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U.S. Agricultural Policy in 2004: Ripe for Reform, Repackaging, or Routine?

Katherine R. Smith*

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* Director, Resource Economics Division, Economic Research Service, U.S. Department of Agriculture (USDA). Paper prepared for presentation during the International Agricultural Trade Research Consortium (IATRC) conference, Philadelphia, June 6-7, 2004. I am grateful for helpful reviews, comments, and suggestions on a previous draft, from Jeffrey Hopkins, Mitch Morehart, and Keith Wiebe. The views expressed herein are the author's and are not necessarily those of the Economic Research Service or the USDA.

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Current U.S. agricultural policy rests on the foundation of the Agricultural Adjustment Act of 1938, the Commodity Credit Corporation Charter Act of 1948, and the Agricultural Act of 1949, the only permanent farm legislation. The retrofit of 1930/40's agricultural policy to the world of 30, 40, and 50 years later, has been roundly criticized, and such criticism well rationalized, by a series of keen analysts over the years. Yet, little fundamental change has taken place. The scope of farm payments and the cost of agricultural support have not only continued, but have grown, even since passage in 1996 of the Federal Agriculture Improvement and *Reform* (FAIR) Act. In the words of recent critics, "the central policy reform problem in American agriculture endures: the problem of removing programs and entitlements that have lost their original justification" (Orden, Paarlberg and Roe, p. 2). Without rehashing the question of *how* current farm policy fails to further, and in a number of ways conflicts with, efficient market function in 2004, this paper seeks to identify and examine a series of factors that may drive or constrain U.S. farm policy change between 2004 and 2007 (The latter is the year during which current farm legislation is due to expire).

Major reform¹ doesn't happen as the result of logical argument. It occurs when the costs (monetary, political, strategic, and/or psychic) of existing policy exceed the costs of reform, and/or when those bearing the costs of the *status quo* have greater political clout than those bearing the costs of reform. The political economic view of the world relates clout, in turn, to the per capita gains or losses experienced by a stakeholding group as a result of policy change (Becker; see Gardner for empirical evidence of this for

agricultural programs). A number of factors appear to be tipping the scales toward higher costs of keeping than adjusting U.S. farm policy. But, in handicapping change in U.S. farm policy, it is important to account also for who bears the costs of adjustment.

Here, I present interpretive implications of the Federal budget situation, WTO commitments, the politics of environmental quality, land values, and resource fixity/flexibility in agriculture, for the chances that farm policy reform occurs.

Fiscal Fidelity

The FAIR Act decoupled farm payments from specific commodities' production, but it has not proven successful in reducing the level of farm payments. Total Federal government payments to farmers exceeded \$22 billion per year, each year, 1999-2001, with 40-45 percent of those payments coming from emergency supplemental appropriations. Emergency, disaster, and ad-hoc payments are playing an ever larger part in supplementing cash returns to production, and the definition of what constitutes an "emergency" has broadened to include low prices (through supplemental Market Loss Assistance programs), Federal nonagricultural actions (water diversion from agriculture to protect salmon in the Klamath River basin), and a potpourri of situations that, while not emergencies in the traditional sense, are disadvantageous to particular producer groups (Smith, 2004). Figure 1 shows the substantial growth in total payments to farm operators that occurred over the period 1991-2001, and its acceleration from 1997 following passage of the FAIR Act. Only high commodity prices have kept government payments down in 2002-2004. But when commodity prices decline next time, they could do so in a period characterized by a growing Federal budget deficit, and high

¹ The concept of "reform" is subject to interpretation. When I use the word in this paper, I am referring to a consistent, long-standing shift in the philosophical bases for and/or goals and mechanisms of Federal farm

expectations by producers that the Federal government will “resolve” any low price “emergency.” The expectation of government support goes well beyond the counter-cyclical payments designed to buffer traditional program crop producers against market volatility. Market loss assistance has gone in recent years to producers of all sorts of commodities, including fruits and other specialty crops.

There is, then, a high probability that a large number of different types of American farmers who have been sensitized to Federal support will again be expecting substantial, collective government payments, just as the Federal budget is being cut to lessen the deficit. Clearly, the monetary costs of maintaining current policy are high. At question is whether they are high enough to be a “tipping factor.” Even at their highest (in 2002), agriculture program costs represented only 2 percent of all Federal budget outlays (Economic Report of the President).

Furthermore, the flip side of having broadened the definition of “emergency” and the types of producers who qualify for market loss assistance is that current farm policy has gained new stakeholders. The more stakeholders there are in the *status quo*, the harder it is to reform. Once apple and cranberry growers have felt the warmth of government support, how can they be sent back into the cold, cruel world of market forces?

World Trade Organization Challenges

The (still, as of this writing) purported decision of a World Trade Organization (WTO) dispute settlement panel favoring Brazil in alleging that U.S. cotton support payments harm other countries, could be the first in a series of challenges to the way American farm programs have been doing business. The dispute contends that Federal

policy. Major reform would require replacement of the 1949 legislation with a new *permanent* Act.

payments to cotton producers (decoupled or not) violate WTO rules because they artificially increase American competitive advantage in cotton production, keeping world cotton prices low, and impoverishing cotton producers in less developed countries. The signal from the WTO seems to be that it is not just the level of support that counts in reforming trade, but also the nature of the support and its effect in the global marketplace. If this decision stands, it could be only the first among a number of other obvious targets (rice, for example) for the same argument. Failing to comply with the removal of a WTO violation carries a potentially large price tag. WTO-allowable retaliation against the U.S. could occur within or outside the agricultural sector. If an agricultural subsidy ends up harming interests in a more powerful sector against which retaliation is aimed (telecommunications, for example), new, extra-agricultural domestic as well as international pressure could be aimed at reforming American farm policy.

An alternative to fighting the WTO decision would be to comply by dismantling the policy mechanisms through which U.S. cotton production is supported -- an action that, if it is politically possible at all, would not be possible without simultaneously making radical changes in the programs supporting other traditional "program crops" and benefiting the downstream industries that rely on sustained production.

The question at this point is whether WTO-induced costs of retaining current U.S. farm programs are more likely to lead to true policy reform, or to "repackaging" farm programs so that they deliver the same benefits to the same stakeholders via WTO-legal means. Under the WTO Agreement on Agriculture, minimally distorting payments for a variety of purposes (such as environmental enhancement) are classified within the "green box" and are exempt from domestic support reduction commitments. Would the same

level of support (as now) to cotton producers for practicing environmentally sound production methods be subject to the same scrutiny by the WTO? Perhaps -- but if so, might it act to slow down the rate of true reform?

Valuing Environmental Quality

Over the last four decades, concern about environmental quality has grown from a liberal, fringe movement to a generally accepted, consensual force of politics. While the environment competes with other contemporary priorities, and, in the absence of major environmental crises, does not automatically manifest itself in support for specific policies, it does translate into “opportunities to transform attitudes into action” (Bosso, p. 58). Thus, the approach of every new farm bill’s debate since 1985 has been hailed as an opportunity for merging agricultural and environmental quality goals (See, Taylor, for example. ...Okay, okay, I’ve done too! ...Smith, 1995) The Conservation Security Program (CSP), authorized by the 2002 Farm Security and Rural Investment (FSRI) Act, is an important example of this kind of opportunism.

The CSP, which is not yet implemented, would provide payments to all participating producers, no matter what they raise, in return for a particular, demonstrated level of environmental stewardship or conservation practice (<http://www.nrcs.usda.gov/programs/csp/>). It is the first agri-environmental program classified as an entitlement. If implemented as originally envisioned by its chief legislative sponsor, Senator Tom Harkin, the CSP could easily cost as much to operate in any given year as do traditional farm programs now. Consequently, various alternatives for essentially capping the entitlement (oxymoronic as that may be) have been proposed by the Executive Branch to keep costs under control. The cap, in turn, creates a dilemma:

If all producers are eligible, but funds are limited, how can the program be implemented? Disputes between the Legislative and Executive branches over the implementation of the CSP suggest a grappling with the question of how Americans value farming/farmers/farm safety nets vis-a-vis environmental quality; this despite evidence that environmental stewardship can easily be consistent with good business (Aigner, Hopkins, and Johansson). It all comes down to a simple fact: if the agricultural budget is to remain constant or decrease to do its part in deficit reduction, even a limited CSP, estimated by the Congressional Budget Office to cost \$13 billion in its first 7 years, is either an addition to whatever traditional farm programs cost (making agricultural funding more visible and potentially vulnerable) or a subtraction from the funding devoted to farm support via traditional policy mechanisms. Green payment programs like the CSP would have to replace traditional farm programs if they are to be carried out in full under a budget constraint. That *would* constitute major reform.

The CSP, like broadened “emergency” payments, also acts to increase the number and type of stakeholders in agricultural policy, including producers of commodities that are not now supported in any other way. But in this case, the stakeholders have a stake in seeing a reformed or, at a minimum, repackaged farm policy – one that builds economic support on the back of environmental enhancement.

Farmland Values

There is ample evidence that farm program payments are capitalized into farmland values (Moss and Schmitz). This effect creates an obstacle to reform of traditional farm policy because any drop in land values increases the cost of farm policy change relative to the cost of retaining the *status quo*.

Based on survey data from 2000, ERS analysts found that, nationwide, farm commodity payments account for 19.7 percent of the value of farmland used in the production of program crops; farm programs have the highest proportionate effect on land values in the heartland region (Barnard, et al.) A recent Heartland-centered analysis of Illinois production under current commodity programs finds that programs authorized by the 2002 FSRI Act provide a stronger safety net to corn/soybean producers than did programs in effect between 1974-2001, and suggests that, because “the attendant land price support effect is also large,” the risk associated with any change in commodity policy is also heightened (Hauser et al.). This is what that study’s analysts refer to as the “bad news of today’s commodity programs” (Hauser et al., p. 1).

If farm program payments were to drop abruptly, or be redistributed more broadly, farm operators who had recently purchased land would be unable to pay off their debt as land prices adjust downward to reflect lower expectations about program payments. Farm operators who rent land on a share lease basis would likely see an initial jump in the landlord’s share required to renew a lease, and cash renters would see initial increases in rent from landlords that have to pay off debt on land whose value is dropping. Since land rental or land payments can be a large portion of farm operator’s expenses, and land is the principal asset keeping farm operator-owner’s wealth at high levels (Mishra, et al.), the immediate effect of depressed land prices due to lowered farm program payments would be a loss in farm wealth and/or income.

On the other hand, over time, as land prices and adjusted cash and share lease arrangements begin to reflect more the market value of their return to farming than the

value of expected farm program payments, farmers, in aggregate, could be better off than before the radical change occurred. Why? Those farmers who survive the transition period and rent land will face lower land rental costs. With lowered costs of production, they are more likely to weather periods of commodity price downturns. And, it would be easier than at present for beginning farmers to invest in lower priced land and enter the farming sector.

But, wait a minute: If the fact that high farmland prices are tied to high support payments is in some ways “bad news,” then it is bad news to a lot of people besides farm operators. A substantial portion of land used in farming – 42 percent in 1999 -- is not owned by farmers. Non-operator owners receive much of the cropland value attributable to commodity program payments – as much as \$25 billion of the total \$40 billion value of cropland in commodity programs in the Heartland in 2000 (Barnard et al.). Thus, there would be an additional cost, borne by a relatively wealthy nonfarm population, of any change in farm policy that lowers or redirects farm program payments. Guessing how the farmland value tie-in to farm policy affects the chances of policy reform, repackaging, or routine, involves the difficult task of comparing the values of near term costs to current farmers and permanent losses to current farmland owners, against the values of production cost-savings gains to future farmers and easier entry into farming.

Diversification in Agriculture

There is no denying the growing breadth of stakeholders in traditional U.S. farm policy mechanisms. But is the *depth* of stake-holding as strong as it was in the past; still strong enough to turn stakeholders into proactive rent-seekers? This is an important question given evidence that American agriculture, farming, and farm production may be

acting more as a part of a portfolio of diversified interests than being the sole interest at stake.

Let's look at farm households, a group generally considered to have the greatest stake in a Federally supported agricultural sector. Recent ERS analysis of farm household financial information demonstrates that the contribution of farming to the income of farm households is decreasing as farm households have diversified how and where they earn income. In 1999, nearly 90 percent of total farm household income originated from off-farm sources (Mishra, et al.). Furthermore, it is off-farm income that appears to stabilize farm household income, even as agricultural markets exhibit volatility. This phenomenon is not restricted to the households of small or financially struggling farms, nor is it related so much to a need to cover farm/ranch expenses as it is to increasing family income in general (Johnson and Mishra). The wealth base as well as income streams of farm households have diversified over time. The nonfarm share of farm household wealth increased from 15 to 31 percent of total farm household wealth between 1993 and 1999 (Mishra, et al.). Farm household financial diversification may suggest that the cost to farm households of farm policy reform is declining, at least in aggregate.

Let's also look upstream and downstream from the farm. Seed, agricultural chemical, and other farm input industries have always had a stake in the maintenance of a large, viable farm sector, since farms make up their market. However, these input industries are increasingly subject to mergers into and acquisitions by more diversified corporations. Fernandez-Cornejo's diagrams of the evolution of major seed companies, for example, show how Arnold Thomas Seed Company, and 6 other independent seed

companies, were acquired by Pioneer Hi-Bred International which, in turn was bought by Dupont Corporation. Dupont, as a highly diversified chemical corporation, is less invested, in absolute terms, in American farm policy than Pioneer Hi-Bred as a Dupont Company, and certainly less so than the original Arnold Thomas Seed Company and its kin would have been if they still existed.

Downstream from the farm, we find similar firm consolidation, but also increasing geographical diversification in terms of sourcing commodities for processing and end-use. Warren Staley, Chairman and CEO of Cargill, states that “Supplier diversity is a key priority for many of our customers...Cargill is also committed to supplier diversity because it enhances our ability to provide distinctive value for our customers...” (<http://www.Cargill.com/supplier/diversity.htm>, 2004). Cargill is one among many formerly domestic firms that have increasingly spread their sources of supply across many countries. Globalization of downstream industries of all sorts makes U.S. farm policy less critical to the income of downstream firms, and, consequently, may marginally lower these stakeholders’ costs of reforming farm policy.

Summary and Conclusions

The last few farm acts have brought to the farm program dessert tray a variety of new stakeholders who are not likely to give up their piece of the pie without a fight. In addition, the broadening of eligibility for programs that, themselves, have broadened purposes has, as U.S. House of Representatives Agriculture Committee staff person, Chip Conley puts it, created “payment envy” among other producer groups who see the payment door opening wider. On the other hand, diversification of farm households’ income and wealth portfolios, input industries, and downstream industries may reduce the

investment of traditional stakeholders in maintaining present farm policy practices. Commodity, farmer, farm household, landowner, and environmental proponent stakes notwithstanding, if Federal budget pressures continue, if commodity prices fall, and/or if WTO commitments raise the visibility of agricultural policy costs, the price of policy reform will start looking relatively smaller.

The careful reader will note that I have not included the coincidence of business, commodity price, and political cycles as a factor in real policy reform. Conventional wisdom has it that the climate for political compromise (between different stakeholders) and the chances for policy reform are greater during the up side of the business cycle. The facts that commodity prices were high and the general economy was robust in 1996 are cited frequently as the basis for the successful passage of the 1996 FAIR Act, which represents an attempt to reform farm policy. As we have seen, however, it is easy to backslide when economic conditions worsen. Any lasting policy reform will have to have benefits that outweigh its costs across both good and bad economic times.

A recap shows:

Factors raising costs of retaining current farm policy

Federal budget spending stringency

WTO-induced backlash against agricultural support

A budget-competitive Conservation Security Program

Long-run adjustment of land prices to reflect true value in agriculture

Traditional stakeholders' reduced reliance on agriculture, due to diversification

Factors raising costs of farm policy reform

Continued invisibility of agricultural spending

Environmental supporters as new stakeholders in the *status quo*

Short-run consequences of lower farmland prices

New groups of stakeholders and "payment envy"

Only fools predict farm bill outcomes. Those who want to keep track of the odds will need to estimate the monetary, strategic, political, and psychic costs on either side of this scorecard, and weigh them according to the political will derived from the per capita expression of costs to those who bear them. Not an easy task, but systematic thinking within this framework may give the best chance for picking which horse could win the farm policy adjustment race.

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Figure 1: Federal government payments to farmers, 1991-2002

