Feasibility of Farm Program Buyouts: Is it a Possibility for US Sugar?

David Orden[1]

INTRODUCTION

As the Doha Round of WTO negotiations unfold, achieving substantial liberalization of agricultural trade remains elusive. One reason is that just a few years after the WTO Uruguay Round agreements put a set of multilateral trade and subsidy rules in place for agriculture, the level of US farm subsidies rose sharply. Simultaneously, some developing countries with smaller fiscal resources responded by raising applied tariffs to shield their domestic farmers from declining agricultural prices. Continuation of high subsidies in developed countries matched by high tariffs in developing countries remains a possible result of domestic and WTO policy decisions. A more desirable outcome would be the globally efficient and welfare-enhancing solution of low subsidies and low protection.

This chapter explores a policy option that the United States might use to reduce the long-run cost of subsidies and facilitate the liberalization of agricultural trade, while providing substantial transition support to farmers. The focus is on whether reforms to decouple farm support programs, which are supposed to reduce their production and trade-distorting effects, can be made more convincing through a long-term buyout that would end farm subsidies. Buyouts have not been feasible in the past but recent reforms for several specialty crops provide evidence of what might be done (Alston and Sumner; Barichello, Cranfield, and Meilke; Orden and Diaz-Bonilla). Estimates are provided of the potential

[1] This chapter draws on a research project about a "new generation" of farm policy tools funded by the US Department of Agriculture (USDA), Economic Research Service. An initial presentation was made at the USDA Agricultural Outlook Forum, 24 February 2005. The opinions expressed in this chapter are those of the author and should not be attributed to USDA or the International Food Policy Research Institute. The author thanks Fuzhi Cheng and Owen Wagner for research assistance and Ed Young, Paul Westcott, Erik Dohlman, John Nash, and Eugenio Diaz-Bonilla for helpful review comments.

cost of a buyout of the main US 2002 Farm Bill supports of fixed direct payments, counter-cyclical payments, and marketing loan benefits. The recent EU sugar reform, which includes some buyout dimensions, is also examined and the feasibility of a buyout of US sugar protection is considered. Buyouts of this type should be on the agenda in discussions of the next Farm Bill.

RECENT US BUYOUTS: PEANUTS AND TOBACCO BUT NOT SUGAR

A number of recent policy reforms around the world have provided buyouts. In the United States, contrasting recent policy outcomes among the historically similar peanut, tobacco, and sugar support programs provides some evidence about the conditions conducive to a buyout and its consequences. Very briefly, the 2002 restructuring of the peanut program included a buyout of production quota rights together with new direct and counter-cyclical payments; the 2004 tobacco buyout ended production quotas and eliminated the loan rate program without implementing new payment mechanisms. There has been relatively little reform of the generous US support program for sugar (Brown, Thurman, and Snell; Dohlman et al.; Tiller, Snell, and Blake; Womak 2004a, 2004b).

One lesson from the two recent US reforms is that narrowly defined benefits, specifically production quotas, may be easier to buy out than broader support policies. Binding quota rights were bought out both for peanuts and tobacco, whereas sugar marketing allotments that are only intermittently binding have not been bought out.

The onset of reform aligns closely with the reduction of the benefits obtained by participants in the old program. The pressure from reduced quotas and revenue was most severe for tobacco and the tobacco buyout was the most complete. The unique characteristics surrounding tobacco also explain the more complete buyout of tobacco support compared to peanuts. Domestic tobacco producers had been less successful than peanut or sugar producers in securing restrictions on imports to protect their quota rents. The substantial health-cost-related transfers financed by manufacturers, importers and consumers in the 1998 Master Settlement Agreement (MSA) are also unique to the tobacco industry. This set the precedent for financing the tobacco buyout with specific assessments instead of general tax revenue. Had this precedent not existed, the higher cost of the tobacco buyout ($9.6 billion over ten years) compared to peanuts (about four billion dollars including ongoing payments) might have blocked its enactment. The health issues associated with tobacco consumption also contributed to the outcome of full elimination of the support programs for producers.

In contrast, peanut producers were able to align ongoing support with the cash payment programs for other crops.

Consumers have influenced whether buyouts have occurred to the extent that their demand behavior contributes to declining benefits under the quota program. But the political condition necessary for the buyouts in the United States appears to be the emergence of substantial support for reform among producers. Emergence of such opinion is obviously related to the shrinkage of benefits. Producers excluded from having quotas also tend to favor reform. This is especially evident in the case of producers of what were "additional" peanuts, who gained in 2002 by becoming eligible for a stronger support program. The opinion among producers in favor of reform does not have to be unanimous. In both the peanut and tobacco cases, minorities of producers in high-cost production regions opposed elimination of the location-specific quotas.

It is also the case that while a buyout may be conducive to liberalization of trade policy, the peanut and tobacco buyouts benefited domestic not foreign producers. The United States was already a net peanut exporter of additionals – imports were artificially drawn in primarily because of the high domestic price under the quota program. In the case of tobacco, total US output is likely to rise with the buyout, displacing imports.
In terms of compensation, the buyout payments have been quite lucrative in the recent reforms, especially given the circumstances of declining benefits to quota owners that have provided the reform triggers. The quota buyout payments for peanuts and the quota and total (quota owner and operator) buyout payments for flue-cured and burley tobacco are compared to a seven-year average (1995-2001) of pre-buyout poundage quota rental rates in table 7.1.

For peanuts the lump-sum payment of \$0.55/pound made available in the 2002 Farm Bill is equivalent to an infinite stream of payments of \$0.026/pound at a five percent discount rate. This is about 70 percent of the average of past quota rental rates. Alternatively, the quota buyout payment is equivalent to the average of annual past rental payments, discounted at five percent, made for a period of 24 years. The buyout payments exceed this potential future payment stream to the extent that domestic peanut prices might have fallen had the earlier program continued. Likewise, the buyout payments exceed this future rental revenue stream under the old program if the quantity eligible for sale in the domestic market would have continued to decline under its continuation.

For tobacco, the ten-year stream of annual buyout payments is first discounted back at a five percent rate to an equivalent initial lump sum. This reduces the payment from the nominal \$7.00 to \$5.68 per pound, as

Table 7.1: Value of the peanut and tobacco buyouts (per pound of quota).

	Peanuts	Flue-cured	Burley
7-Year Simple Average Quota Rent (1995-2001)	$0.037	$0.471	$0.411
		$7.00 Tobacco Buyout	
Quota Buyout Present Value	$0.550	$5.675	$5.675
Equivalent Infinite Annuity	$0.026	$0.270	$0.270
Years for Average Rent	24	16	21
		$10.00 Tobacco Buyout	
Quota Buyout Present Value	--	$8.108	$8.108
Equivalent Infinite Annuity	--	$0.386	$0.386
Years for Average Rent	--	34	56

Sources: Womach (2003) and author's calculations. Present values, infinite annuities, and years for average rent are based on a five percent discount rate.

shown in table 7.1. The lump sum payment is equivalent to an infinite stream of payments of $0.27/pound, about 57 percent of the average of past quota rentals for flue-cured tobacco and about 66 percent for burley tobacco. The lump sum payment is more than double the private market prices that had prevailed for sales of quota rights before the reform. It is equivalent to discounted average rental payments for 16 and 21 years for flue-cured and burley tobacco, respectively. Including the three dollar payments to growers (also discounted to an up-front lump sum), raises the equivalent number of years of past rentals covered (to 34 and 56 years for flue-cured and burley, respectively). Again, the buyout is more lucrative for producers to the extent that tobacco prices or quota allocations were likely to have continued to fall under continuation of the old program.

THE EU SUGAR REFORM

Under internal pressure for reform within the CAP, the Everything But Arms (EBA) initiative for least-developed countries, and further pressure from a successful challenge to its past sugar program in the WTO, the EU is undertaking a rather substantial sugar policy reform (Commission of the European Commission). In the WTO case, the panel and Appellate Body ruled that the EU re-exports of sugar imported under preferential agreements from African-Caribbean-Pacific (ACP) countries counted against the EU export subsidy limits, that the EU was in violation of these limits in quantity and value terms, and that its sugar quota system ("A" and "B" quota sold at supported domestic prices) cross-subsidized its "C" sugar sold at world prices. Under the reforms being taken, A and

B quotas are to be combined and punitive levies will be imposed to limit total production.

Although production quotas are retained, the EU reform is substantial. Domestic prices for raw sugar are to decline from Euros (€) 496.8 to €355.2 per metric ton (MT) ($0.27 to $0.19 per pound using an exchange rate of $/€ = 1.20). EU domestic sugar production is anticipated to fall from 19.7 million MT (16.7 under A and B quotas and 3.0 in category C) to around 12 million MT (Economic Research Service). Domestic sugar farmers with A and B quota are to be compensated for the price decline with annual decoupled payments averaging nearly 65 percent of the price difference. The payments are tied to the farmer not to the land and are nontransferable except through inheritance. These direct payments lack the finality of a fixed buyout, but the annual level of compensation to farmers is in the range observed for the infinite annuity values of payments versus annual quota rental rates for the US peanut and tobacco buyouts. The EU sugar reform is scheduled to remain in effect through 2014-15, with total anticipated annual payments about €1.5 million. Thus domestic producers have short-term assurance of their payments but are not assured of their permanence. Moreover, if the planned restructuring program fails to curb production sufficiently to bring the EU into compliance with its WTO commitments with sustainable domestic stock levels, further quota restrictions can be applied on a proportional basis.

The second interesting feature of the EU reform is its transition compensation program for sugar processing plants. Processors may sell their production rights for prices as high as €730 per MT for a plant that is dismantled in 2006-07 or 2007-08, and lesser payments through 2009-10 or for less than full dismantling. Plants that remain in production will be assessed temporary fees to largely pay for the industry restructuring (€126.4 per MT in 2006-07, €173.8 per MT in 2007-08 and €113.3 per MT in 2008-09). Total cost of the buyout of processing capacity is anticipated to exceed €5 billion. While total EU quota production will fall, provision is made for reallocation to efficient producers and processors of 1.1 million MT of new quota (limited by country-specific caps). The new quota rights have to be purchased for a fee also set at €730 per MT. Thus, while the processing plant closure buyout is expected to be taken in relatively inefficient sugar supplying areas, a net shift of production is facilitated toward areas that are most efficient in production and processing. Specific Member Countries and geographic areas are anticipated to be affected by termination or reduction of production and additional regional assistance payments are provided to facilitate the sugar program reform.

Foreign sugar producers with preferential access to the EU market will face a similar price decline under the EU reform. There is a possibility of some adjustment compensation for these countries, but foreign producers are not assured of specific payments. Representatives of the high-cost preferential access countries likely to be negatively impacted by the lower EU sugar prices have objected to the low level of assistance they might receive. Other (lower cost) foreign producers anticipate gains from the EU reform as the volume of their exports increases.

The EU sugar reform has dimensions for farmers of what Orden, Paarlberg, and Roe have called a “cash out” (partial reform that reduces the intrusiveness of farm programs over the long-run by offering their beneficiaries a continuous stream of cash compensation payments) rather than a buyout (a quick termination of support entitlements made feasible by significant but temporary compensation up front in the form of a large cash windfall). But the EU sugar reform is less gradual, and being undertaken more definitely within a short time period, than the slow cash out of the main commodity support programs that has occurred since the 1960s in the United States. The EU buyout of sugar processing capacity differs from the US peanut and tobacco program buyouts in two dimensions. First, in the US cases there was no buyout scheme for processors, even though geographic shifts in production were anticipated from high-cost to low-cost areas. Second, although the elimination of sugar processing capacity is being accommodated with clear buyout payments, it is only a partial buyout – the entire industry is not being paid to close down.

Overall, with its abrupt cash out and partial buyout dimensions, the EU is undertaking a rather substantial sugar program reform. The EU is anticipated to increase annual net imports of sugar from -0.8 million MT (net exporter) to 3.5 million MT (net importer) by 2015. World sugar prices are anticipated to rise as a result of the EU reform, benefiting low-cost producers in these markets. Thus, the EU sugar reform provides an example of the feasibility of sharp reform facilitated by direct payments, the basic idea of a buyout.

FEASIBILITY OF A LARGER US BUYOUT

So far there has not been a convincing buyout proposal for the main farm support programs in the United States or European Union. The fixed payments adopted in the US 1996 Farm Bill provided a windfall to farmers in a year of high market prices, but that legislation failed to ensure a buyout in three respects: a budget baseline remained in place for future farm program spending, the permanent farm program legislation from 1949 and related acts was retained, and the 1996 Farm Bill took no other steps to bind the actions of a future Congress. When farm commodity prices fell, the next Congress quickly stepped in with additional payments.

A buyout of the 2002 US farm programs could focus on the fixed direct payments, the counter-cyclical payments, and/or the loan rate price guarantees (marketing loan benefits). The fixed direct payments provide a narrowly-defined benefit which increases the feasibility of a buyout. Bringing their eventual elimination would ease concerns about continued subsidization but would accomplish the least economically or institutionally. This is because either the fixed payments or a buyout replacement are relatively decoupled and are WTO green box policies.

A buyout of the counter-cyclical payments would accomplish more, since these payments are a particularly contentious form of decoupling likely to have some production stimulating effects. A buyout of counter-cyclical payments would let the United States abandon the WTO blue box, potentially allowing simplification and improved transparency of the WTO rules for agriculture. The value to producers of counter-cyclical payments is not as certain as the fixed payments under the 2002 Farm Bill, but there is an upper bound because the payments are made on fixed quantities and at per-unit levels no greater than the difference between the target price and the sum of the loan rate and per-unit fixed direct payment rate for each commodity. Farmers who succeeded politically in building the counter-cyclical payments into the 2002 Farm Bill to address what they viewed as an inadequate safety net in the 1996 legislation are not clamoring to eliminate these new payments. But government fiscal deficits that had eased when the 2002 Farm Bill was enacted have increased again. So farm program spending will be under scrutiny. A Doha Round WTO agreement could also constrain the current counter-cyclical payments.

Table 7.2 provides information on the potential costs for a buyout of the fixed and counter-cyclical payments. Results are shown separately for a buyout (for all commodities aggregated) of the fixed direct payments, the maximum possible counter-cyclical payments, and the expected counter-cyclical payments as evaluated by the Economic Research Service, USDA (USDA, Farm Services Agency; Young et al.). Under the 2002 Farm Bill, for example, fixed direct payments over six consecutive years (crop years 2002-2007) have an average annual value of $5.292 billion and a discounted present value (at a five percent discount rate) of $28.198 billion (row 1).

Buyout payments shown in table 7.2 are assumed to be made in equal nominal installments over ten years, as in the tobacco case. The buyout costs shown in row 2 are those required to compensate for annual payments made for 25 years at the average level of the 2002 Farm Bill

Table 7.2: Possible buyouts of the US 2002 Farm Bill direct and counter-cyclical payments.

	Fixed direct payments[a]	Counter-cyclical payments	
		Maximum possible[b]	Projected level
	………….billion dollars………….		
2002 Farm Bill payments (crop years 2002-2007)	5.292 (average) 28.198 (lump sum)	7.302 (average) 38.787 (lump sum)	3.505 (average) 18.303 (lump sum)
Buyout payments[c] over ten years equivalent to annual payments at 2002 Farm Bill level for 25 years	9.659 (annual) 78.311 (lump sum)	13.328 (annual) 108.065 (lump sum)	6.398 (annual) 51.870 (lump sum)
Infinite annuity[d] equivalent of buyout payments	3.729 (annual)	5.146 (annual)	2.470 (annual)

Notes: [a]Fixed direct payments and projected counter-cyclical payments are from USDA, Farm Services Agency and Young.
[b]Estimate of maximum counter-cyclical payments is from Young et al.
[c]Buyout payments are assumed to be made in equal installments over ten years.
[d]Present values and infinite annuities are based on a five percent discount rate.

– this is roughly consistent with the buyout compensation provided for peanuts and tobacco. The nominal values of annual payments for which these costs are equivalent as an infinite annuity are shown in row 3.

A buyout of the fixed direct payments along the lines shown nearly doubles the annual expenditure (from \$5.292 billion to \$9.659 billion) that would have to be made for ten years compared to expenditures each year under the 2002 Farm Bill. It almost triples the present value of the payments under the 2002 bill (from \$28.198 billion to \$78.311 billion). This buyout raises short-term costs, but the annual value of equivalent payments in perpetuity (\$3.729 billion) is less than the average annual payment the 2002 Farm Bill will deliver during 2002-2007. A buyout of the maximum possible counter-cyclical payments is more costly, while a buyout of their projected value has a lower cost than for the fixed direct payments.

Marketing loan benefits are the most directly production-linked of the main commodity programs and have an uncertain level of annual expenditures depending on low market prices and current production levels. Table 7.3 provides an estimate of the marketing loan benefits delivered by the 2002 Farm Bill and the cost of a buyout of a 25 year discounted stream of payments at the average level expected under this bill.

Table 7.3: Possible buyout of the US 2002 Farm Bill marketing loan benefits.

	Marketing loan benefits[a] (billion dollars)
2002 Farm Bill payments (crop years 2002-2007)	2.970 (average) 15.774 (lump sum)
Buyout payments[b] over ten years equivalent to annual payments at 2002 Farm Bill level for 25 years	5.420 (annual) 43.945 (lump sum)
Infinite annuity[c] equivalent of buyout payments	2.093 (annual)

Notes: [a]Marketing loan benefits projected under the 2002 Farm Bill are from USDA, Farm Services Agency and Young.
[b]Buyout payments are assumed to be made in equal installments over ten years.
[c]Present values and infinite annuity are based on a five percent discount rate.

Table 7.4: Cost summary for a possible buyout of the main US 2002 Farm Bill support programs (buyout over ten years of 25 years of future payments at 2002 Farm Bill levels).

	Fixed direct payments	Counter-cyclical payments (projected level)	Marketing loan benefits	Total
	…. billion dollars….			
Present value	78.311	51.870	43.945	174.126
Annual cost[a]	9.659	6.398	5.420	21.477
Infinite annuity[b] equivalent	3.729	2.470	2.093	8.292

Notes: [a]Buyout payments are assumed to be made in equal installments over ten years.
[b]Present values and infinite annuities are based on a five percent discount rate.

A summary of the costs of a full buyout of the direct payments, countercyclical payments, and marketing loan benefits is shown in table 7.4. The present value of a full buyout provides a measure of the economic values at stake – with or without a buyout – under legislation along lines of the 2002 Farm Bill. The estimate of the discounted value of payments for 25 years such as the 2002 bill has provided is nearly $175 billion. Much of this payment stream is capitalized into present farmland values. The annual cost of a buyout for each of ten years is nearly $21.5 billion. This is high, but not unprecedented, compared to past annual farm support payments. Finally, the value of the buyout as an infinite annuity is nearly $8.3 billion. One view of a buyout is that once enacted it is equivalent to farm producers securing payments at this level forever, but without the need for subsequent political battles to secure the future payments.

Table 7.5: Cost summary for an alternative possible buyout of the main US 2002 Farm Bill support programs (buyout over ten years of 15 years of future payments at 2002 Farm Bill levels).

	Fixed direct payments	Counter-cyclical payments (projected level)	Marketing loan benefits	Total
		…. billion dollars….		
Present value	57.673	38.200	32.364	128.237
Annual cost[a]	7.113	4.712	3.992	15.817
Infinite annuity[b] equivalent	2.746	1.819	1.541	6.106

Notes: [a]Buyout payments are assumed to be made in equal installments over ten years. [b]Present values and infinite annuities are based on a five percent discount rate.

Overall, buying out farm support payments raises short-term budget costs but reduces expenditures in the long-run. Drawing on the recent buyouts for peanut and tobacco quotas, the buyout illustrated in tables 7.2-7.4 provide a relatively high level of compensation and a long transition period. Sharper, shorter buyouts could be undertaken. The costs of an alternative buyout over ten years of only 15 years of discounted payments at levels comparable to those delivered by the 2002 Farm Bill are shown, as an example, in table 7.5. This alternative buyout has a lower present value, annual cost (over ten years) and infinite annuity equivalent than the buyout shown in table 7.4. Reducing the length of the buyout payments to five years raises the annual cost of either buyout (to a total of $38 billion for the buyout of 25 years of payments and $28 billion for the buyout of 15 years of payments). But, it does not change the present value or infinite annuity equivalent of a buyout since these depend on the number of years of payments bought out, not on how fast the buyout takes place.

In each case, short-term costs must rise in order for a buyout to provide some compensation for the loss of payments further in the future. This can still be considered a good deal by taxpayers (who gain in the long-run) and farmers (who receive a short-term boost).

THE CASE OF SUGAR

Sugar presents a somewhat different case than the main US farm support programs. For sugar, the cost of US protection is borne not by taxpayers but by consumers, as it was for peanuts and tobacco. The sugar program remains dependent on binding import restrictions under tariff rate quotas (TRQs) and on domestic marketing allotments that only constrain domestic production in some years. There is no established market price for rental or purchase of marketing allotments, as there was for peanut and tobacco quotas before the buyouts of those programs. And so far, domestic sugar producers have not seen their benefits erode as dramatically as peanut and tobacco quota owners. Yet, the precedent from the tobacco buyout of a temporary tax on processing of domestically produced and imported sugar provides an example of how a sugar buyout might be financed by a consumer tax.

Table 7.6 shows estimates of the order of magnitude of the cost of a sugar program buyout. Annual production is assumed to be 9.5 million tons by domestic producers and holders of TRQs (assuming buyout payments are made to longstanding sugar TRQ holders deviates from the experience for peanuts where holders of more recently granted TRQs were not given compensation). There is substantial uncertainty about how much the US prices for raw sugar would fall with a sugar program buyout. This would depend on the trade policy adopted. Column 1 draws on a recent study for the American Farm Bureau Federation that assumed a limited increase of duty-free imports (by 1.3 million tons). In this case, the domestic price falls by about \$0.019 per pound (Abler et al.). Adopting this price decline, the nominal annual value of protection lost under this scenario is \$0.355 billion, which has a discounted lump sum value for the six years of the 2002 Farm Bill of \$1.887 billion. A ten-year buyout of 25 years of anticipated producer revenue that would be lost under this trade policy would have an annual cost of \$0.647 billion and corresponding present and infinite annuity values. The cost of a more complete buyout allowing free trade would depend on the expected decline in US prices. Columns 2 and 3 show the results for assumed price wedges of \$0.06 and \$0.09 per pound, respectively.

Several aspects of the EU sugar reform are also of interest in terms of a possible US sugar program buyout. First, one issue is whether NAFTA and other trade agreements or preferential access decisions could put enough pressure on the current US program to force reform, as the EBA and WTO dispute cases did for the EU. This could occur if increased foreign access resulted in imposition of tighter domestic US marketing restrictions. As in other buyout cases, such shrinking of benefits could be a necessary condition for substantial reform. With the recent WTO ruling against Mexican taxes on corn-sweetener based soft drinks, net sugar exports from Mexico to the United States could increase. Effects of other bilateral or regional trade agreements (e.g., Thailand) remain uncertain after sugar was excluded from the US-Australia bilateral free trade agreement.

Table 7.6: Possible buyouts of US sugar protection[a].

	Partial buyout (limited trade)[d]	Full trade opening[e]	
	$0.019 price decline	$0.06/lb price wedge	$0.09/lb price wedge
	…………billion dollars…………		
Approximate protection lost compared to period of 2002 Farm Bill[f] (crop years 2002-2007)	0.355 (average) 1.887 (lump sum)	1.140 (average) 6.053 (lump sum)	1.710 (average) 9.080 (lump sum)
Buyout payments[b] over ten years equivalent to lost protection at levels above for 25 years	0.647 (annual) 5.240 (lump sum)	2.081 (annual) 16.810 (lump sum)	3.121 (annual) 25.215 (lump sum)
Infinite annuity[c] equivalent of buyout payments	0.248 (annual)	0.798 (annual)	1.197 (annual)

Notes: [a]Table 7.6 gives approximations to the order of magnitude of the cost of a buyout of the sugar program assuming 9.5 million tons produced domestically and by TRQ holders.
[b]Buyout payments are assumed to be made in equal installments over ten years.
[c]Present values and infinite annuity are based on a five percent discount rate.
[d]Column 1 reflects a price loss to these producers from limited increase in imports based on a recent study of reform with lower sugar loan rates and introduction of direct, counter-cyclical and loan benefit programs (Abler et al.).
[e]Columns 2 and 3 assume a drop of US prices to world levels by the price wedge given.
[f]For consistency with the other tables, row 1 provides estimates of the value of protection lost annually and for a six-year period (of the 2002 Farm Bill). Effects of price changes on quantities produced and consumed are not incorporated in this preliminary analysis. An argument can be made that buyout compensation should only be for producer surplus lost, not gross revenue, in which case buyout payments could be lower.

Second, the EU processor buyout sets an interesting precedent. Whereas the peanut quota and tobacco program buyouts were complete across an entire industry, would there be an option for a partial buyout of the US sugar program? If a fee/compensation scheme were offered, the obvious application would be for low-cost cane producers to pay fees to continue production that would be used to buy out higher-cost beet processors. Direct buyout payments to beet growers could supplement the industry-financed partial buyout. Whereas payment limitations concerns are an obstacle to a publicly-funded buyout of the huge cane producers in the Southeast, payment limitations are less of a problem for a buyout of sugar beet producers in the Midwest and West because of the smaller size of the beet producing farms. A partial buyout along such lines does not have the appeal of definitive support program termination through a full buyout. But, such a partial buyout could facilitate enough reduction in US domestic sugar production to accommodate stronger liberalization provisions for sugar in trade agreements, which in turn might lead broadly to more ambitious agreements. The net effect in the US case would be the same as in the EU case – to reduce domestic production and expand net imports.

ENFORCING A BUYOUT

If farm subsidy payments for the main crop programs were bought out, there is also an issue of whether any buyout could be enforced. The record from the post-1996 increase in support shows new expenditures can arise.

But, several steps can be taken that would improve the prospects for adherence to a buyout. The first would be to eliminate the permanent legislation for farm support programs. A WTO agreement built around a buyout of US counter-cyclical payments or incorporating tight limits on US amber box payments might also provide enforcement mechanisms. For sugar, a commitment to a higher TRQ or lower over-quota tariffs could lock-in lower domestic producer prices in the future. If the buyout were paid for with a temporary tax on sugar processing, consumers would only see lower prices once the tax was rescinded.

Stronger steps could also be taken to ensure the long-run credibility of a buyout of the main commodity payment programs. Contracts for buyout payments could require that the acreage for which the payments were bought out (and the output from that acreage) be ineligible for future support legislated by Congress. To ensure compliance, such contracts might be structured similarly to those by which some farmers sell their "development rights" to state and local governments for the different purpose of their land remaining in rural condition or agricultural use. The state governments have devised binding legal criteria to ensure compliance from the contract beneficiaries who have sold their development rights.

CAN THERE BE A BUYOUT IN THE NEXT FARM BILL?

Achieving beneficial multilateral liberalization of agricultural trade has remained elusive. This chapter has discussed a long-term buyout that would end farm subsidies as a policy option the United States might use to facilitate progress while providing substantial transition support to farmers.

The differing recent policy outcomes among the historically similar US peanut, tobacco, and sugar support programs provide some evidence about the conditions conducive to a buyout and its consequences. Narrowly defined benefits, specifically quota rights, may be easier to buy out than broader support policies. The onset of reform aligns closely with a sharp shrinkage of the benefits obtained by participants in the old program. The political condition necessary for a buyout appears to be the emergence of substantial support for reform among producers, which is related to the shrinkage of benefits. While a buyout may be conducive to liberalization of trade policy, the peanuts and tobacco buyouts have benefited domestic not foreign producers.

In terms of compensation, the payments have been quite lucrative for the buyout reforms that have occurred, especially given the circumstances of declining benefits to quota owners that have provided the reform triggers. For peanuts, the lump-sum payment of $0.55/pound is equivalent (at a five percent discount rate) to previous average quota rental payments for a period of 24 years. For tobacco, the ten-year stream of owner buyout payments is more than double the private market prices that had prevailed for sales of quota rights before the reform. It is equivalent to discounted average rental payments for 16 and 21 years for flue-cured and burley tobacco, respectively.

There has not yet been a convincing buyout proposal for the main supported farm commodities and the political environment may still be far from prompting such a reform. Yet such a reform should be on the agenda in discussions of the next Farm Bill. Buyouts of the fixed direct payments, counter-cyclical payments, and marketing loan benefits along lines similar to the peanut or tobacco quota buyouts would nearly double the annual expenditures that would have to be made for ten years compared to expenditures each year under the 2002 Farm Bill, and almost triple the present value of those payments. Thus, a buyout will raise short-term costs, but the equivalent annual payments in perpetuity will be less than the 2002 Farm Bill has delivered in recent years. A buyout of the sugar program could be modeled on the tobacco buyout with financing by a temporary tax on sugar processing. The recent EU sugar reform provides additional interesting precedents for a partial buyout of the US sugar program. Such buyouts are an investment in the future. A buyout provides long-term savings for taxpayers, enhanced transition support to farmers, and a basis on which to pursue more open global agricultural markets.

REFERENCES

Alston, J. and D. Sumner. 2004. "Compatibility of National Policies and Multinational Agreements: An Introductory Overview of Issues and Approaches." Paper presented at the Silverado Symposium on Agricultural Policy, Napa, California, January.

Abler, D., J. Beghin, D. Blandford, A. Elobeid, and P. Westoff. 2005. “Sugar Policy Options and Consequences.” Study prepared for the American Farm Bureau Federation, Department of Agricultural Economics and Rural Sociology, Pennsylvania State University, February.

Barichello, R., J. Cranfield, and K. Meilke. 2006. “Options for Supply Management in Canada with Trade Liberalization.” In K.M. Huff, K.D. Meilke, R.D. Knutson, R.F. Ochoa, and J. Rude, eds. *Achieving NAFTA Plus*. Texas A&M University, University of Guelph, and Inter-American Institute for Cooperation on Agriculture-Mexico.

Brown, B., W. Thurman, and W. Snell. 2003. “Policy Issues Surrounding Tobacco Quota Buyout Legislation.” University of Kentucky Cooperative Extension, June.

Commission of the European Communities. 2005. “Reforming the European Union’s Sugar Policy.” Commission Staff Working Document SEC (2005) 808, Brussels, June.

Dohlman, E., L. Hoffman, E. Young, and W. McBride. 2004. “Peanut Policy Change and Adjustment Under the 2002 Farm Act.” Washington, DC: US Department of Agriculture, Economic Research Service, OCS-04G-01, July.

Orden, D. and E. Diaz-Bonilla. 2006. “Holograms and Ghosts: New and Old Ideas for Agricultural Policy.” In K. Anderson and W. Martin, eds. *Agricultural Trade Reform and the Doha Development Agenda*. Washington DC: World Bank and Palgrave Macmillan.

Orden, D., R. Paarlberg, and T. Roe. 1999. *Policy Reform in American Agriculture: Analysis and Prognosis*. Chicago: University of Chicago Press.

Redland, C. 1999. *Tobacco Master Settlement (1998): Overview, Implementation by States, and Congressional Issues* RL30058. Washington, DC: Congressional Research Service, 5 November.

Tiller, K., W. Snell, and B. Brown. “Tobacco Quota Buyout: Questions and Answers: Fair and Equitable Tobacco Reform Act of 2004.” University of Kentucky Extension.

US Department of Agriculture, Economic Research Service. 2006. *EU-25 Sugar and Sweeteners Policy Reform*. Sugar and Sweeteners Outlook SSS-245, Washington, DC, January 31.

US Department of Agriculture, Farm Service Agency. 2005. *Commodity Estimates Book for FY 2006 President’s Budget*. Washington, DC, February.

Womach, J. 2003. *Comparing Quota Buyout Payments for Peanuts and Tobacco*. Washington, DC: Congressional Research Service, CRS Report RS2 1642, October.

____. 2004a. *Tobacco Price Support: An Overview of the Program*. Washington, DC: Congressional Research Service, CRS Report 95-129 ENR, June 10.

____. 2004b. *Tobacco Farmer Assistance*. Washington, DC: Congressional Research Service, CRS Report RS20802, June 10.

Young, C.E. 2005. “Estimates of Costs of U.S. Commodity Programs.” Personal correspondence.

Young, C.E. ,D.W. Skully, P.C. Westcott, and L. Hoffman. 2005. *Economic Analysis of Base Acre and Payment Yield Designations Under the 2002 U.S. Farm Act*. Washington, DC: USDA, Economic Research Report No. ERR12, September.