

The Next U.S. Farm Bill

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Outline of Today's Presentation: Take the Questions in Reverse Order

- Importance of policy consensus or convergence in a free trade area
 - Do we have the institutions to attain it?
- Large U.S. payments drive larger payments in Canada and Mexico (“subsidy envy”)
 - But all are under-investing in adjustment assistance
- The next U.S. farm bill
 - Do FTAs help or hinder?
 - Internal and external pressures influencing outcome

Policy Convergence Essential in a Free Trade Area

- Cannot have free trade without consistent ag policies
- Ag policy is generally seen as too difficult in FTA negotiations and gets left for the WTO MTN (more later on this)
- The U.S., formerly the leading advocate for liberalization of world ag trade, reversed course in 2002 farm bill

Convergence of Ag Support?

(Most recent OECD data for 2003)

- Need similar PSEs for free trade among states, provinces or countries
- Overall ag PSEs very similar among U.S., Canada and Mexico (range 18-21%)
- Relative PSEs among products are quite divergent, except in wheat and pork.
- Convergence is easier said than done. The U.S. has not even been able to achieve this in all cases
 - E.g. U.S. fluid milk market is carved up into non-competing zones (“marketing orders”) protected from one another by variable import levies

North American Agricultural Support, 2003: Converging?

<u>Commodity</u>	<u>USA</u>	<u>Canada</u>	<u>Mexico</u>
Wheat	25	21	30
Maize	15	15	36
Oilseed	19	9	65
Pork	4	8	7
Beef/veal	3	18	9
Broilers	4	7	19
Milk	45	59	33
Sugar (ref)	61	--	49
Overall	18	21	19

Source: OECD PSE database

U.S. Was a Leader in Uruguay Round Ag Negotiations

- Got domestic agricultural policies on the negotiating table and got production- and trade-distorting subsidies capped
- Sold importance of decoupling payments from production of specific commodities
- Got export subsidies capped and reduced
- Sold importance of converting all non-tariff barriers to tariffs and to reduce them
- Hung tough on requiring sound science basis for sanitary & phytosanitary barriers

Brief History of U.S. Ag Policy

- U.S. agriculture thrived in 1910s; depression in 1920s
- First attempts to support prices or income in late 1920s
- Combinations of price supports with government purchases and production controls/set-asides from 1930s to 1980s
- 1981 Farm Bill's failure to recognize that being a large exporter constrains freedom of action in domestic policy formation led to PIK Program in 1983

More History

- Long-term Conservation Reserve started in 1985 Farm Bill (the first farm bill in which environmentalists played a role)
- Began decoupling in 1985 Farm Bill; completed in 1990 Farm Bill
- “Freedom to Farm” in 1996 eliminated set-asides
- Rise of large emergency payments
- Reversed course in 2002 Farm Bill

A Quick Review of the Commodity Programs in the 2002 Farm Bill

- Raised (lowered) loan rates on grains (soybeans)
- Reestablished a target price system
- Created new counter-cyclical payments (to replace annual ad hoc emergency payments)
- Watered down payment limitations
- Authorized updating of program bases and yields
- Institutionalized fixed payments (in place of AMTA payments)
- Significantly increased authorized spending levels

2002 Farm Bill (cont'd.)

- Added new commodities (small legumes)
- Recreated wool, mohair, & honey programs
- Added a new dairy program focused on small herds
- Created a new peanut program, while buying out quotas
- Sweetened the sugar program
- Initiated country-of-origin labeling for meat, fish and peanuts
- Expanded export promotion programs
- Banned Vietnam from calling its catfish exports to the U.S. “catfish” (“basa”).

2002 Farm Bill Seen as Abdication of U.S. Leadership

- Retreat on decoupling: By allowing bases to be updated, U.S. farmers know that “fixed payments” are not necessarily “fixed.”
- The U.S., which had led global effort to reduce ag subsidies appears two-faced: increasing its budget authority for agricultural subsidies while telling the rest of the world to cut theirs.
- Counter-cyclical payments reduce U.S. farmers’ responsiveness to (downside) market signals.
- Marketing loans are effectively export subsidies, as are some forms of food aid and export credits.

Lack Institutions to Coordinate Ag Policy Among NAFTA Countries

- Meetings among political- and working-level staff members of departments of agriculture are essential. They need to know one another.
- However, the legislative bodies do not provide them with sufficient discretion to effect policy convergence, particularly farm price and income policies
 - The U.S. Congress is not about to be coordinated by anybody, particularly not by “unelected bureaucrats.” Need regular meetings of Congressional and parliamentary ag committee members, too.
 - In 2002 farm bill Congress reduced Secretary of Agriculture’s discretionary power over price policy.
 - Prevailing unilateralist mentality of Executive branch of USG reinforces this.

Subsidy Envy

- Modern telecoms informs farmers in other countries instantaneously of what assistance farmers elsewhere are receiving
 - They demand parity of treatment by their governments (even if budget doesn't allow)
 - Feel sense of injustice
 - when other countries' farmers get incentives to increase production in less efficient areas
 - When other countries' farmers get richer from capitalization of benefits into land and/or quota values.

Increased Demand for Structural Adjustment?

- This is the wrong question.
- All 3 countries are under-investing in adjustment assistance to facilitate structural change
 - There are always gainers and losers from policy reform
 - Unless you neutralize opposition from rich and politically powerful losers, they will stop reform dead (e.g. US sugar, dairy, cotton; rice; Canadian dairy and poultry)
 - Failure to facilitate adjustment of low-income small farmers bring cries of injustice from activists, who have political power to stop the reform (e.g. small maize growers of Chiapas)

Towards the 2007 Farm Bill: Points to Remember

- The farm bill is much more than commodity programs
 - 2002 Farm Bill had 10 titles
- A farm bill is authorizing legislation; without an appropriation each year, nothing happens.
 - Exception: entitlements under CCC
- Two-thirds of U.S. agriculture receives no commodity payments, but most is affected by programs authorized in one or more title

2002 Farm Bill Had 10 Titles

- I. Commodity Programs
- II. Conservation
- III. Agricultural Trade and Aid
- IV. Nutrition Programs
- V. Farm Credit
- VI. Rural Development
- VII. Research
- VIII. Forestry
- IX. Energy
- X. Miscellaneous

2007 Ag Market Conditions

- Every farm bill is influenced disproportionately by the current economic condition in the farm sector and commodity markets *at the time* the bill is written (myopic future expectations)
- While one cannot predict how crop conditions here and around the globe will evolve between now and 2007, we can predict with some assurance that whatever they are will affect the content of the next farm bill.
- The big jump in farm program payments from 2004 to 2005 will not go unnoticed. 2006?

Direct Government Payments

USDA Forecasts for FY 2004 and 2005 (\$ billions)

<u>Total direct payments</u>	<u>14.5</u>	<u>24.1</u>
Fixed direct payments	5.3	5.3
Counter-cyclical payments	2.0	6.0
Loan deficiency payments	3.2	4.8
Marketing loan gains	0.5	0.8
Milk income loss payments	0.2	0.5
Conservation payments	2.6	2.8
Ad hoc & emerg. payments	0.7	3.9

Source: USDA

Role of Government Payments in U.S. Farm Income, 2001-2005

(\$ billions)

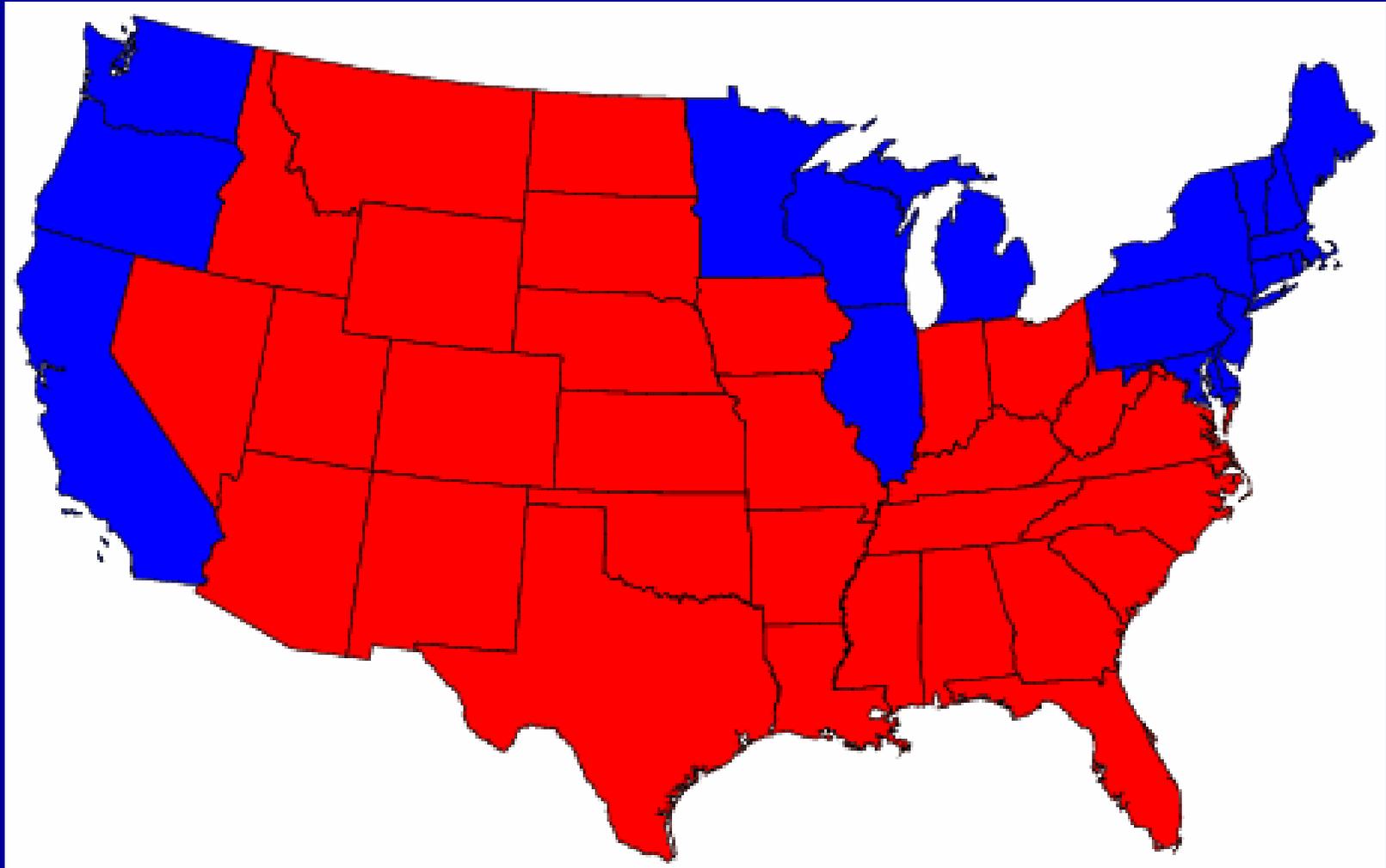
	2001	2002	2003	2004 (est)	2005 (est)
Total cash receipts	200	195	212	235	222
Net cash income	60	51	69	78	78
Net farm income	51	37	59	74	64
Total Government Payments	21	11	16	14	24

Source: ERS

Politics

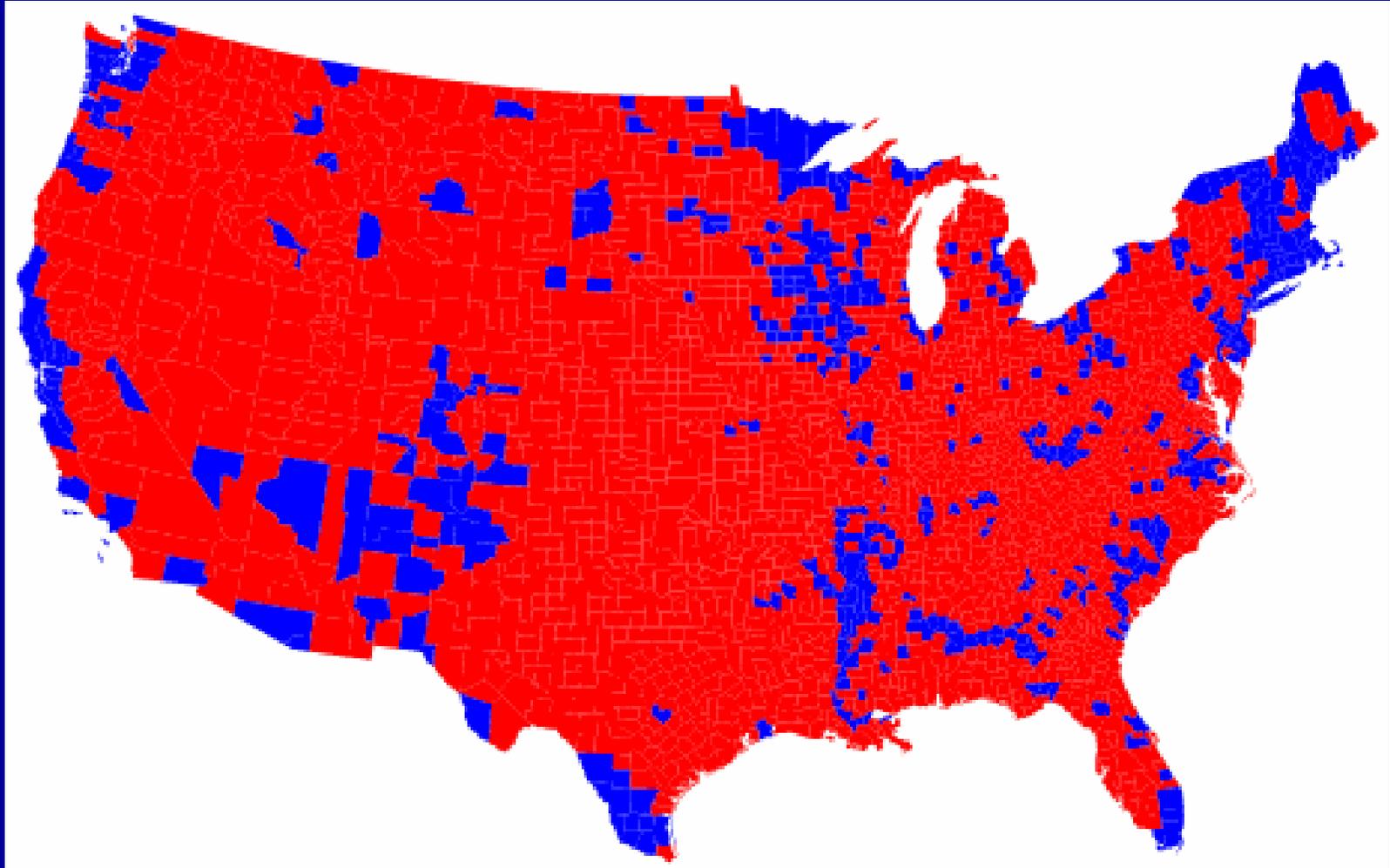
- Don't forget that rural America reelected George Bush!
- The Congress & the White House are now extremely politicized: there is no bipartisan cooperation among either ag committee members or their staffs. Each party is doing everything possible to make the other look bad, even it means Congressional paralysis.
- We won't know the Republican-Democrat split in the Senate and House which will write the next farm bill until Nov. 2006.

Who Reelected President Bush? The Electoral College Results



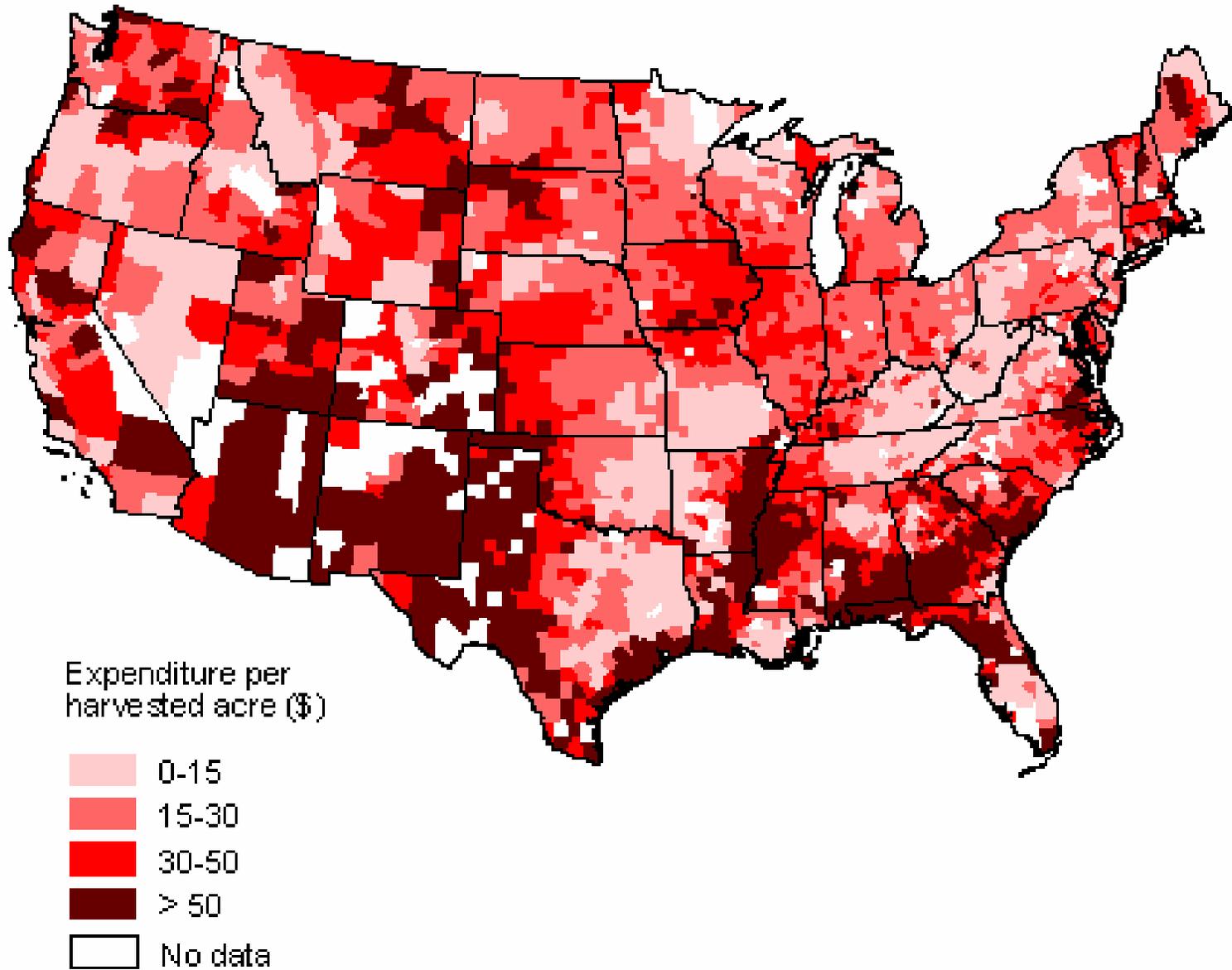
Source: Univ. of Michigan

Who Reelected President Bush? Rural America



Source: Univ. of Michigan

Distribution of commodity payments per harvested acre



Source: ERS

High \$ Cost of Reelection

- Congressional and Presidential elections are extremely expensive in the United States.
- Little real campaign reform has been achieved.
- The farm, food and agribusiness sectors are generous campaign contributors (see tables that follow)
- Agribusiness and the food industry (including fast food) sat out the last farm bill debate and are “committed not to make that mistake again.”
- Many promises made on campaign trail are also expensive, e.g. MILC program extension for at least two more years.

Food & Agricultural PAC Contributions to Federal Candidates, 2004 Election Cycle

<u>Sector</u>	<u>Contributions (\$ million)</u>
Agric Inputs & Services*	3.2
Food Processing/Sales	2.7
Sugar growers/proc'ors	2.4
Tobacco companies	2.1
Crops other than sugar	2.0
Dairy	1.8
Other livestock & poultry	0.7
Vegetables, fruits & nuts	0.6

* Machinery, pharmaceuticals, credit, insurance, fertilizer, seeds, ag chems, etc.

Ag Commodity PAC Contributions to Federal Candidates, 2004 Election Cycle

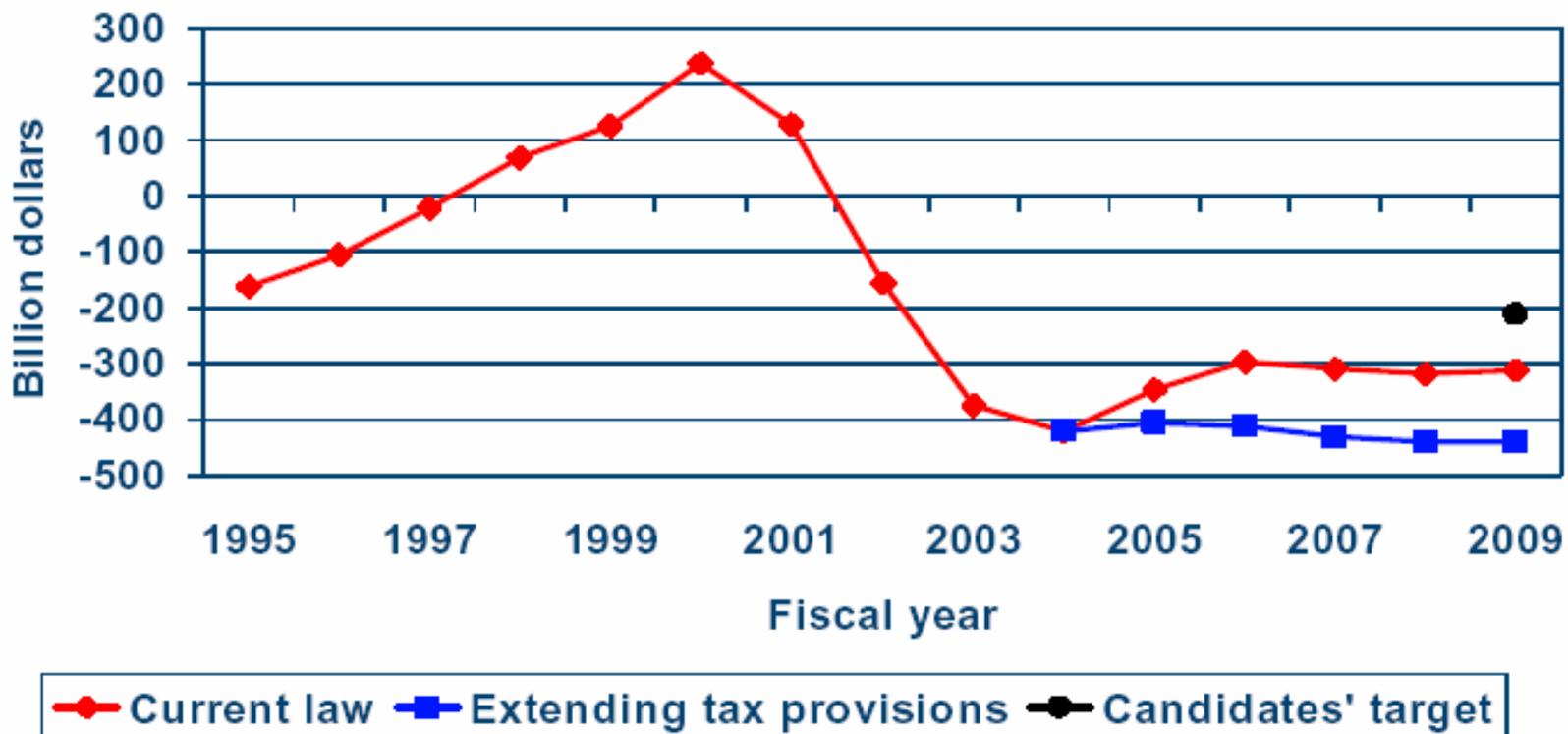
<u>Commodity</u>	<u>Contributions (\$ 1,000)</u>
Sugar	2,375
Dairy	1,757
Cotton	479
Rice	283
Peanuts	218
Citrus	167
Wheat	100
Potatoes	57
Corn	37
Soybeans	17

CCC Outlays, by Commodity

Commodity	2002	2003	2004	2005E
Corn	2,959	1,415	2,504	7,683
Wheat	1,190	1,118	1,173	1,495
Rice	1,085	1,279	1,130	586
Upland cotton	3,307	2,889	1,372	4,721
Soybeans	3,447	907	595	1,563
Dairy	622	2,494	295	633
Total	15,680	17,425	10,575	24,065

Source: USDA CCC

“Something Has to Be Done About the Federal Budget Deficit”



Source: Congressional Budget Office, Sept. 2004

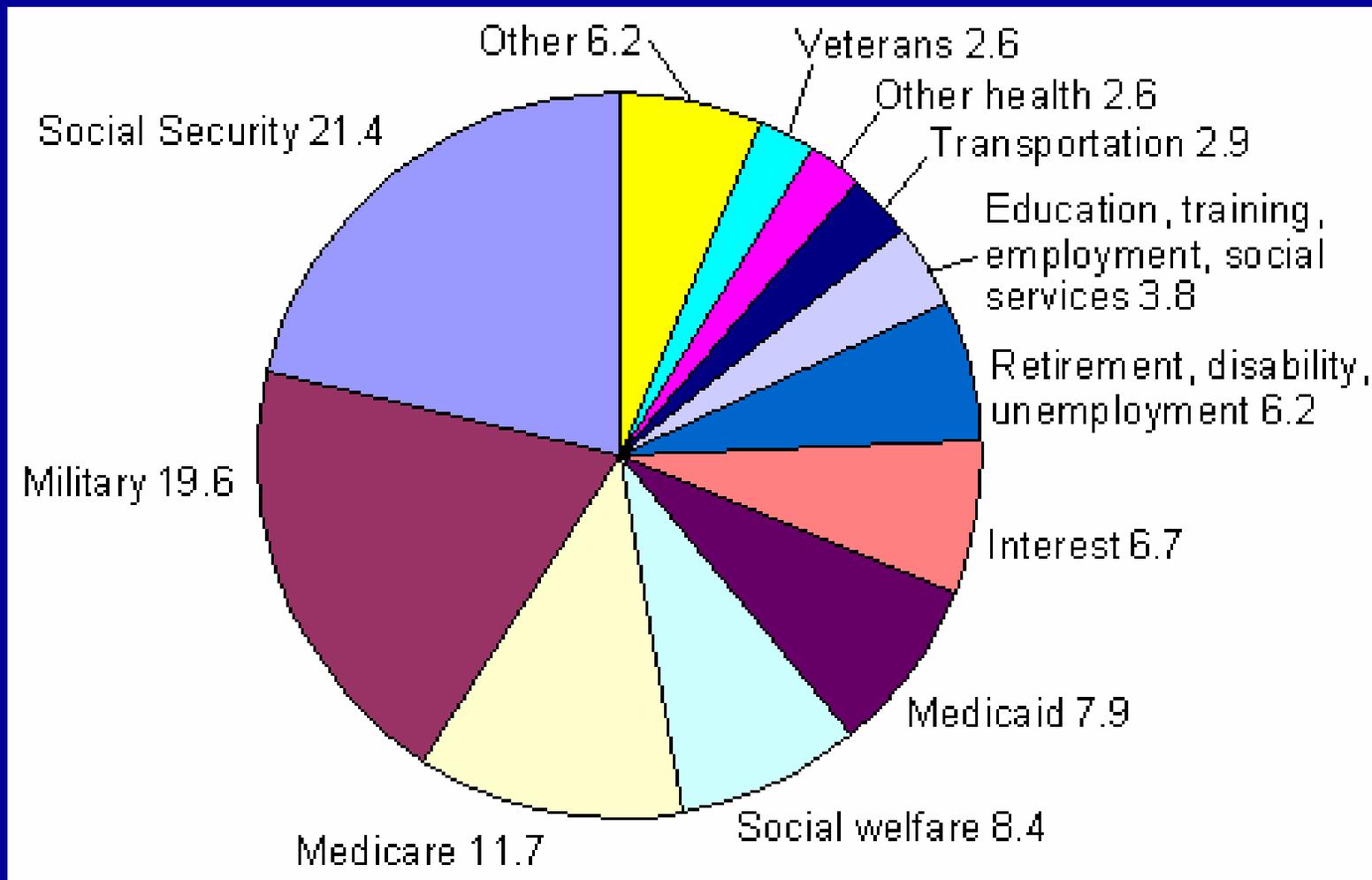
Implications for Farm Policy

- Remember that the 2002 Farm Bill was written under unrealistic Federal budget expectations
- Many more people are concerned about AMT relief, local schools and prescription drugs under Medicare than sustaining farm programs.
- There's little public goodwill towards a farm program that gives most of the benefits to largest producers and land owners
- However, political support for agricultural spending is such that some Congressmen recently suggested taking proposed cuts out of food stamps instead of payments to farmers!

FY 2006 Budget Resolution

- \$2.6 trillion budget resolution was passed by Congress on April 28, 2005. (This is the first budget passed by Congress in 3 years!)
 - Most “savings” came out of Medicaid.
 - Federal debt grows by over \$600 billion in each of next 5 years. (So much for deficit reduction!)
- “Cuts” farm program spending (relative to baseline) by \$3 billion over 5 years, with *all but* \$173 million put off until 2007, when the next farm bill is written, and beyond.
- Despite many anti-farm subsidy editorials, agricultural spending was not asked to make any meaningful contribution to deficit reduction.

Federal Outlays* to Agriculture May Be Imperceptibly Small, But...



*FY 2004

Widespread Confusion About Modern Agriculture

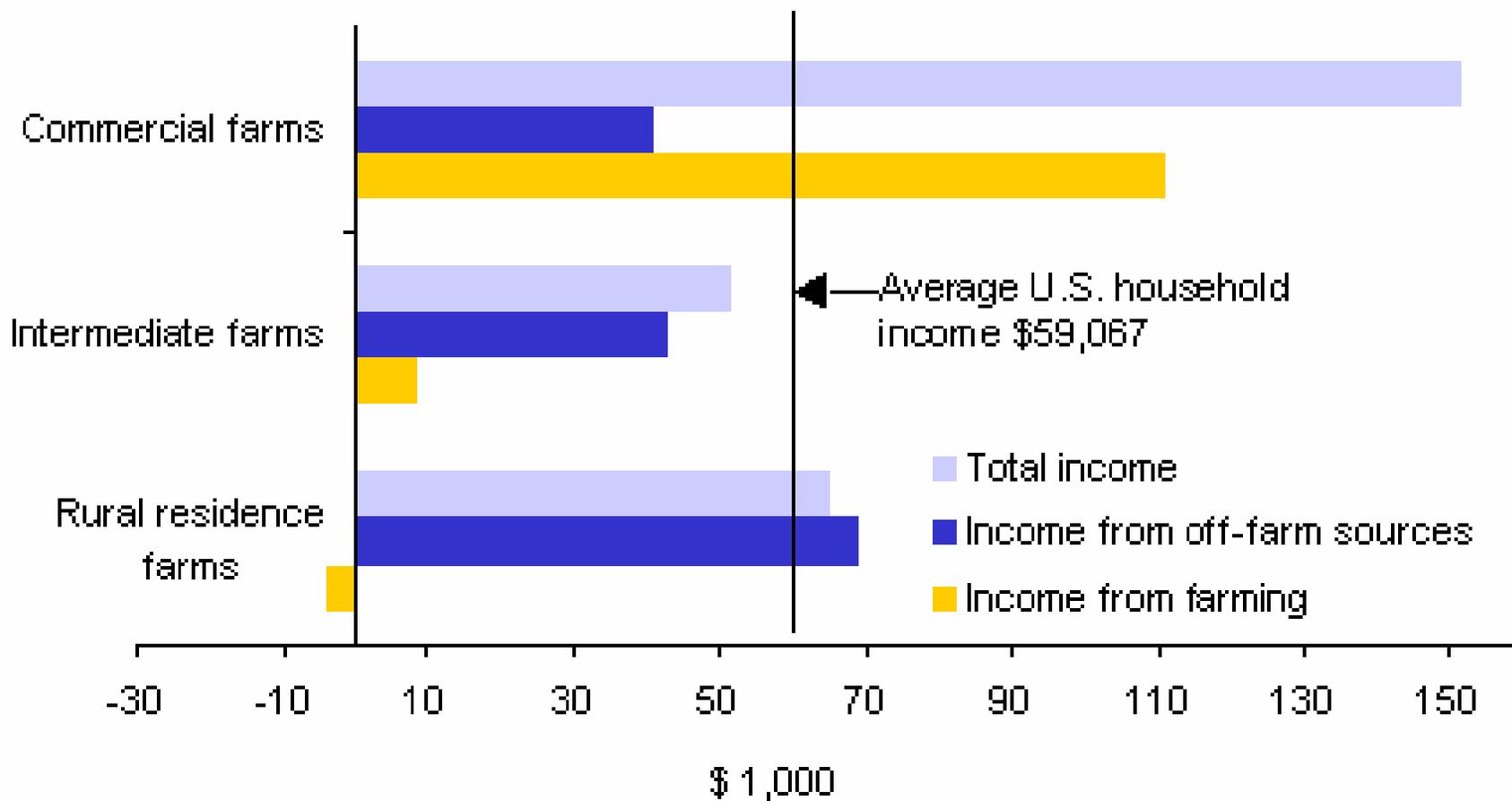
- Increasingly urban population is too many generations removed from the farm to understand where their food comes from.
- Widely-held nostalgic view of small family farm out of date vis-à-vis modern farming.
- Sources of confusion include
 - Statistics on the “average US farm” (>\$1,000/yr def’n)
 - Transnational NGOs’ disinformation campaigns
 - Farm organizations defending the status quo ante
 - Diversity of modern agriculture, esp. diffs between bulk commodity and specialty crop production

Size Distribution of U.S. "Farms," 2003

Size in \$ thousand	Thousand farms	% of all farms	% with payment	Ave \$/ pay farm (000)
<10	1,227	58	20	2
10-49	398	19	53	6
50-99	172	8	71	10
100-249	165	8	78	19
250-499	86	4	78	34
500-999	45	2	70	55
>1000	29	1	56	82
All	2,123	100	39	13

Source: ERS

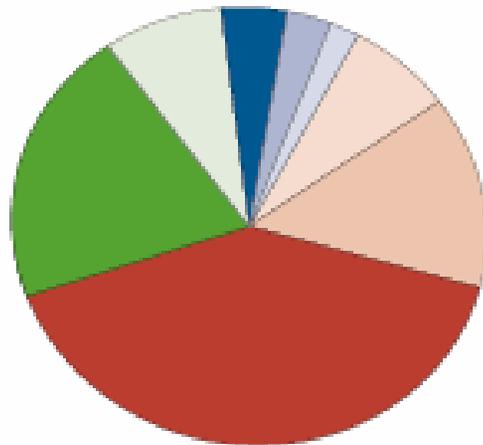
Sources of operator household income by typology group, 2003



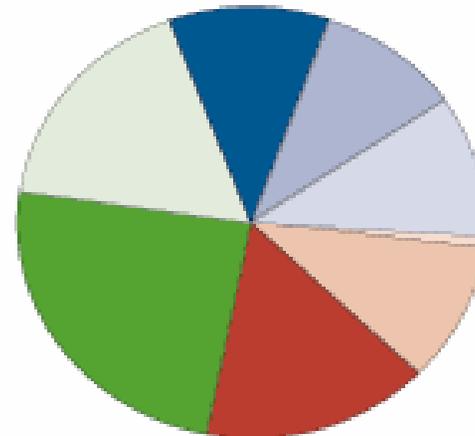
Source: 2003 US DA *Agricultural Resource Management Study*.
 Economic Research Service, USDA.

Share of value of farms, land owned, and value of production by typology group, 1998

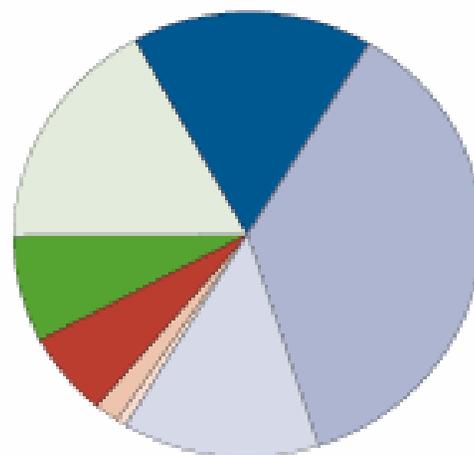
Farms
(2.1 million)



Land owned
(540 million acres)



Value of production
(\$191.5 billion)



- Limited resource
- Retirement
- Residential lifestyle
- Farming-occupation, low-sales
- Farming-occupation, high-sales
- Large
- Very large
- Nonfamily

What Role Will Environmental Groups Play?

- 1985 Farm Bill was first in which environmental groups were a real player
 - Long-term conservation reserve
 - Conservation compliance
 - Swampbuster and sodbuster.
- All budget cuts from agriculture since 2002 have come out of conservation programs.
- The *Environmental Working Group* has increased transparency of who gets most farm program payments (<http://www.ewg.org/farm/>)
- “Doubly green” payments (green box payments for conservation) are a likely winner in WTO ag negotiations.

Fragmenting of Agricultural Solidarity

- Many farm group leaders recognize that there will be less budget authority for agriculture in next farm bill.
- Large differences among program crops and regions in PSEs and payments per farmer are creating “subsidy envy”
- Profitability of the 2/3 of agriculture not producing program crops is calling into question what the programs accomplish
- Traditional solidarity among commodity groups and among commodities in general farm organizations is starting to show cracks. Also, fruits and vegetables vs. program crops.

Importance of Exports to U.S. Ag

- American agriculture exports $\frac{1}{4}$ to $\frac{1}{3}$ of its production of many commodities
 - without exports, farm sector would have to downsize
 - significant contribution to balance of trade.
- Exports can grow by expanding the total size of the market or by increasing market share.
 - Need econ. growth in LDCs to increase size of market (consumption growth will outstrip prod'n potential)
 - preserve competitiveness to protect market share
- Capitalization of farm program benefits into land values undermines long-term competitiveness
 - Farm land price rise driven more by 1031 exchanges
- Continued drop in U.S. dollar exchange rate will facilitate U.S. agricultural exports

Agriculture as Energy Supplier?

- Many farmers and politicians are enamored with potential for agriculture to supply energy
 - e.g. ethanol and bio-diesel
- Economically viable only with large up-front and continuing subsidies *and* with protection from imports from lower-cost suppliers
 - cheaper to produce ethanol from sugar cane
- Ethanol production is highly capital intensive and creates few additional jobs in rural America.
- By-products compete with other commodities and may create other environmental problems
- Petroleum industry controls access to gas pumps, & they have deeper pockets for political campaign contributions than corn growers.

U.S. Farmers' Changing World View

- Losing confidence in their international competitiveness (benefits of URAA oversold)
- Think URAA was unfair in that allowed EU and Japan much higher AMSs
- See world market as a zero-sum game (If you increase your exports, I have to reduce mine.)
- Don't recognize potential growth in LDC markets
- Reluctant to accept that being a large exporting country constrains our freedom of action in domestic policy making. You cannot have it both ways.

World Trade Organization

- A voluntary association of 148 countries which meet periodically (“rounds”) to review and revise the rules of the road on international trade (by consensus)
- Its Secretariat, located in Geneva, organizes these meetings, as well as a dispute settlement process to resolve differences among members over whether these mutually agreed upon rules are being broken
- Dispute settlement panels and an appellate body (effectively the “supreme court” of international trade) interpret agreements and build up a body of case law (necessary when wording of agreements is fuzzy)
- WTO cannot force any country to change its policies, but it can authorize the victims of violations to collect compensation via import duties on the violator’s exports

The WTO Cotton Case: Brazil's Allegations

- U.S. policies in 2002 Farm Bill stimulated larger production and exports of cotton
- This depressed the world price of cotton, reducing the earning potential of Brazilian cotton growers
- The U.S. cotton program violates the Uruguay Round Ag Agreement, of which the U.S. was a principal author (with the E.U., against which Brazil brought a similar case on sugar policy)
- The U.S. and E.U. should change those policies or pay compensation

The WTO Cotton Decision

- Certain U.S. policies depressed the world market price by enough to cause “serious prejudice” to interests of other exporters:
 - Marketing loan
 - Loan deficiency payments
 - Counter-cyclical payments
 - Market loss assistance payments
 - Step 2 cotton payments
- Other U.S. policies didn't:
 - Direct payments
 - Crop insurance subsidies
 - Production flexibility contract payments

Cotton Decision (cont'd.)

- Certain payments, which the U.S. reported as decoupled (green box) payments should have been categorized as “amber box;” since they were not fully decoupled (fruit & veg exception). If they had been, the U.S. would have exceeded its allowed aggregate measure of support.
- Export credit guarantees are export subsidies and should be eliminated before July 1, 2005, as should Step 2 cotton payments, which are subsidies to both domestic consumption and exports of cotton.

Implications of Cotton Decision for 2007 Farm Bill

- Congress heeded the URAA AMS cap when it wrote the 2002 farm bill, but it ignored the fact that marketing loans work as export subsidies and can depress world market prices.
- Need to change marketing loan, LDP and CCP provisions for cotton and other program crops.
- The fruit and vegetable production exclusion in qualifying for direct payments needs to be changed. This will bring huge political opposition from fruit & vegetable growers, esp. California.
- Note: The U.S. cannot claim any credit in the Doha Round agreement for changes it makes in policies found to be in violation of the URAA.

WTO Negotiations and 2007 Farm Bill Are on Same Time Path

- 2005
 - Reduce Federal budget deficit
 - Extend Trade Promotion Authority (“fast track”) & decide to stay in the WTO
 - WTO negotiations to put meat on the skeleton of the Framework Agreement (Hong Kong Ministerial to assess progress in Dec. 2005)
 - Field hearings for 2007 Farm Bill
 - Minor farm policy changes to accommodate WTO cotton decision
 - Energy Bill?
- 2006
 - Farm bill hearings
 - Serious offers & requests in WTO negotiations
 - More budget cuts? (but an election year)
- 2007
 - Congressional approval of new WTO Trade Agreement and signing before TPA expires (06/07)
 - New Farm Bill
 - More budget cuts

Uruguay Round Agreement on Agriculture: Accomplishments

- Increased market access as % of consumption
- Reduced export subsidies (value & volume)
- Converted all non-tariff barriers to tariffs
- Required scientific basis for all SPS barriers
- Acknowledged that some domestic agricultural subsidies can distort trade and categorized them by degree of trade distortion:
 - “Green box” = non trade distorting investments in public goods and decoupled income transfers
 - “Amber box” = trade-distorting (bound and reduced)
 - “Blue box” = trade-distorting, but offset by production controls or set-asides

World Agriculture Still in Disarray*

- Most high income countries subsidize their agriculture, distorting relative returns to various outputs and inducing larger total investment in agriculture relative to other sectors.
- Many LDCs' food policies turn the terms of trade against agriculture to keep urban food prices low, reducing the incentive to invest; agriculture underperforms relative to its potential.
- Protectionist import policies and export subsidies further distort what is produced where.

*to paraphrase D. Gale Johnson's book World Agriculture in Disarray

OECD Producer Support Estimates, 2003, in Percent

Switzerland	74
Japan	58
European Union	37
Canada	21
Mexico	19
United States	18
Australia	4
New Zealand	2

Source: OECD PSE database

Average Producer Support in OECD Countries, 2003, in Percent

Rice	74
Sugar	56
Milk	49
Wheat	37
Beef & Veal	35
Oilseeds	22
Corn	21
Eggs	5

Source: OECD PSE database

Effects of Coupled Farm Payments

- Distort what gets produced where and, in turn, ag trade flows
- Depress world market prices below long-term trend
- Reduce price and/or income risk to one country's farmers while increasing price volatility in world market
- Largest producers and farm land owners get most of the benefits

World Market Prices Depressed Below Long Term Trend

Rice	33 - 50 %
Sugar	20 – 40 %
Dairy Products	20 – 40 %
Cotton	10 – 20 %
Peanuts	10 – 20 %

Source: World Bank. Global Economic Prospects 2002, Chap. 2.

Doha Round Must Do Better

- Uruguay Round established a useful framework
- But, it did little to open markets, and OECD countries are still spending over \$750 million per day subsidizing their farmers (32% of farmers' incomes)
- Doha Round needs to be more ambitious than the Uruguay Round by closing loopholes and tightening disciplines to prevent circumvention of the intent of the agreement.

Why the Development Focus in This WTO Round?

- It's in our economic self-interest:
 - 50% more population by 2050 -- all in low income countries
 - Half the current population lives on less than \$2/day.
 - They are the only potential growth market for agricultural products, but only if and when they can afford to eat meat, fruits, vegetables; edible oils.
- Trade is a more powerful engine of growth than aid.
- Persistent poverty can have adverse geopolitical effects (Doha soon after 9/11) and cause illegal immigration
- Developing countries are now the majority of WTO members; there will be no agreement until they perceive something of value in it to them (unlike the past).

Huge Market Growth Potential from Poverty Reduction

Country	Population	%<\$1/day	%<\$2/day
China	1288.7	18.8	52.6
India	1068.6	44.2	86.2
Indonesia	220.5	7.7	55.3
Brazil	176.5	11.6	26.5
Pakistan	149.1	31.0	84.6
Bangladesh	146.7	29.1	77.8
Nigeria	133.9	70.2	90.8
Mexico	104.9	15.9	37.7

Source: World Bank. World Development Indicators database

The Global Trading Environment Hurts LDC Agriculture

- OECD protectionist barriers to LDC goods reduces their foreign exchange earning capacity and economic growth.
- OECD agricultural production and export subsidies depress world market prices below long term trend and increase variance around that trend
- Food aid is most available in years of OECD surplus, not LDC deficit.
- Depressed world market prices reduce returns to poor farmers, increasing their poverty, and slowing agricultural and national economic growth.
- Widespread poverty in LDCs impedes growth in their food demand, preventing them from fulfilling their potential as growth markets.

LDCs' Own Policies Also Impede Their Agricultural Development

- Lack of technology adapted to local agro-ecological conditions (soils, climate; slope)
- Cheap food policies to keep urban consumers quiescent – often reinforced by food aid or subsidized exports from OECD
- Underinvestment in rural infrastructure and education
- Lack of definition or enforcement of property rights and contract sanctity
- Corruption and/or macroeconomic instability.

Key Outcomes Developing Countries Need from OECD Countries

- A more open trading environment that can stimulate faster economic growth
- Market access for goods in which developing countries have a comparative advantage
- Eliminate import barriers and domestic and export subsidies which depress world market prices and increase their variance
- Foreign aid and international lending for investment in necessary infrastructure, technology, know-how, etc. and to facilitate adjustment.

What Is Possible in the Current WTO Ag Trade Negotiations?

- Eliminate all forms of ag export subsidies *by a date certain*
- Cap and reduce trade-distorting domestic subsidies *commodity by commodity*
- Allow *no* trade-distorting amber box policies to be moved to the blue box
- Reduce highest tariffs the most (by a minimum amount?) (*commodity by commodity?*) (increase minimum market access TRQs?)
- Allow LDCs longer phase-in period, but exempt *no* products from cuts

Free Trade Agreements vs. Multilateral Trade Liberalization

- FTAs are clearly second best – but often better than no liberalization (e.g. the huge success of free trade among the 50 United States!)
- Questionable tactic as practiced today
 - Generally leave out agricultural trade liberalization (“leave it for the MTN”)
 - Risk addressing other sectors’ problems and losing leverage from them in the MTN

Implications for 2007 Farm Bill

- Hard to predict course of negotiations and vagaries of Congress
- By breaking recent deadlock Wednesday (5/4) on tariff conversions, should see additional progress by end of summer – but only if all parties show some flexibility
- Biggest sticking point: Who goes first?
 - Developing countries won't open their markets as long as world market prices are depressed by ag subsidies in OECD countries
 - U.S. says it will reduce its ag subsidies only if developing countries open their markets

Other Issues Driving 2007 Farm Bill

- Rural development: Acknowledgment that ag commodity programs make weak rural development policy.
- Science: Implications of shifting investments in ag research from public to private sector are being recognized.
- Food aid: when is it an export subsidy?
- Concerns re structure of agriculture.
- Future role of ethanol and bio-diesel in U.S. energy policy
- Crop insurance: would Congress keep hands off to allow an actuarially viable approach to function?
- Subsidy to gross revenue insurance as an alternative to marketing loans, LDPs, and CCPs.