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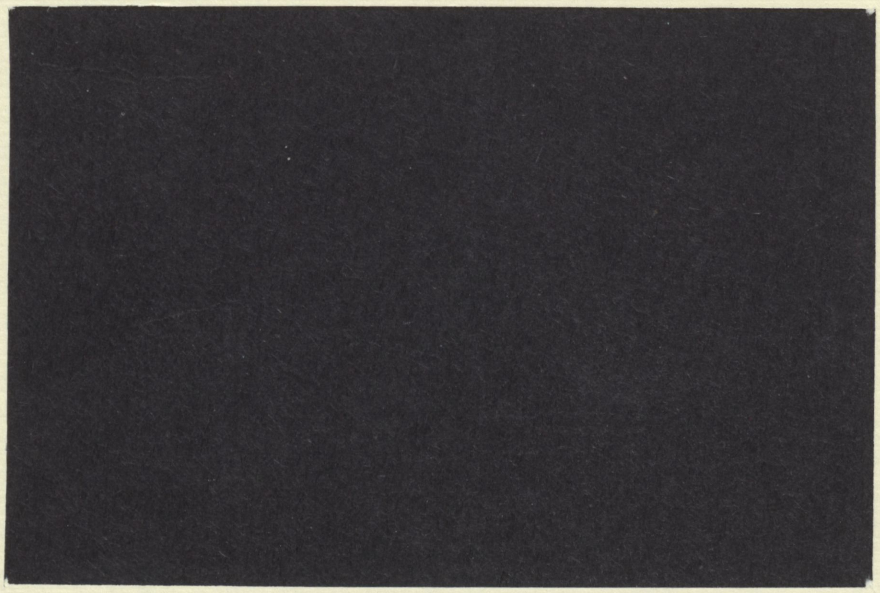

1990 Farm Bill Analysis and Implications

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The House and Senate have passed their versions of the 1990 Farm Bill. Although most of the differences between the House and Senate bills are relatively minor, the final shape of the legislation is very uncertain. Depending on the outcome of the budget negotiations, the conference committee may make substantial changes in the House and Senate bills to achieve whatever budgetary savings are required.

Even if a compromise is reached and new farm legislation is signed into law sometime this fall or winter, it is very likely that the Congress will again be debating farm policy in 1991. The GATT trade negotiations are scheduled to conclude in December, and even a limited agreement is likely to require significant changes in U.S. law.

The Food and Agricultural Policy Research Institute (FAPRI) has been actively involved in the 1990 Farm Bill debate, providing analysis of various options to the House and Senate agriculture committees. In the months to come, FAPRI will examine the consequences of possible outcomes to the budget and trade negotiations.

The following notes summarize important implications of the House and Senate bills, and discuss what the budget and trade negotiations may mean for U.S. agriculture.

House and Senate Bills

Flexibility

Both the House and Senate bills permit farmers to plant part of their program acreage to soybeans or other crops and still maintain their program base. Both bills require farmers to give up deficiency payments on "flexed" area on an acre-for-acre basis. Differences are minor: the Senate bill allows hay and other nonprogram crops to be produced on flexed acres while the House bill is more restrictive; the House bill allows more acres to be flexed. Implications:

* By eliminating the base penalty, farmers would be more likely to plant alternative crops on program base acreage when market conditions indicate. However, for soybeans the program adds little that is not in the current 0-25 program. It would still require farmers to compare the target price of corn, for example, to the market price of soybeans when making planting decisions.

* While the additional flexibility will benefit some individual producers, it is unlikely that large acreage shifts will occur at the national level. FAPRI estimates indicate that average planted area for each of the program crops would change by less than 200,000 acres over the 1991-95 period because of the flexibility provisions. If the Senate provisions prevail, hay acreage may increase more than the change in acreage for any other crop.

* Acreage effects may be larger under unusual market conditions. If, for example, a drought in the Plains resulted in $4.00 wheat in 1991, more acreage in the Corn Belt might shift to wheat than under current law.

Soybean Support

A marketing loan program for soybeans is part of both the House and Senate bills. At projected levels of stocks, the Senate loan rate would be $5.50 per bushel for 1991-95, and the House loan rate would be $5.25 for 1991-92, $5.40 for 1993, and $5.51 for 1994-95. Implications:

* The marketing loan would provide income protection for U.S. soybean producers without creating a price floor for foreign producers.

* Both bills set the loan rate low enough that the budgetary cost of the program is minimal, given current projections of soybean market prices. For example, projected FAPRI soybean prices range from $5.66 per bushel in 1991/92 to $6.44 per bushel in 1994/95, given current policies.

* Given the FAPRI and CBO baselines, the net effect of the marketing loan on soybean acreage is likely to be relatively small. Given expected market conditions, the marketing loan would do more to reduce producer risk than it would to increase producer income. FAPRI estimates indicate that the increase in soybean acreage resulting from the soybean marketing loan and the flexibility provisions would average about 600,000 acres (1.1 percent) between 1991 and 1995.

* The marketing loan would have a much larger effect on the soybean market in the case of a large crop or weak demand. In such a case, producers would continue to be guaranteed $5.50 per bushel (in the case of the Senate bill), even though the market price might well fall below $5.00 per bushel. Potential budgetary costs are large--a $4.50 market price would cost the government about $2.0 billion.

Target Prices and Loan Rates

In general, both the House and Senate bills freeze target prices at 1990 levels (the Senate bill does allow target price increases for oats, and gives farmers the ability to receive a higher target price in exchange for higher ARP rates). The House bill does not permit the Secretary of Agriculture to reduce loan rates as much as he can under current law, but the basic structure of loan rates is maintained. The Senate establishes a marketing loan program for wheat and corn. To reduce the wheat loan rate below $2.44 per bushel and the corn loan rate below $1.96 per bushel, the Secretary must make additional advanced payments to producers. Implications:

* A freeze in target prices would protect crop producer income. Budget pressure is likely to force either lower target prices or a restriction in the amount of production eligible for deficiency payments.

* Projected market prices are above even the higher loan rates in the Senate bill. For example, corn prices are projected to range from $2.15 per bushel in 1991/92 to $2.36 per bushel in 1995/96, and wheat prices from $3.01-$3.52 per bushel over the same period. Under such conditions, the proposed loan rate increases relative to current law would have only a small impact on grain markets.

* In the case of a large crop or weak demand, the marketing loan program proposed in the Senate bill would let market prices fall below the loan rate. The government would not accumulate stocks, but would subsidize producers for the difference between the loan rate and the market price. The House bill allows lower loan rates, but since the loans are nonrecourse, they would act as a price floor.

Dairy

Both the House and Senate bills prohibit the price support level from falling below $10.10 per hundredweight. Government net removals would be measured on a total solids basis, rather than a milkfat basis. If projected removals exceed 7.0 billion pounds, a supply management program would be implemented. The nature of that program is uncertain, but it would not allow another dairy herd buyout program. Implications:

* The support price was likely to fall to $9.60 per hundredweight next January under current law. However, measuring net removals on an all solids basis would probably be sufficient to avoid the support price decline, since almost all removals are of butter (high in milkfat equivalent, but low in total solids).

* Under current policies, FAPRI projects that milk prices would fall from $14.23 per hundredweight in 1990 to $12.12 in 1992. Even at a $10.10 support price, however, removals are likely to remain below the 7-billion-pound trigger.

Conservation and Environmental Provisions

Additional conservation reserve program enrollment is permitted in both the House and Senate bills, with greater targeting of environmental benefits. Maximum enrollment is 50 million acres in the Senate bill and 45 million acres in the House bill (current enrollment is 34 million acres). Special programs to preserve and restore wetlands are included in both bills. A new program would provide farmers incentives to develop and implement plans to improve water quality. Implications:

* A larger conservation reserve would provide environmental benefits if properly targeted, but would also reduce the acreage available to respond to another severe drought. A larger CRP implies smaller annual set-asides and more price variability.

* The environmental provisions in the House and Senate bills generally rely more on the carrot than the stick to encourage more environmentally sound practices. In general, they appear likely to result in only very modest changes in cropping patterns on a national basis, although the effects may be more significant in environmentally sensitive areas.

The Farm Bill and the Budget

In July, the Congressional Budget Office estimated that the fiscal 1991 budget deficit would be $164 billion given current policies, a full $100 billion above the Gramm-Rudman target. Including spending by the Resolution Trust Corporation needed to deal with the S&L crisis, the deficit would balloon to $232 billion, a new record. Senator Leahy has said that he wants the House-Senate conference committee to delay its work so that the members can bring the cost of the farm bill in line with the agreement expected to come out of the budget summit. Three possible ways to reduce the government cost of farm programs would be to reduce target prices, institute a triple-base program, or allow Gramm-Rudman cuts to go into effect.

Gramm-Rudman

Given the projected size of the defict, allowing Gramm-Rudman cuts to go into effect could be considered a worst-case scenario. According to the July CBO report, the current deficit estimate would trigger a 38-percent cut in non-exempt domestic spending. If past precedent is followed, all payments made on the 1991/92 crop would be reduced by 38 percent. Implications:

* Participation in farm programs would fall, reducing the amount of land idled under government programs. This would result in increased production of at least some commodities, particularly soybeans.

* Much more important than the effect on commodity markets would be the effect on crop producer income. Past FAPRI analysis indicates that every dollar reduction in deficiency payments reduces crop producer income by about one dollar, all else equal.

Target Price Reductions

The conference committee may decide to reduce target prices to achieve budget savings. If a budget agreement is reached, it is likely that the necessary cuts would be less draconian than would occur under Gramm-Rudman (budget cuts of $20-$50 billion are often discussed, as opposed to a Gramm-Rudman cut of $100 billion). Implications:

* For the most part, market and income effects would be proportional to those under Gramm-Rudman.

* A Gramm-Rudman cut reduces payments by a given proportion; a target price reduction cuts payments by a given absolute amount.

Triple Base

Many members of the agriculture committees have indicated that they would prefer that budget cuts be achieved by reducing the amount of production eligible for payments rather than by cutting support prices. Under a triple base program, only a certain proportion of a farmer's base acreage would be eligible for payments. On the remaining acreage, any crop could be planted without loss of base history, but no deficiency payments would be made. Implications:

* Unlike Gramm-Rudman cuts or target price reductions, a triple base program would be likely to have significant effects on cropping patterns. On the flexible base, target prices would have no effect on planting decisions; only market returns would matter. Given projected market conditions, this would be likely to result in increased soybean, wheat and cotton acreage, and reduced feed grain area.

* In terms of likely market impacts, the difference between a triple base program and the House or Senate flexibility provisions is greater than the difference between the House or Senate provisions and current law. In fact, the triple base would have essentially the same impact at the margin as the administration's flexibility proposal, which was dismissed by the agriculture committees early in the negotiations.

* One quirk of the law may occur if a triple base is enacted, the marketing loan is available on all soybean production, and a large crop or weak demand results in low prices: surplus production of soybeans may result as acreage decisions are driven by a comparison of corn market prices to the soybean marketing loan rate, rather than soybean market prices. This would be just the opposite of the perceived problem with current law.

The Farm Bill and the GATT Negotiations

It is very difficult to predict what, if any, agreement will come out of the current GATT negotiations on agriculture. The public positions of the U.S. and EC are still very far apart, even though the negotiations are supposed to be wrapped up in December.

If the final agreement more closely resembles the U.S. position:

* Export subsidies would be eliminated or at least sharply curtailed. This would limit the ability of the European Community to export wheat, barley and other products, but would also force the U.S. to abandon EEP.

* Import quotas would be changed to tariffs, which would then be reduced over time. This would result in increased U.S. imports of sugar and dairy products, Japanese imports of rice, and significant changes in world livestock trade.

* Internal producer supports tied to production would be reduced. These could be replaced with "decoupled" payments that could protect producer income so long as they do not distort production and trade. This implies lower target prices or a payment program where, at the margin, support prices do not affect production decisions. The triple base program or something like it might qualify.

If the final agreement more closely resembles the EC position:

* An "aggregate measure of support (AMS)" will be used to determine obligations. Countries would be required to reduce their AMS a certain amount, but would be given wide latitude in deciding how to do so.

* "Rebalancing" would be permitted; e.g., the EC could introduce tariffs on soybeans and soybean products in exchange for reduced levels of support for grains. This would tend to increase U.S. wheat and feed grain exports, but reduce U.S. soybean and soybean product exports.

* Policy changes and market impacts would be smaller than if the final agreement resembles the U.S. position. Recently, the EC called for a 30 percent reduction in support from 1986-88 levels, implying less reduction from current levels.

If the negotiations break down:

* A trade war could ensue, with increased use of export subsidies, escalating support prices, etc.

* Budgetary pressures in both the U.S. and the EC are likely to keep a trade war from spinning out of control, however, and may force negotiators to return to the table. Pressure from other major trading countries is also likely to avert the trade war scenario.

FAPRI Publications related to the 1990 Farm Bill:

"FAPRI 1990 U.S. Agricultural Outlook." Staff Report #1-90. March, 1990. Outlook for U.S. agriculture, assuming an extension of the provisions of the 1985 Food Security Act. Based on market conditions of early 1990.

"FAPRI 1990 World Agricultural Outlook." Staff Report #2-90. March, 1990. Outlook for world agriculture, assuming a continuation of current agricultural policies in the U.S. and other countries. Based on market conditions of early 1990.

"An Evaluation of Planting Flexibility Options for the 1990 Farm Bill." Staff Report #3-90. April, 1990. Implications of a planting flexibility program similar to that proposed by the Administration.

"An Evaluation of Price Support Equilibration Options for the 1990 Farm Bill." Staff Report #4-90. April, 1990. Implications of a normal crop acreage (NCA) system operated in conjunction with a marketing loan program for soybeans and higher target prices for barley and oats.

"An Evaluation of the Soybean Marketing Loan Option for the 1990 Farm Bill." Staff Report #5-90. April, 1990. Implications of a marketing loan program for soybeans, with loan rates ranging from $5.25 to $6.00 per bushel.

"An Evaluation of Flexibility and Soybean Support Options for the 1990 Farm Bill." Staff Report #6-90. June, 1990. Implications of a soybean marketing loan program and a limited producer flexibility program (similar to that in the House and Senate farm bills) operated separately or jointly.

"Assessing the Effects of the 1988 Drought on U.S. Agriculture under Alternative Stock Scenarios." Staff Report #7-90. July, 1990. Implications of policies that would have reduced grain stocks available at the time of the 1988 drought.

FAPRI publications can be obtained by writing:

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FAPRI publications can also be obtained by calling 515-294-7519 and asking for Carol Hunczak.