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Domestic Farm Policy for 2007: Forces for Change

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The fundamental political rationale of U.S. farm policy, to support and stabilize the incomes of family farmers, has been embodied in farm bills since the early 1930s. U.S. agriculture has changed dramatically since the Great Depression in ways that matter from the perspective of policy makers. In the 1930s, farm household incomes and wealth were lower on average than nonfarm household incomes and wealth. In 2006, that situation has reversed. In the 1930s, the average farm size was much smaller than in 2006, both in land area and value of sales. The types of products being produced were also far less diverse. In the 1930s, more than 75% of all farms raised commodity program crops such as corn and wheat. Today, only about a quarter of all farms grow such crops. In the 1930s, agricultural resource policy was focused on enhancing farmland productivity. In 2006, preserving natural resource attributes of that farmland is also a major policy concern.

These changes in structure and focus have created substantive policy issues. Some ideas, such as imposing tighter limitations on government payments to individual farms and proposals to target assistance more towards low income households, have been sources of controversy for several decades. Other issues, such as expanding the scope of government support to be provided to other commodities, including fruits and vegetables and livestock, are relatively new concerns. All are in play in the context of current debate over the likely shape of the 2007 Farm Bill. In addition, since 1994, U.S. farm policy has been constrained to some degree by the U.S. Government's commitments under the Uruguay Round Agreement on Agriculture (URAA), as implemented through the World Trade Organization (WTO). Further, funding for farm programs, and therefore the scope and structure of those programs, are contingent on the status of the federal budget during the period in which a new farm bill is debated. The next farm bill is also likely to reflect broader societal interests, with particular attention paid to the environmental and energy impact of farm policy.

Budget Issues

When legislators have been faced with substantial federal budget deficits, as in the 1990s, many farm programs have been cut back or eliminated. In contrast, the 2002 Farm Bill was developed in a brief era of budget surpluses when funding was much less constrained. The March 2001 budget baseline released by the Congressional Budget Office (CBO) projected a $5.7 trillion budget surplus in the federal budget over the period 2002-2011. In this environment, farm state members of Congress were able to obtain $73.5 billion of additional funding for the 2002 Farm Bill. The August 2006 CBO baseline assessment paints a very different picture, projecting a ten-year cumulative deficit of $1.8 trillion.

Moreover, this official or 'status quo' CBO baseline projection does not account for the potential extension of expiring tax cuts after 2010, changes in the Alternative Minimum Tax to reduce its adverse tax impacts on middle-class Americans, and the cost of a continuing military role in Afghanistan and Iraq. A separate CBO analysis, which accounted for these impacts, results in annual budget deficits averaging more than $500 billion over the next ten years. In addition, the increase in the national debt implied by these deficits will raise federal debt service interest costs. In this fiscal environment, framers of the next farm bill are likely to have to work with no more than current baseline funding, and conceivably less (Figure 1).

Under the budget resolution for fiscal 2006, the House and Senate Agriculture Committees were required to cut spending by $3 billion over five years, along with similar cuts required for other Congressional Committees. For agriculture, the largest cuts were in commodity and conservation programs and agricultural research funding. For reconciliation, CBO projected that spending for all mandatory farm programs (including food stamps) over the five-year period 2006-2010 would be $278 billion. Since the effort to make cuts in the fiscal 2006 budget was successful, Congress is more likely to repeat the exercise in the future, further reducing funding for the 2007 Farm Bill.

The Farm Security and Rural Investment Act of 2002 consisted of ten separate titles. These included commodity and conservation programs, trade (including food aid), nutrition, farm credit, rural development, agricultural research, forestry, renewable energy, and miscellaneous issues. Under the August 2006 CBO baseline, spending on farm bill programs (other than nutrition programs) is expected to be about $195 billion over the ten-year period beginning in 2008.[1] Proposals for new programs or modifications to current programs in the 2007 Farm Bill will likely have to fit within the baseline funding level to be projected by CBO in March 2007.

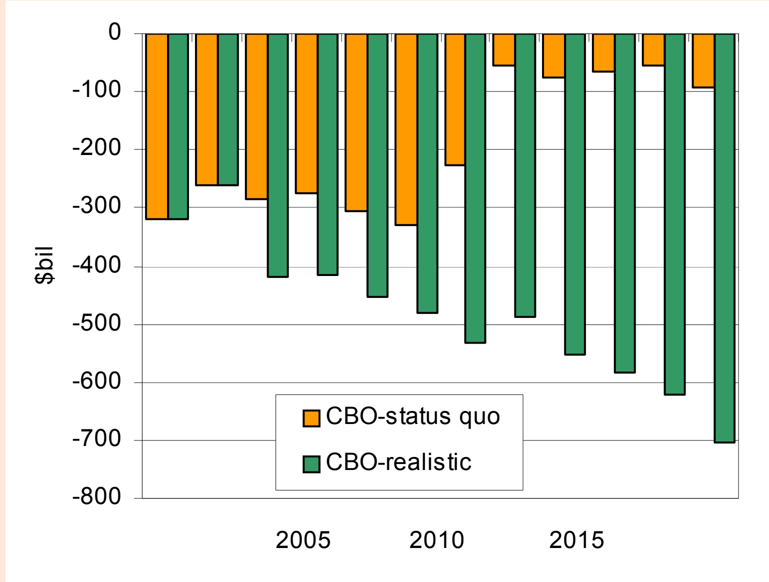

Figure 1. U.S. budget projections, 2007-2016.
Source: CBO budget baseline, August 2006.

Changing Demographics

Farm bills are not written in a vacuum. Although farmers and rural communities are the direct beneficiaries of farm programs, the interests of other groups also matter in the current political environment. In the U.S. House of Representatives, agricultural interests are not the force they once were. Every decade, seats are reallocated to states on the basis of new Census population estimates and Congressional District reapportioned by state legislatures. Over the last 50 years, the regions in which agriculture is economically important have shrunk significantly. An analysis by USDA's Economic Research Service (ERS) shows changes in farming-dependent counties between 1950 and 2000.[2] In 1950, farming-dependent counties were located in nearly every state. By 2000, these counties had dwindled in number and had become concentrated in a belt 1-2 states wide stretching from eastern Montana to the Texas panhandle.

The political implications of this demographic shift are important. Data from the 2002 Census of Agriculture indicate that among all Congressional District (representing an average of 646,000 residents), fewer than half contain more than 1,500 farmers. Thus, only a minority of members in Congress have substantial farm-based constituencies that are committed to maintaining funding for federal farm programs. Moreover, the proportion of families in the United States directly involved in farming has become very small, about 2% of the population. Most Americans have no, or only distant, connections with agriculture as a source of income and a way of life.

Many members of the general public who do hold opinions on U.S. farm policy base their views on information from the mass media, which is often critical of the distribution of farm program funds. For example, in 2001, data on farm program payment recipients disseminated by the Environmental Working Group sparked public interest and debate about whether wealthy farmers with large operations should receive substantial annual government pay-

1. *The current CBO baseline runs for 2007-2016. The $195 billion figure extrapolates spending trends for 2017, the last year of a ten-year baseline for a 2007 Farm Bill, excluding food stamp spending.*

2. *ERS defines farming-dependent counties as those with at least 15% of income from farming.*

ments. An amendment to sharply limit payments was added to the Senate version of the 2002 Farm Bill, but dropped from the final legislation at the insistence of conferees from the House Agriculture Committee. This issue has already resurfaced in discussions about the 2007 Farm Bill, but faces opposition from commodity groups, especially rice and cotton producers in California and the South, which include most recipients of large payments because of the structure of their farms.

The Evolving Structure of Political Interest Groups

The politics of agricultural policy have generally become more complicated over the past two decades. Arguably, the major commodity policy elements of the 1985 Farm Bill were framed to address the concerns of feed grains, cotton, rice, soybean, sugar, wool and mohair and wheat producers along with environmental interest groups concerned about conservation. Among livestock producers, dairy operators with a price support program to preserve were probably the most active participants in the policy process. Players in the current debate over the future of farm programs are more numerous. In the last Farm Bill, along with the producers of traditional program commodities and sugar and dairy, growers of minor oil seeds and pulse crops sought and acquired loan rates for their crops. They too have a stake in maintaining loan rate programs or negotiating other means of support if loan rate benefits were to be reduced.

In addition, producers of fruits and vegetables have become actively engaged in the 2007 policy debate. This is partly because of the increased importance of the federal crop insurance program as a source of subsidies and risk management for these commodities. Beef cattle producers also have recently become involved in crop insurance debates as new policies covering grazing land and livestock price risks have been introduced.

Advocates for low income household programs such as food stamps and school lunches and breakfasts are also participants in farm bill debates, although child nutrition programs are usually handled in separate legislation. Further, in addition to environmental interest groups, advocates for renewable energy production are now active advocates for certain farm bill programs. Given the recent sharp increases in oil prices and the resulting expansion of interest in renewable fuels, lobbyists for the ethanol and biodiesel industries may be effective voices in the writing of the next farm bill. These groups seek energy-related incentives or mandates aimed at increasing domestic demand for major commodities such as corn and oilseeds and reducing exportable surpluses. Energy programs that increase domestic consumption of grains may also be viewed benignly by other countries and could therefore resonate with legislators.

Other groups without a direct stake in agriculture are also seeking to be heard in the policy process. Humanitarian groups such as Oxfam America are raising questions about the adverse impact of U.S. farm programs on farmers in developing countries. Some conservative or libertarian groups, such as the Cato Institute and Heritage Foundation, assert that farm programs represent corporate welfare and should be ended.

Inertia is also an important factor in policy formation. Gary Becker pointed out that major policy shifts tend to occur only when the economic and political benefits of change outweigh the costs. The increased income flow from farmland resulting from most U.S. commodity policies has led to an increase in the value of U.S. farmland over time. Ending some of these programs or reducing the subsidies they provide will inevitably lower land values, with concomitant impacts on farm wealth. By some estimates, for example, abandoning loan rate programs and direct payments could reduce prices for agricultural land in several states by 20% or more. Farm interest groups are deeply concerned about such effects, and policy makers, therefore, have to be conscious of the impacts of proposed policy changes on land prices in evaluating the 2007 Farm Bill.

Implications of the WTO Agreements for the 2007 Farm Bill

For the first time, under the terms of the 1994 URAA, agricultural policies that affect trade were to be subject to an agreed set of international rules. The URAA also introduced new and binding procedures to resolve disputes between member countries over whether specific trade policies were consistent with WTO obligations. Previously, individual member countries had been able to block the implementation of panel findings.

In September 2002, the government of Brazil filed a landmark case against the U.S. Government's cotton support programs, the first in which one country claimed that another country's domestic support programs were incompatible with that country's WTO obligations. Several important elements of Brazil's claims were supported by a WTO panel's rulings in August 2004 and were subsequently upheld by the WTO appellate body in March 2005. The WTO panel found that the United States had forfeited protection under the peace clause of the URAA by spending more each year on domestic support for cotton between 1999 and 2002 than in 1992, the benchmark year.[3] Further, U.S. price-related support programs had depressed prices in the world cotton market. The WTO panel therefore determined that the U.S. government must modify or eliminate those programs. The panel also found that the Step 2 cotton program and U.S. export credit guarantees were export subsidy programs, and should be modified or eliminated.

In response, the U.S. Government took some steps to bring the relevant programs into compliance. USDA modified the operation of the export credit program by issuing new regulations, basing fees that countries must pay on the risk of nonrepayment of loans made under the program. The Step 2 cotton program was terminated August 1, 2006, Congress having let the program complete the 2005 marketing year.

The WTO panel report offered no further guidance on U.S. compliance. However, Congress may also need to make changes to domestic price-related programs, chiefly the marketing assistance loan and countercyclical payments (CCPs), to comply with the panel's findings. In addition, current limits on the use of land for the production of fruits and vegetables associated with the direct payment program may have to be modified. Within policy circles, Congress is expected to incorporate any changes it deems necessary into the 2007 Farm Bill and, for reasons of political balance, will likely make similar changes to programs for all crops, not just cotton.

Since November 2001, WTO member countries have also been engaged in agricultural negotiations in the Doha Round, aimed at further reductions in domestic support, improved market access, and elimination of export subsidy programs, in addition to reforms in trade in services and market access for manufactured goods. However, in July 2006 negotiations appeared to collapse, mainly over gaping differences between the United States and other countries such as India and the European Union with respect to agricultural provisions, and negotiations were formally suspended. There is widespread agreement that Trade Promotion Authority (TPA) for the President is a necessary prerequisite for any new WTO agreement to insulate legislation to implement the agreement from Congressional amendments. Current TPA legislation expires July 1, 2007, and there is no guarantee it will be renewed beyond that date. Thus, the Doha Round of WTO negotiations may have very few implications for the 2007 Farm Bill. However, some farm groups are advocating an extension of the 2002 Farm Bill for a few years until the Doha Round can be completed. Under those circumstances, the 2007 Farm Bill could have a very short lifetime, and significant policy change could come in response to a delayed Doha Round Agreement.

U.S. negotiators did submit a substantive proposal to the WTO on agricultural reform in October 2005, whereby the United States would reduce the ceiling for its trade-distorting domestic programs from $19.1 billion annually under the URAA by 60%, to a maximum of $7.6 billion annually. Had the U.S. proposal been adopted, the U.S. Government would have obligated itself to make changes in many of the programs that make up the farm safety net. Congress could respond to such constraints in three ways: 1) simply cut program spending, 2) transfer a portion of spending into direct payments while maintaining a reduced farm safety net within the new caps, or 3) undertake a fundamental shift from price-related support to decoupled, 'green box' programs, including those which address broader societal objectives such as conservation and rural development. Whether these policy reform proposals will now receive much attention in the 2007 Farm Bill debate is much less clear, although budgetary pressures may be an important driving force for some changes in these areas.

In the current policy mix, the U.S. Government provides a portion of support to farmers through green box programs that are deemed to be minimally trade-distorting, including direct payments and conservation payments. Other U.S. green box programs support development of infrastructure or improved economic opportunities through rural development initiatives and agricultural research programs. To compensate for potential reductions in price-related subsidies resulting from the Brazil cotton case or a resuscitated Doha Round, the United States could choose to expand funding for these programs, while phasing out or substantially reducing domestic subsidies provided by the marketing loan and countercyclical payments programs. Concerns have been raised about the use of decoupled direct

3. *The peace clause is contained in Article XIII of the URAA, and exempted countries from actions against their domestic agricultural policies under other Agreements if support remained below the level provided in 1992. It expired in 2004.*

payments by some farm groups. These groups have argued that a substantial proportion of all direct payments accrue to 'absentee' land owners who are not involved in farming. Second, such payments drive up land values and land rents. Finally, because direct payments are not linked to production–the very characteristic that makes them tenable under current WTO rules–many legislators and the general public could perceive them to be analogous to welfare checks. This perspective, some farm groups suggest, could make direct payments vulnerable to Congressional reduction in periods of fiscal constraint.

Other Free Trade Agreements

While the Bush Administration has undertaken the negotiation of 11 free trade agreements (FTAs)–six in force and five still underway–no FTA has directly obligated the U.S. Government to make changes in domestic farm programs. In fact, U.S. trade negotiators have steadfastly resisted such commitments, reserving domestic policy issues for multilateral negotiations within the WTO. However, providing increases in market access for FTA partners for products that are protected by the use of tariff-rate quotas incrementally reduces the effectiveness of U.S. price support programs for commodities such as sugar and dairy. These indirect effects led the U.S. sugar industry to unsuccessfully oppose the Central American FTA in 2005, fearing a long-term degradation in their support system if more market access is provided in future FTAs.

Conclusions

The 2007 Farm Bill will be developed in a very different political environment than the 2002 Farm Bill. In 2002, Congress and the Administration were enjoying the flexibility in policy making provided by substantial federal budget surpluses. The 2007 Farm Bill will be developed in the context of official federal budget deficits on the order of $300 billion per year, or about 2% of current Gross Domestic Product. Past budget proposals indicate the Administration is willing to support some reduction in funding for agricultural commodity programs; this perspective resonates with many members of Congress.

Federal budgetary constraints are also being reinforced by some recent developments with respect to the obligations of the United States under its WTO commitments. Specifically, the recent WTO Dispute Resolution determination in the Brazil cotton case, that several elements of U.S. cotton programs violate U.S. commitments under the 1994 Uruguay Round Agreement, raises similar questions about U.S. programs for other commodities such as corn, oilseeds, and wheat. Price supports and the level of funding for subsidies derived from marketing loan programs and CCPs have all been brought into question. The Brazil case findings have even raised questions about the validity of direct payments to producers of program commodities under the WTO. The U.S. responses to the Brazil Cotton Case findings, including actions already taken and those that may yet occur, and the U.S. WTO proposal in 2005 to cut amber box payments by 60%, reflect both the domestic budgetary and WTO-related pressures for changes in the structure and funding of farm programs.

Other pressures may also come into play. Domestic agricultural commodity groups may resist changes in the funding and structure of farm programs that adversely affect farm incomes, farm household wealth, and farmland values. Changes in farm programs that fail to largely maintain the benefits currently accruing to the agricultural sector would be resisted by most farm groups. Within the agricultural sector, however, a broader array of interest groups is likely to be involved in the policy process because livestock producers and growers of fruits and vegetables now have a more direct stake in a range of federal programs, including conservation, crop insurance, trade promotion, and agricultural research. Environmental and wildlife groups will also seek to maintain and expand conservation programs that improve environmental amenities in rural areas. In the face of recent spikes in energy prices, a wide range of groups seeking to reduce reliance on imported petroleum may seek additional incentives or research funding for processing agricultural commodities or new dedicated energy crops into biofuels.

This mix of budgetary concerns, political commitments under the WTO, and the broadening of issues to be encompassed in agricultural policy raise an intriguing possibility. While funding for agricultural commodity programs is almost certainly not going to be expanded and most likely will be somewhat reduced, the potential for substantial changes in the structure of U.S. farm programs genuinely exists. Major changes could be made to the marketing assistance loan programs and other programs that are linked to domestic production. However, farm state members of Congress will be reluctant to approve substantial reductions in funding for programs that support farm incomes. Therefore, major reductions in existing programs are likely to be offset by expansions of other existing programs or introduction of new programs that fall into the WTO green box category of agricultural support programs. The results of all of these factors, some of them with pressures moving in opposite directions, could make for a very lively 2007 Farm Bill debate.

For Further Information:

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