which the US had proposed. The agreement left a lot of details to be resolved in not only the agriculture negotiations, but also in those dealing with manufacturing and services. The negotiators achieved little progress in the ensuing 12 months. Despite the encouraging words from the G-8 heads of state in their Gleneagle Summit communiqué of 8 July 2005, they did not give their negotiators sufficient discretion to reach the necessary compromises prior to the August 2005 recess in negotiations.

The next milestone in the Doha Round is the Ministerial meeting to be held in Hong Kong in December 2005. Negotiators will have to work very hard to resolve the many open issues between now and December. If too many issues remain to be resolved at the ministerial level in Hong Kong, that meeting will fail. If the modalities of an agreement can be defined by December, then the negotiators should be able to finalize the specific details via each country's offers and requests during 2006. If Hong Kong fails, it will be very difficult to complete the Doha Round before US fast-track negotiating authority expires in mid-2007.

To meet this deadline will be very hard for the US negotiators who would be prejudging by December 2005, what the next Congress will be willing to do in the 2007 farm bill. If the WTO negotiations can be concluded by the end of 2006, then Congress can be notified early in 2007, and the agreements can be tidied up and translated into *legalese* in time for a signing ceremony by June 2007. This would dovetail with the timetable on which the 2007 farm bill should be written.

Before discussing the specific aspects of the WTO Framework Agreement which have bearing on the 2007 farm bill, one other point should be clarified. As in US Federal budgeting, a cut does not necessarily imply a reduction. It is essential to pay attention to what the baseline level, from which any cuts are to be made, is. This is particularly important with respect to agreed upon reductions in tariffs and in trade-distorting domestic support. Many countries charge lower tariffs than the maximum rates they agreed to (bound rates) in the last round of trade negotiations. The difference between bound and applied rates is often referred to as water in the tariffs. When there is a lot of water in tariffs, it takes a very substantial reduction in a bound tariff rate before any reduction in the applied tariff and increase in market access occurs.

Similarly, in high-income countries the bound aggregate measures of trade-distorting support are in general higher than the total support provided. So, while the Framework Agreement calls for a 20 percent reduction in total trade-distorting domestic support, in the first year of implementation of the DDA Agricultural Agreement, this would require no reductions at all in either the US or the EU. In both cases there is more than 20 percent unused capacity in their AMS, and the new lower maximum AMS would still exceed the levels that the US and EU have been providing to their farmers.

Domestic Support In the Framework Agreement, the negotiators agreed that each high-income country should make a "substantial reduction in the overall level of its trade-distorting support from bound levels," with the highest levels of support being reduced the most. In the US case this would entail more than proportional reductions in commodity-specific support to rice, cotton, sugar, dairy, and peanuts. Product-specific caps on support would be imposed in addition to the binding on the aggregate support provided to the agricultural sector. The size of these caps and substantial reduction remain to be defined in the ongoing negotiations.

In the Framework Agreement, US negotiators obtained agreement to broaden the definition of the blue box beyond policies that, while providing production and trade- distorting support, also entail an offsetting supply constraint such as a marketing quota or land set-aside. The broadened definition would also include direct payments that do not require production so that the US could include its counter-cyclical payments in the blue box. Counter-cyclical payments do not qualify for inclusion in the green box because, while there is no link to the current volume of production, the payment is based on current market price. In the URAA there was no cap on blue box payments; in the July Framework, as redefined, they are capped at less than five percent of a country's total value of agricultural production (i.e., all commodities, not just those for which there are farm programs). During the remaining negotiations there will likely be further tightening of the definition of the blue box to ensure that such policies are less trade-distorting than the amber box. There is widespread unhappiness in other countries with the redefinition of the blue box, and we can anticipate continued attempts to tighten the criteria as much as possible in the remainder of the negotiations.

The Framework Agreement would leave green box payments unrestricted, but there is likely to be some further tightening of the green box criteria to ensure that support categorized there really is minimally trade-distorting in practice. Since the signing of the URAA, the US, EU, and Japan have made substantial shifts in agricultural subsidies from amber box support to specific commodities to direct (decoupled) payments. There is a widespread perception in other countries that such large green box payments cannot possibly be production and trade neutral.[5]

Export Subsidies The Framework Agreement contains a commitment to eliminate all export subsidies, with the date yet to be defined. The elimination of direct export subsidies affects mainly the EU. However, to obtain the EU's commitment on this issue, other countries had to agree to discipline policies they employ which have an effect equivalent to an export subsidy. In the case of the United States, this involves subsidized export credits and export credit guarantees with a repayment period beyond normal commercial terms (180 days). This is the same issue that was flagged by the WTO Cotton Panel.

The US also provides part of its food aid on other than a fully grant basis, e.g., providing it to private voluntary organizations and nongovernmental organizations which sell the products in the recipient country markets to generate local currency which is used to support their development and humanitarian activities. While much good undoubtedly comes from these activities, it is hard to argue that they do not displace commercial sales (from local farmers and/or commercial import suppliers).

Accepting greater discipline in these areas would be a small price for the US to pay for a complete ban on agricultural export subsidies,

[5] There can be little doubt that they induce larger investments in the agricultural sector as a whole relative to other sectors of an economy than would otherwise be the case. The issue here is whether they distort the mix of products produced. For example, some argue that in relatively specialized production regions (e.g., rice in Japan), the fact that support formerly distributed to Japanese rice growers via price supports which it now distributes as direct payments based on historical production patterns, is still supporting rice production.

which have caused significant distortions in world commodity markets. Parenthetically, eliminating export subsidies will force the EU to make larger reforms in its domestic agricultural policies. For example, despite its milk marketing quotas, the EU still has to buy dairy products (intervention) to support the internal price of milk. It gets rid of these intervention stocks by subsidizing their sale on the world market.

Market Access Market access, the most important of the three pillars in liberalizing trade, is the least well defined of the three in the Framework Agreement. Beyond general agreement that the highest tariffs should be reduced the most and that the negotiated reductions will be from bound, not applied, tariff rates, not much has been agreed. Because there is so much water in tariff rates, in many cases it would take a substantial reduction in bound tariffs to cause any reduction in applied rates and, in turn, generate an increase in actual imports.

Moreover, in response to insistence from the most protectionist agricultural importers (e.g., Japan, South Korea, Norway, and Switzerland), the Framework provides an escape clause with respect to the principle that the highest tariffs should be reduced the most. The Framework would allow all countries to designate an appropriate number of sensitive products to which the tariff reduction formula will not apply. In exchange for a smaller tariff reduction on sensitive products, however, the Framework suggests that the minimum market access for the sensitive products be increased, but many details remain to be negotiated.

In many instances, tariff rate quotas (TRQs) constrain access to highly protected markets. A relatively low tariff rate is charged on imports that enter within the quota, but a much higher, often prohibitively high, tariff is charged on imports in excess of the tariff rate quota. For example, the US maintains tariff rate quotas for sugar, dairy, cotton, peanuts, tobacco, and beef. In the cases of beef, sugar, and butter, the US would have to reduce its import tariffs by 77, 38, and 19 percent, respectively, before any increase in imports would occur (Tutwiler).

The sensitive product loophole provides a possible way for the most politically powerful commodities, which enjoy the largest subsidies and highest rates of import protection, to avoid reductions in tariff rates as large as for other products. Nevertheless, those commodities should anticipate having to allow foreign suppliers to compete for a larger fraction of domestic consumption. Larger imports might be enough to force more change in those commodities' domestic farm programs.

Developing Country Issues There is another important way in which the Doha Round of WTO negotiations is likely to affect the 2007 farm bill. This relates to the fact that there is a strong development focus in the Doha Round, which is officially dubbed the Doha Development Agenda. This occurred for several reasons. The Doha Ministerial, which launched the Round, was held during 9-13 November 2001, exactly two months after the September 11th terrorist attacks in the United States. Global poverty and the extent to which it facilitates recruitment by extremists were very much on delegates' minds.

Trade is widely acknowledged to be a powerful engine of economic growth, more so than aid. It was widely recognized that high-income countries tend to be most protectionist in the sectors where low-income countries have a comparative advantage, particularly labor intensive manufactures and certain agricultural products that thrive in the tropics (e.g., sugar, cotton, and rice). It was also acknowledged that developing countries had gained little from past rounds of multilateral trade negotiations and since they now represent the majority of members of the WTO, there will be no Doha Round agreement until they feel the benefits justify it.

Between 2001 and 2003, numerous proposals were introduced by individual countries and groups of countries, including several from various groups of low-income countries, however, little progress was made in the negotiations. Several attempts at outlining a framework for an agricultural agreement were made, but without success. In August 2003, in an attempt to advance the agricultural negotiations, the other members asked the US and the EU to bring forward a proposal that would at least be satisfactory to both of them. They produced a proposal just before the Cancun Ministerial meeting in September 2003, however the document was seen as so self-serving (in terms of neither having to make many concessions) and out of keeping with the development spirit of the Round that it precipitated the emergence of an unlikely group of about 20 developing countries (the G-20) led by Brazil and including India, China, South Africa, and other agricultural product exporting developing countries. The G-20 emerged as an effective counterweight to the US and the EU in the negotiations and ended the era when the US and EU could go behind closed doors to hammer out the terms of a deal. Unless the G-20 perceives the deal to be worthwhile for its various members, there will be no deal.[6]

In the runup to the Cancun Ministerial meeting, Oxfam and other nongovernmental organizations waged a high profile publicity campaign

[6] Brazil and other agricultural exporters in the G-20, will insist on real agricultural policy reform in the agreement, however, India is less prepared to reform its own policies, and China perceives that it already conceded enough in its WTO accession negotiations.

against high-income country agricultural subsidies. They focused on the adverse effects of subsidies which drive down world market prices and, in turn, incomes of poor farmers in low-income countries who get their entire income from the market. Just before the Cancun Ministerial, the World Bank released estimates of the world market price depressing effect of high-income countries' agricultural subsidies and protectionism. The World Bank analysts estimated that the world market price of rice is depressed by 33-50 percent relative to the level at which it would otherwise reside (World Bank). The Bank's estimates for the depression of sugar and dairy product prices were 20-40 percent, and cotton and peanut prices, 10-20 percent.

Oxfam built its campaign around US cotton subsidies and how they hurt low-income cotton producers in four of the poorest countries in West Africa (Oxfam International). The campaign was so effective that when delegates arrived in Cancun, cotton, specifically the US cotton program, was on everyone's mind. The US negotiators were in an impossible situation, caught between one of the most powerful lobbies in Washington and virtually all the other delegations. When the US advanced a proposal that assistance be provided to the West African countries to help their farmers diversify out of cotton, the anger at the US was palpable, and the stage was set for the Cancun Ministerial to fail.[7]

Because agriculture is so important in the economies of most low-income countries, it is viewed as the make or break issue in this round of trade negotiations. The US has said that it would reduce its trade-distorting agricultural subsidies if other countries will reduce tariffs and increase quotas to provide greater market access. The developing countries say they cannot open their borders to products whose world market prices are artificially depressed by the subsidies high-income countries provide to their producers. The developing countries, in effect, say the high-income countries have to go first. The US responds that it cannot sell subsidy reductions to the Congress without significant market opening abroad, including in developing countries. This led to a stalemate in the agricultural negotiations for more than a year up until the 31 July 2004, Framework Agreement.

There is a tradition in WTO agreements to allow developing countries special and differential treatment (S&DT), which usually translates into smaller reductions in protection phased in over a longer transition period. That this will once again be the case was confirmed in the July

[7] The Cancun Ministerial nominally failed over disagreement between the high- and low-income countries over whether to address national rules in four new areas on the Doha Round negotiating agenda: customs procedures, investment, competition, and government procurement, but the United States' inability to be forthcoming on cotton had already poisoned the well.

2004 Framework Agreement. US agricultural interests have expressed significant concern about one aspect of S&DT. Most interests other than sugar have little argument with the 50 or so least developed countries receiving special treatment. However, in the WTO, the next higher income category of countries – developing countries – is a self-designating category, and some countries' self-declaration seems to stretch the definition (e.g., Singapore and South Korea). Moreover, there is a problem with certain large countries which have highly competitive export sectors, but yet significant regional concentrations of poverty (e.g., Brazil in soybeans and China in labor-intensive manufactured goods). This is a highly political issue in the WTO, but US agricultural organizations are very unlikely to go along with a Doha Round Agreement in which they see their prime competitor, Brazil, being able to claim special privileges just because it declares itself a developing country.

It is in the economic self-interest of the United States for this to be a successful development round. The (almost) three billion people to be added to the world's population in the first half of the 21st century plus the three billion people (almost half of the world's present population) who live on less than two dollars per day are the only potential growth market for world agriculture. But their need will be translated into market demand only if they experience broad-based economic growth that empowers them with the purchasing power to translate need into market demand. Because many countries, especially in Asia, have a much larger fraction of the world's population than of the arable land, the growth in their food demand will quickly outstrip their production capacity, and they will need to import a larger part of their food supply. However, this will happen only if they can export products in which they have a comparative advantage to earn the foreign exchange needed to buy goods in which other countries have a comparative advantage, including part of their food supply.

OTHER ISSUES

There are a number of other issues that will influence the 2007 farm bill. Now that agricultural commodity programs are acknowledged to be weak rural development policy, will a coalition emerge that can secure support for investments in infrastructure and other public goods essential for successful rural development?

Many farmers perceive that the pendulum has swung too far in relying on the private sector for future agricultural technologies. But will the farm organizations that represent them be willing to support shifting some funds from commodity programs to agricultural research?

Another issue that will play into the 2007 farm bill debate is the increasing size of farms and concentration in the agricultural marketing and input sectors. This will be manifested in, among other ways, advocacy for limits on the size of farm program payments any one producer can receive. To be effective, payment limitations will have to constrain how many times a farm can be carved up into smaller units, each of which can receive the payment limit.

Some are concerned that subsidized crop insurance and disaster payments induce expansion of production of certain crops into areas where there are suboptimal (i.e., higher risk) growing conditions for those crops. Over the years, Congress has regularly undermined the viability of the crop insurance program by providing disaster payments. Some farm organizations are studying various approaches to providing gross revenue assurance as a possible replacement for disaster payments, crop insurance, marketing loans, loan deficiency payments, and counter-cyclical payments.

CONCLUSIONS

The 2007 farm bill and the Doha Round of multilateral trade negotiations are progressing on the same timetable. Field hearings on the 2007 farm bill will start in the fall of 2005, with hearings in Washington, DC continuing through 2006, in anticipation of writing the next farm bill during 2007. The most likely time for the Doha Round to conclude is June 2007, when the current US Trade Promotion Authority (i.e., fast-track negotiating authority) expires. If history is any guide, this will be an effective decision forcing date to bring the WTO negotiations to closure, so any changes in farm policy agreed to in the DDA Agricultural Agreement can be implemented in the 2007 farm bill.

Within US farm organizations there is little enthusiasm for the trade negotiations or even for exports in general. Many American farmers are taking a defeatist attitude about their ability to compete internationally. They see the world market as a zero sum game and are betting their future on ethanol and biodiesel instead. Unless farm organizations enthusiastically embrace whatever is coming out of the Doha Round, don't expect the Congressional agriculture committees to do so.

Many farm organizations and commodity groups organized task groups to work on future farm policy alternatives already in 2004. Their leadership appears to believe that the probability that there will be a binding budget constraint in 2007 is sufficiently high that they need to analyze alternatives. Nevertheless, most farm organizations' first priority seems to be to preserve everything they got in the 2002 farm bill intact. There is likely to be a continuing stream of anti-farm program editorials, however both political parties may view rural America as sufficiently important to their political futures that neither will risk losing any rural votes by proposing to change farm policy.

If one had to predict, the safest best would be that the commodity programs in the 2007 farm bill will not look a lot different than at present. Moreover, with the definition of the special and sensitive products and the redefinition of the blue box to include counter-cyclical payments in the WTO Framework Agreement of July 2004, there is a significant probability of the Doha Round ending with a minimalist agreement in agriculture that requires little change in US farm programs. Based on behavior in past rounds of multilateral trade negotiations, the US and EU would probably go along with this.

However, agriculture is central to the interests of the least developed and developing countries, which make up the majority of WTO members. The least developed countries might be appeased with special and differential treatment preferences, however, the G-20, led by Brazil, is likely to take the attitude that a bad agreement is worse than no agreement, and they will view any agreement that does little to reform agriculture as a bad agreement. There will be no agreement until both the least developed and the developing countries perceive there to be something of value in it for them. The ingredients are in place for at least one more high profile failed WTO ministerial gathering. Finally, sugar and other highly subsidized commodities came close to blocking Congressional approval of the CAFTA-Dominican Republic Free Trade Agreement at the end of July 2005. This close call casts a great deal of doubt on the ability of the US negotiators to deliver Congressional approval on much agricultural policy reform that they might agree to in a Doha Round agricultural agreement.

A betting person would have to wager that the 2007 farm bill will look a lot like the 2002 farm bill. However, there is just enough higher likelihood of change due to the Federal budget deficit, the breadth of recognition that the programs are not achieving their stated objectives, and the Doha Round of WTO negotiations that some more fundamental change might be possible. Readers should stay tuned.

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