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## The US Farm Bill: Lessons for CAP Reform?

J. CHRISTOPHE BUREAU<sup>1</sup>

### ABSTRACT

In an analysis first posted on his blog at <http://capreform.eu>, the author considers differences between the agricultural support programmes of the United States of America and those of the European Union, in terms both of levels of support and of institutional processes. The likely content of the forthcoming US Farm Bill is discussed, including the likelihood of a rebalancing of direct and indirect farm support away from 'decoupled' payments. One possible consequence is reinforcement of the arguments of those who feel that the CAP should move back towards more product-specific subsidy and away from environmental support – as many emerging countries are already doing. Bad economic ideas, such as recoupling or making payments countercyclical, will gain influence in the EU if it becomes the only 'country' sticking to the spirit of the WTO discipline.

**KEYWORDS:** Farm Bill; agricultural policy; CAP; institutional differences; subsidies; decoupling

The current CAP reform debate and the US Farm Bill debate have been taking place in parallel for several months. There are some interesting contrasts between the two procedures, which are explored in a note for the European Parliament (Bureau 2012). The note also describes the current situation of the Farm Bill negotiations, based on the proposals tabled by the Senate and by the Committee of Agriculture of the House of Representatives (not endorsed by the House as a whole, so far).

It is difficult to compare the proposed €370 billion for 7 years in the CAP (a crude estimate based on recent budget proposals) with some US\$ 690 billion, i.e. €523 billion budget projected in the US Senate Farm Bill proposal for an equivalent period of time<sup>2</sup>. Indeed, almost 80 percent of the US Farm Bill budget is devoted to nutrition programs such as food stamps and school lunches that benefit primarily to the urban poor and the unemployed. Nutrition programs do benefit farmers by raising demand for food products, but the transfers are much more indirect and diffuse than with the EU direct payments (US nutrition programs also benefit EU farmers by raising global demand). The fact that the main US welfare program is included in the agricultural legislation is puzzling. It results from the progressive expansion of food aid in the US. For decades, farm interests insisted for maintaining this welfare program within the Farm Bill, since it ensured that urban areas Representatives would support legislation that also included generous farm payments. Ironically, the current opposition of conservative Representatives to welfare transfers now hampers the adoption of a Farm Bill. As a result, the 2012 Farm Bill has been delayed. Some

provisions of the 2008 Agricultural legislation expired on September 30 2012, threatening a variety of programs in an immediate future. And because of the automatic budget stabilizers voted by Congress, even a temporary extension of the 2008 Farm Bill is problematic.

As shown in another report for the European Parliament (Butault *et al.*, 2012), the EU provides more subsidies to its farmers than the US. This holds in absolute value as well as in percentage of production<sup>3</sup>. The proposals tabled in the US and the EU will not change this situation. However, EU farm support under the CAP proposal relies more on production neutral instruments than the US ones. Indeed, the proposals currently discussed in Congress show that future US support will rely more on market conditions and that it is likely to induce distortions for third countries.

### Institutional differences

US and EU farm policies moved together in the 1990s, with a shift away from price support and towards decoupled direct payments. They have now taken diverging paths. Institutional differences, and in particular the fact that Congress has all power on US farm policy, are part of the explanation. Within the European Parliament, there are voices calling for the EU to follow the new US orientation that focuses on protecting farmers from adverse situations (e.g. countercyclical payments, insurance, etc.). The new powers of the European Parliament could mean that the CAP setting procedure will be more US like in the future. This would not be a good thing.

<sup>1</sup> Professor of Economics at AgroParisTech, Paris Institute of Technology, and Deputy Director of the INRA research unit in public economics. This article first appeared in his blog at <http://capreform.eu>, and we are grateful to both the author and the CAP Reform.eu team for their permission to reprint it here.

<sup>2</sup> The US Senate schedules nearly US\$1 trillion for 10 years in its Farm Bill version.

<sup>3</sup> Supporters of farm programs point out that there are more farmers in the EU, though. For more details on the measurement of support and a EU-US comparison see Butault *et al.* (2012).

The US Farm Bill procedure is hardly a worthy source of inspiration for the EU. The cleavage between Republican and Democrats in an election year has turned the debate on the Farm Bill into a partisan battlefield, with little attention paid to the general interest and even less to international commitments. In the Senate proposal, every vested interest seems to get its share of the taxpayer's money. Both the Senate and the House proposals maintain and even expand the budget for the most cost-inefficient policies, in particular the insurance subsidies whose ratio of the benefits for the farmers to the cost for taxpayers is particularly low as shown by Bruce Babcock (2011) in a recent report.

In the EU, the decision making process is not satisfactory, as shown by decades of petty bargaining for maximizing budget returns within the Council. However, the specific role of the EU Commission, co-decision with the Council and the way the Parliament is elected make the procedure less subject to short term clientelism. For example, in the US House of Representatives, members are elected for two years from a local constituency and are therefore in permanent electoral campaign. The US procedure of working on scenarios as a difference with a 'baseline' is also a source of bias in Congress' decisions compared to the Commission's impact assessment. It leads to focus, somewhat artificially, on the fixed decoupled payments and conservation programs for budget cuts<sup>4</sup>.

## The US Farm Bill proposals

As we write this article<sup>5</sup>, the content of the future US Farm Bill is still uncertain. Some of the disagreements within Congress regarding the overall budget and the cuts in the nutrition program will be hard to solve. Within the House of Representatives, the Farm Bill proposal by the agricultural committee is not consistent with the budget cuts adopted by the budget committee. However, on the farm support issue, the House Committee and the Senate proposals share many common points and show the likely content of the future Bill.

The main budget cuts will take place in the nutrition programs (food stamps) and in conservation programs, especially those that rely on a 'land sharing' approach, i.e. on which conservations relies on land retirement. Most of the farm support programs will be maintained and the multiple layers of payments, some of them overlapping, will persist. The 'direct' (i.e. the decoupled) payments will be eliminated in both proposals. However, claims by Congress that "direct payments will be cut" are largely bogus: among the many different layers of direct payments, i.e. the marketing loans

program, the countercyclical payments, the fixed direct payments, the insurance payments, the Average Crop Revenue Election payments, the disaster payments, etc. It is only the most decoupled and production neutral ones that will be cut. A paradox is that the measures that will be cut are part of the World Trade Organisation 'green box' measures, which are the ones that generate the smallest international distortions.

At the same time, schemes that isolate farmers from adverse conditions will be reinforced. Both the Senate and House Committee proposals include some enlarged insurance programs, as well as some 'shallow loss' payments that are triggered by a fall in income. The Senate Bill is particularly ambitious in this area, with revenue targets that adjust with market prices, countercyclical payments that are increasingly coupled to current production through higher target prices, and updated yields and base acreages. If, under the next Farm Bill, payments are made on planted acres instead of historical base acres as proposed by the Senate this would involve some 'recoupling' as benefits would be more closely tied to producer loss. This will create the potential for market-distorting behaviour and might also lead to larger payments under the WTO 'amber box'. Already, preliminary figures for 2012 suggest that if the US does not exceed its WTO commitments on domestic support, it is thanks to particular (and questionable) conventions used to notify crop insurance payments<sup>6</sup>.

## Consequences for the EU

The Congress proposals for the US Farm Bill have been criticized by most of the prominent US economists who think that many of the proposed payments are either useless, inefficient or encourage perverse behaviour (see for example Goodwin, Smith and Sumner (2012)). In the EU, recent declarations by some European Parliament's COMAGRI heavyweights suggest that they look at the US Congress proposals as a source of inspiration. Some of them propose making direct payments more countercyclical, which would require going back to product specific payments and giving up any attempt for environmental conditionality. Many want to water down the Commission's proposal for greening the CAP. Others press for more ambitious insurance programs. The example of the US situation, where the insurance system is such that each dollar of insurance net payment costs twice as much to the taxpayer, and where the layers of countercyclical payments means that the budget could vary by some US\$15 billion from one year to the other, should warn against such temptations.

Another consequence of the US Farm Bill debate for the EU is on the diplomatic side. In the 1990s, both the EU and the US found a source of inspiration in the other party's reforms. The move to decoupled payments in the 1985 and then 1996 Farm Bill was followed by the EU. This dynamics played a considerable role in the achievement and respect of a multilateral discipline, which helped the recovery of world prices and soothed international relations. In the 2000s, the US experienced

<sup>4</sup> The US procedure differs from the Impact Assessment carried out by the European Commission. Rather, the Congressional Budget Office establishes a budgetary baseline which corresponds to the perpetuation of the current law over ten years, and estimates the costs of the reforms proposed as deviations to this baseline. A flaw of this procedure is that the CBO has based its 10 year projection on the current market situation. That is, all the impressive arsenal of payments that depend on market prices appear at almost zero cost over the 10 year period. This results in the largely artificial image that in the future, the fixed decoupled payments are the only ones that will use taxpayers' money. It may have played a role in the fact that Congress cuts mostly those payments that are seen as the most 'virtuous' by economists.

<sup>5</sup> November 2012

<sup>6</sup> See Box 4 and Box 6 in Bureau (2012)

a turnaround by shifting to countercyclical payments. With the Congress proposals, the US will most likely depart further from production neutral payments. At the same time, many emerging countries are also expanding their coupled payments (Russia, China, India, Turkey in particular). Countries, like the EU, that stick to cooperative policies and take care to the preservation a rule based multilateral discipline tend to become exceptions.

The EU takes pride in remaining a leader in the promotion of more neutral support and respect of WTO commitments. But being a leader that no one follows is not a sustainable status. Bad economic ideas, such as recoupling or making payments countercyclical, will gain influence in the EU if it becomes the only 'country' sticking to the spirit of the WTO discipline. The orientation of the US Farm Bill shows that the stalling of the Doha negotiation has far reaching and damaging implications.

### About the author

**Jean-Christophe Bureau** completed his doctorate thesis at the University of Paris I (Panthéon-Sorbonne). He is professor of economics at AgroParisTech, Paris Institute of Technology, and works on agricultural policy and international trade. Jean-Christophe is a research associate at CEPRII (Centre d'Etudes Prospectives et d'Informations Internationales). He is deputy director of the INRA research unit in public economics (UMR INRA 210, Institut National de la Recherche Agronomique) and vice

president of the Economics and Social Sciences Department at AgroParisTech. Previously, he worked in different places including as a volunteer in Haïti for two years, at the Economic Research Service of the US Department of agriculture, at the OECD Secretariat, at Iowa State University and at the Institute for International Integration Studies at Trinity College in Dublin. He was scientific adviser at the Council for Economic Analysis of the French Prime Minister, in charge of agriculture and environment from 2002 to 2004.

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