ICTSD Programme on Agricultural Trade and Sustainable Development

What is the U.S. Farm Policy Future?

By David Orden

ICTSD Draft
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David Orden*
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Abstract

A wide ranging debate is shaping up over the 2007 U.S. farm bill, with the prospect of there being, or not, a multilateral Doha Round WTO agreement simmering in the background. The domestic options being proposed vary from “stay the course” with existing legislation; to existing legislation “plus;” to policies “equitable, predictable and beyond challenge;” to greater environmental emphasis; and others. Bioenergy enthusiasm (and subsidies) are fueling market optimism, with prices high as in 1995-96. A substantial Doha agreement, although not imposing severe cuts in traditional support programs, could require some changes to domestic law that farm groups would resist—a situation that has characterized the EU in the past, but is unhistorical for the U.S. The policy situation overall is highly contingent with lack of a clear reform impetus. Even continuation of the shift toward subsidy payments decoupled from production decisions, as has occurred in fits and starts over the past two decades, may be challenged by a turn toward coupled policy instruments. The stakes are high for U.S. agriculture in these decisions, as indicated in part by the difficulties, and also the relevance, of the WTO. Limited likely reforms and their implications are discussed in this paper, along with the more radical option of a buyout of the main commodity programs—an idea whose time has not come, at least not yet.

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As the U.S. Congress prepares to write a new farm bill in 2007 the policy environment can fairly be called chaotic. Exchange rates are eschewed globally compared to levels that might be necessary for sustainable balanced trade. In commercial policy, the once heralded WTO Doha Development Round remains log jammed. To achieve closure, in a U.S. political context one might envision a repeat of the Uruguay Round experience—a Bush administration coming close to reaching an accord, then the subsequent administration rising to the occasion of seeing it through internationally and driving it through to congressional ratification. But the proximate circumstances are different in 2007 than in 1991. There have been four years of disastrous foreign policy, with collateral effects on world oil prices. No one knows for sure how high short-term oil prices will be or for how long, nor can these effects confidently be disentangle from longer-term supply and demand price determinants. The occurrence of global warming is becoming broadly recognized even in the resistant United States, but what is to be done about it? The call for greater energy self-sufficiency (now called “security,” of course) is flying high politically but is it a viable economic strategy?

Amidst this broader policy uncertainty, the domestic farm policy options being proposed vary from “stay the course” with existing legislation; to existing legislation “plus;” to policies “equitable, predictable and beyond challenge;” to greater environmental emphasis; and others. There is lack of a clearly articulated agenda to reduce trade-distorting or other farm subsidies in line with a more liberal global trade regime for agriculture.

This paper provides a broad examination of issues relevant to the 2007 farm bill. In the non-linear and highly contingent prevailing policy circumstances, the paper can not offer definitive answers about how the 2007 farm bill will turn out. The attempt instead is to shed some light on how to think about the farm bill and to provide a framework in which to learn about farm policy dynamics as the outcome unfolds. If one asks whether farm constituents will be counting their successes at preserving traditional subsidies, or will be staring out blankly wondering what hit them when the final bill is enacted, I would bet on the former. That has been true in every farm bill for fifty years, yet substantial constructive policy reform has nonetheless occurred. The stakes in the outcomes of 2007 are high for American agriculture, and for others who are affected as well.

The paper is organized as follows. The next section reviews several farm policy visioning exercises, finding endorsement of similar long-term themes about a liberalized world trade regime. Sections 3 and 4 bring some historical observations about policy changes to bear on today’s farm policy issues. I discuss both the ebb and flow of past decisions and alternative paths to liberalizing reform. Section 5 discusses a radical reform whose time has not yet come—that of ending the price and income support programs through a general one-time buyout. Section 6 returns to the challenges faced in 2007 in terms of more incremental policy change.
Policy “Visioning” Assessments

One point of reference for a long-term vision of the policy regime for agriculture is my book with Robert Paarlberg and Terry Roe, *Policy Reform in American Agriculture: Analysis and Prognosis* (1999). This book envisions a market-oriented agricultural sector with reduced price and income-support subsidies. We examine how the reform process around these types of interventions has unfolded in the United States as agriculture has evolved from a relatively impoverished and populous sector in the 1930s to its modern relative prosperity and limited number of commercial farms. We argue that the reform process that has proven politically feasible as this evolution has occurred has been a slow and imperfect shift toward market-clearing prices complemented with cash payments in lieu of supply controls and supported price levels. The 1996 farm bill, enacted under high commodity prices and with the first Republican Party control of both houses of Congress in forty years, is described as a significant step along this “cash out” path. But as enacted it did not promise an end to farm subsidies, leaving room for the reversion to more substantial subsidy levels on an ad hoc basis when commodity prices declined sharply starting in 1998. The increased subsidies were re-institutionalized in the 2002 farm bill but the increased production flexibility introduced in 1996 was retained (Orden, 2006a). Thus, the 1996 farm bill deepened the slow cash out that had been underway since as early as the 1960s, but it did not put farm policy on a new strategic reform path.

A more recent visioning assessment of the future of agriculture and agricultural policy comes from the American Farm Bureau Federation’s (AFBF) study-group report *Making American Agriculture Productive and Profitable* (MAAPP Study Group, 2005). Over a two-year period this group of 23 purposefully diverse AFBF members (nominated by state organizations, selected by the AFBF president, and approved by the AFBF Board) held a series of hearings and closed sessions to hammer out their vision of the policy regime for agriculture by 2019, the centennial anniversary of the founding of their organization. Among its recommendations, the MAAPP group envisioned freer world trade achieved through negotiations, but warned that the United States should “resist internal and external calls for unilateral disarmament” to reduce only its own subsidies. Their report calls for a variety of policies to assist farmers to achieve environmental goals, but for less environmental regulatory mandates. It calls for increased public-goods investments and development of new products including ethanol and other biofuels. The report also calls for both continuation of the existing crop insurance programs and a new comprehensive revenue insurance program consistent with international commitments under the WTO and available across all of agriculture, not just to the traditional subsidy-receiving crops. An insightful question the study group indicates they asked in their deliberations was “How would we feel if another country implemented the same program?” (p. 137).

Yet a third recent visioning assessment is provided in *Delivering on Doha: Farm Trade and the Poor* by Kim Elliott, a senior fellow at the Institute for International Economics and Center for Global Development (2006). This book is in the spirit of the earlier classic *A City-Man’s Guide to Farm Policy* that made the sometimes arcane farm policy debates accessible to a broad policy audience. Elliott examines the importance of agriculture among heterogeneous developing countries (for example, food exporters versus importers), then focuses on the subsidy and tariff policies in the U.S. and EU. She makes recommendations for provisions of a substantive Doha agreement that challenge the negotiating positions of each of the major participants: larger cuts...
in domestic subsidies than the U.S. has put on the table and deeper formula tariff cuts and constraints on exceptions for special or sensitive products than the EU or many developing countries have so far accepted. Again, the theme of long-term movement toward a freer trade regime and less extensive use of subsidies to agriculture underlies Elliott’s policy vision.

Finally, consider the recommendations of the Agricultural Task Force convened by the Chicago Council on Global Affairs, co-chaired by Catherine Bertini, August Schumacher Jr. and Robert L. Thompson and comprised of 27 additional agricultural leaders from the private and public sectors and academia. In the area of commodities, their report *Modernizing America’s Food and Farm Policy: Vision for a New Direction* (2006) emphasizes the importance of world markets. As a consequence, the Task Force recommendations call for a shift from existing trade-distorting and product-specific price and income support programs toward forms of support compliant with the WTO green box rules for allowable subsidy programs. Specific recommendations include shifting to direct payments, some type of universal revenue insurance available to all of agriculture at subsidized rates, land stewardship programs that pay farmers for producing environmental goods; farmer saving accounts, and increased investments in public goods that support agricultural competitiveness. These recommendations parallel those of the MAAPP study group, although they differ somewhat in emphasis, with the Agricultural Task Force more inclined than MAAPP toward unilateral reform.

What is apparent from these four visioning statements is that a range of analysts approaching the issues in quite different contexts can share a lot of common ground in their vision of desirable long-term farm policy. But it is about the path and speed by which reform might occur that differences arise and the long-term policy visions are easily set aside. At the same annual meeting as the AFBF Board accepted the MAAPP report, the membership also endorsed continuation of the 2002 farm bill as its immediate policy prescription. Long-run visions of individual academics, or even as diverse a group as the Agricultural Task Force, also remain far from the center of the most immediate farm bill debate.

**Historical Perspective**

The direction of U.S. farm policy at the margin of revising existing programs has ebbed and flowed over the course of various farm bills. At any point, “today’s” issues and proposals are never completely unique. Thus, placing the current debate into historical perspective provides just that—some perspective. Herein, a few relevant points are raised in two dimensions: first about farm policy instruments and, second, about the external forces impinging on the 2007 farm bill.

**Policy Instruments**

Among key aspects of the farm policy debate in 2007 are a focus on the Conservation Reserve Program (CRP), payment limitations, and agriculture as a source of strategic commodities, particularly for the production of ethanol and other bio-fuels. The former and latter issues arise from high oil prices in the short run and longer-term concerns about conflict in the Middle East and global environmental sustainability. The payment limitations issue has been raised as a matter of the fairness of fiscal policy and to focus the support policies on smaller farm units.
End of the Conservation Reserve?

Farm support policies in the United States have been criticized for stimulating production and driving down world prices to the detriment of unsubsidized farmers in developed and developing countries. An oft-ignored “inconvenient truth” is that U.S. policy since 1985 has also had a supply repressing effect through the long-term idling of nearly 40 million acres under the Conservation Reserve Program. Were the CRP truly permanent, perhaps its effects would be appropriate to ignore, but that is hardly the case historically. Instead, the current CRP has the precedent of two similar long-term paid land set aside programs. The first was launched in the 1930s when the U.S. Supreme Court struck down supply control interventions in their own right as a policy instrument. Acreage idling supply control as a measure for achieving conservation provided an acceptable rationale and gained support from a coalition of farmer groups interested in restricting supply to push up prices and conservationist in favor of the environmental goal. The CRP of the 1930s gave way to full-scale production during World War II, but supply abundance in the mid 1950s brought another long-term land conservation program. This second CRP enrolled a peak of 28.5 million acres in 1961 but was allowed to phase out in the 1970s when U.S. agricultural exports boomed. Thus, whatever the environmental gains from setting land aside on a long-term basis, the reality has been that such policies only have been enacted when prices are depressed and the environmental goal aligns nicely with a goal of shoring up commodity markets. When prices rise and appear likely to stay up, conservation reserves have been abandoned.

The recent burst of high prices is currently being projected to last for some years because of high oil prices and the pressure this has created (along with subsidies and regulatory mandates) for production of bio-fuels. Two issues arise. First, will this year’s commodity price boom really last, unlike the price boom of 1995-96 about which the farming industry was also excited when it occurred? Second, if prices do remain relatively high, will the existing CRP follow the elimination path of earlier long-term land set asides despite its support from a substantial conservation community?

Payment Limitations

A lot of attention has been generated by the web site of the Environmental Working Group (EWG) that reports subsidy payments to individual farmers and land owners. One has to admire the millions of hits this web page has received and the related public discussion it has generated about the fairness of the distribution of these payments. The accessibility of this data set is credited with strengthening the push in 2007 for tighter payment limits. But it would be a mistake to think that payment limits are a new issue in agricultural policy. Quite the contrary, payment limits have been debated, and often intensely, in farm bills since the 1960s. That reality makes one less sanguine that the public discourse about the subsidy data is likely to lead to strong new constraints on the levels of payments.
Strategic Commodities

Many political voices are today calling for increased energy self-sufficiency, or “security,” for the United States in ways that the U.S. has long chastised Japan and other food importing countries for whenever they have called for increased domestic food self-sufficiency. In each case, this argument makes an exemption for “strategic commodities” to which general trade and subsidy rules are not to apply. An historic example of such a strategic commodity in the United States is wool, which was argued to be critical to national defense during World War I. Subsidies for domestic wool production have lasted much longer than it can credibly be argued wool remained critical to defense. From this historical perspective, one can ask whether today’s bio-fuel policies are creating an albatross? Will corn-based bio-fuels make more of a contribution to national security than did wool? Or will the enormous ethanol investments that are being driven not just by high oil prices but also by subsidies, tariffs and related regulatory mandates end up as an artificially-induced infrastructure that requires (and can demand) subsidies forever, with little economic or environmental benefit? Does anyone really think the U.S. will eliminate its $0.51 per gallon tax break for ethanol, which provides a coupled subsidy of more than one dollar per bushel for use of corn for this, as opposed to some other, purpose?

External Forces Affecting the Farm Bill Debate

There are a number of broader policy-context factors that historically have influenced the direction of one set of farm policy decisions or another. Among these are party control of Congress, the federal budget, energy prices, and war.

Control of Congress

It is easy to think that farm policy is basically about commodities and regions not political ideology or large policy ideas. Nonetheless, party control of Congress has mattered to the policy outcomes, both in terms of the choices of policy instruments within the agriculture committees and in putting together coalitions on the floor of Congress to achieve passage of the legislation. Among the historical points at which party control has been influential were the change in policy between the 1920s (under Republican control) and the 1930s New Deal. Again, in 1946, a Republican-controlled Congress enacted long-term market-oriented farm bill provisions that a democratic Congress set aside in 1948. Republican election losses in 1984 brought to Congress some supporters of farm policy interventions that affected the 1985 farm bill and who remain in powerful positions. In 1994, the Republicans gained control of the House of Representatives for the first time in 40 years, which was influential on the 1996 farm bill. Thus, one should not underestimate the influence that eventually may be exerted on the 2007 farm bill by the recapture of congressional control by the Democrats in 2006. The Democrats, as a party, have generally tended to favor more interventions in markets and this may show up in changes yet to be proposed to the traditional farm subsidy programs and in other ways.

Budget

Budget is always a factor in farm policy debates. It receives a lot of attention, but its influence can be overstated. Farm bill spending is too small relative to the total federal budget for calls to
cut farm spending to achieve deficit reduction to be much more than symbolic. More important as a constraint is that every dollar is fought over among competing interests. And there can be budget ironies. In 1995-96, despite intense budget battles, more money was spent by enacting a new farm bill than would have been spent had the 1990 bill not been reopened. The 2007 farm bill debate is again taking place in a context of budget deficits, but spending may end up higher under a new farm bill than had no farm bill debate taken place.

**Energy Prices**

Energy prices are arguably the most influential early driver of the 2007 farm bill debate, but this is not the first time that high energy prices have been seen to herald a new era of scarcity and high commodity prices. In the early 1970s, rising oil and farm-gate prices were widely viewed as signaling the end of the era of low food prices. Real oil prices were permanently stepped up in retrospect but not by nearly the degree that short-run nominal prices of the time caused fear of. Real commodity prices were already declining by the mid 1970s.

Many analysts are projecting that long-term real oil prices have been bumped up again since 2002 but it is too early to tell if this will prove correct. The early 1970s oil “supply-shock” also kicked off a period of inflation and macroeconomic instability that lasted more than a decade. It is fortunate for agriculture and more broadly that at least so far the oil crisis of the 2000s has not had this effect. But exchange rate alignments and associated trade imbalances remain of some concern worldwide, and high oil and commodity prices might still create difficult monetary policy challenges (Ahearne et al. 2007).

**War**

It may seem trite to point out that wars are associated with high commodity prices and the ends of wars with collapses of prices in commodity markets. This occurred after World War I, World War II and the Korean War. It is not surprising that oil and farm commodity prices are high in the context of the current conflict in the Middle East, which is smaller than these historical wars but also concentrated in an oil producing region of the world.

We do not know whether or when war in the Middle East will be diminished. But commodity price collapses after the end of armed conflicts have been accompanied by intense political debate about what to do to support farmers. This historical experience serves as something of an antidote to basing policy rules on today’s projections of high commodity prices for years into the future.

**Strategic Reform Paths**

The preceding section has highlighted some of the proximate circumstances that have driven U.S. farm policy at particular junctures. There is also a more systematic dimension to the evolution of policy. That dimension has been a slow and imperfect shift away from supply controls and supported prices toward direct payments from government and less explicit intervention in markets. The support policies have become increasingly—if still far from perfectly—decoupled from production decisions. Orden, Paarlberg and Roe (1999) characterize...
this strategic reform path as a “cash out” of slowly evolving and compensated partial measures, as noted above.

The cash out reform strategy can be contrasted with three alternatives in terms of speed of reform implementation and whether past program beneficiaries are compensated for the policy change (see Figure 1). Reading backwards from the lower right corner, these alternatives reflect outcomes revealing the most to least loss of influence by the farm lobby. A cutout would end farm programs abruptly and without compensation, as might be proposed by conservative fiscal groups or critics of the negative effects of U.S. subsidies on poor countries. Such a draconic

Figure 1. Alternative Reform Strategies

<table>
<thead>
<tr>
<th>Compensation</th>
<th>Speed of Implementation</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Slow</td>
</tr>
<tr>
<td>Yes</td>
<td>Cash out</td>
</tr>
<tr>
<td>No</td>
<td>Squeeze out</td>
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reform has not proven politically feasible in the last seventy years. A slower squeeze out occurs if the farm policy parameters are allowed to erode to the point that effective support is curtailed. A squeeze out has not occurred during past commodity booms, such as when prices rose in the 1970s and inflation could have made the nominal price interventions inoperative (instead, price support parameters were ratcheted up) or the mid 1990s (when payments decoupled from prices replaced price-linked deficiency payments). Nor has a squeeze out occurred over the longer transition as the agricultural sector has systemically shifted to being more prosperous than in the past.

A Buyout of Farm Support Programs

A buyout brings a quick termination of a support program made feasible by a significant but temporary compensation payment up front. The argument for a buyout is that it provides enhanced transition support to farmers, provides consumers and taxpayers with lower market prices or long-term fiscal savings, and can pave the way for more substantial agricultural trade reform. Recently, there have been a few buyouts of some of the smaller market-intervention farm programs both in the United States (for domestic peanut production quotas and the tobacco quota and price support program) and elsewhere (such as the buyout of the Australian dairy support program or some buyout dimensions of the recent EU sugar reforms).

A review of the U.S. buyouts of peanut quotas and the tobacco quota and price support program suggests that narrowly defined benefits (such as quota rights) are easiest to buy out, that the onset of such reforms aligns with sharp contraction of past benefits, and that producers must support the reform (Orden 2006b). Buyout compensation has been quite lucrative, essentially
providing a generation (20-25 years) of past benefits from the program being terminated (Womak 2003; Orden 2006b). Given the circumstances under which buyouts have occurred, it is not surprising that there has not been a credible buyout proposal for the main U.S. commodity programs, although discussion of this option continues at the fringe of the policy debate (Stokes 2007).

A buyout of the 2002 U.S. farm programs could focus on the fixed direct payments, the counter-cyclical payments (CCPs), and/or the loan rate price guarantees (marketing loan benefits). The fixed direct payments provide a narrowly-defined benefit which increases the feasibility of a buyout. Bringing their eventual elimination would ease concerns about continued subsidization but would accomplish the least economically or institutionally. This is because either the fixed payments or a buyout replacement are relatively decoupled and are (arguably) a WTO Green Box policy.

A buyout of the counter-cyclical payments would accomplish more, since these payments are a particularly contentious form of decoupling likely to have some production stimulating effects. A buyout of counter-cyclical payments would let the United States abandon the WTO Blue Box, potentially allowing simplification and improved transparency of the WTO rules for agriculture. Marketing loan benefits are the most directly production-linked of the main commodity programs and have an uncertain level of annual expenditures depending on market prices and current production levels. A buyout of these payments would end an Amber Box policy.

The costs of a full 25-year buyout of the direct payments, countercyclical payments and marketing loan benefits are summarized in Table 1. Buyout payments shown are assumed to be made in equal nominal installments over 10 years, as was the case for tobacco. Annual expenditures under the 2002 farm bill are shown in the first row, based on actual past expenditures and projections in the president’s fiscal year 2007 budget (December 2006). The annual buyout costs, shown in row 2, are those required to compensate for annual payments made for 25 years at the average level of the 2002 farm bill—this is roughly consistent with the buyout compensation provided for peanuts and tobacco. Using a 5 percent discount rate, the present value of these payments and the value of annual payments for which these costs are equivalent as an infinite annuity are shown in the last two rows.

The present value of a full buyout provides a measure of the economic values at stake—with or without a buyout—under legislation along lines of the 2002 farm bill. The estimate of the discounted value of payments for 25 years such as the 2002 bill has provided is $151 billion.1 Much of this payment stream is capitalized into present farmland values. The annual cost of a buyout for each of 10 years is around $18.6 billion. This is high, but not unprecedented, compared to past annual farm support payments. Finally, the value of the buyout as an infinite annuity is nearly $7.2 billion. One view of the buyout illustrated in Table 1 is that once enacted it is equivalent to securing payments at this level forever, but without the need for subsequent political battles to secure the future payments.

1 Orden (2006) shows this cost as $174.126 billion based on projections in the president’s fiscal year 2006 budget (December 2005). The decline reflects higher than anticipated subsequent prices, and thus lower expected CCPs and marketing loan benefits under the 2002 bill, which are reflected in the cost estimates for the fiscal year 2007 budget.
Table 1: Cost Summary for a Possible Buyout the Main U.S. 2002 Farm Bill Support Programs
(Buyout over 10 years of 25 years of future payments at 2002 farm bill levels)

<table>
<thead>
<tr>
<th></th>
<th>Fixed Direct Payments</th>
<th>Counter-cyclical Payments</th>
<th>Marketing Loan Benefits</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyout:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Cost</td>
<td>9.593</td>
<td>4.300</td>
<td>4.736</td>
<td>18.629</td>
</tr>
<tr>
<td>Present Value</td>
<td>77.775</td>
<td>34.867</td>
<td>38.396</td>
<td>151.038</td>
</tr>
<tr>
<td>Infinite Annuity Equivalent</td>
<td>3.704</td>
<td>1.660</td>
<td>1.828</td>
<td>7.192</td>
</tr>
</tbody>
</table>

Note: Author’s calculation of buyout payments assumed to be made in equal installments over 10 years. Present values and infinite annuities are based on a 5 percent discount rate. Costs incurred under the 2002 farm bill are based on actual past expenditures and projections in the president’s fiscal year 2007 budget (December 2006).

Overall, buying out farm support payments raises short-term budget costs but reduces expenditures in the long run. Sharper, shorter buyouts than illustrated in Table 1 could be undertaken, with lower present value and annual cost if the number of years for which compensation is paid is reduced. For example, a buyout of 15 years of the 2002 farm bill payments shown in Table 1 has a present value of $111.234 billion and annual cost for ten years of $13.720 billion. Several policy advocacy or private-sector groups are exploring other buyout options with even smaller up front payments as proposals for the 2007 farm bill.

Were farm subsidy payments for the main crop programs to be bought out, the issue would also arise of whether any buyout could be enforced. The record from the post-1996 increase in support shows new expenditures can easily be enacted under existing farm program legislation. Several steps can be envisioned that would improve the prospects for adherence to a buyout. The first would be to eliminate the permanent legislation for farm support programs. A WTO agreement built around a buyout of U.S. counter-cyclical payments, or incorporating tight limits on U.S. Amber Box payments might provide enforcement mechanisms. Stronger steps could also be taken to ensure the long-run credibility of a buyout of the main commodity payment programs. Buyout legislation could stipulate that the acreage for which the payments were bought out (and the output from that acreage) becomes ineligible for future support legislated by Congress—essentially creating “non-base” as opposed to “base” acreage. To formalize this approach, buyout contracts might be structured similarly to those by which some farmers sell their “development rights” to state and local governments for the different purpose of their land remaining in rural condition or agricultural use. No congress (federal or state) can
unambiguously bind the actions of a future congress. But conditions could be defined that would make it much more difficult to reinstate bought out farm programs than it has been to maintain the existing ones.

**Incremental Policy Challenges in 2007**

A large-scale buyout is not on the political agenda for the near term. Instead, the prospect is for incremental reforms along the messy cash-out line or for possible reversion to support programs more coupled to production incentives. At issue are what will be the policy instruments and who will be the recipients.

One starting point for considering these issues is the proposals made earlier this year by the administration. Secretary of Agriculture Johanns had called regularly for policies that are “equitable, predictable and beyond challenge” throughout the early farm bill discussions. In January 2007, USDA released a farm bill proposal that presumably met these criteria. Key points of the USDA proposal are summarized in Figure 2. The administration’s proposal can fairly be described as calling for a set of incremental reforms along the cash out/decoupling path, tempered by some of the proximate drivers of farm policy this year.

In aggregate, the USDA proposal holds the line on spending for agricultural programs at the level projected under existing legislation, which is lower for the next ten years than under the 2002 farm bill because of anticipated higher commodity prices. By finding several cost-saving measures, USDA proposes that it would be feasible within this budget to shift nearly $8 billion over ten years from commodity support to conservation programs. Together with the decreased spending level being projected, this would create something of a squeeze out of the traditional commodity support programs, with marketing loan gains and CCPs falling sharply.

There are also some substantial reforms proposed in policy instruments. Part of the cost savings claimed by the administration come from converting CCPs from a price-basis to a nationally-calculated revenue basis. This conversion lowers expenditures by taking advantage of the natural price-quantity hedge (when output is low, prices are higher and vise versa which partly stabilizes revenue). For cotton, lower loan rates are recommended offset by higher direct payments that do not require continued cotton production. Payment limitations are proposed based on a cap on adjusted gross income of recipients. The administration proposes that cultivation of fruits and vegetables be permitted on base acres, which would presumably allow direct payments to be counted in the WTO Green Box. It proposed more flexibility about U.S. food aid programs, which would help defuse objections that have been raised to these programs as providing export subsidies. Less reform-oriented provisions of USDA farm bill proposals include that ethanol subsidies are promoted and the sugar and dairy price support programs are maintained.

The USDA proposal, even with its reform provisions, is in many ways less reform-oriented than proposals made by past Republican administrations. In part this undoubtedly reflects anticipation prior to the 2006 elections that Republicans would continue to control Congress. This would leave the party accountable for the final farm bill, whereas past Republican administrations have known they could make whatever proposals they chose with a Democratic congress eventually liable for the final outcome. With Congress now under Democratic control, one can anticipate...
Secretary Johanns having a freer hand than before to call for reforms and should expect to hear him do so in coming months.

**Figure 2. Selected Commodity Provisions of the USDA 2007 Farm Bill Proposals**

- Lower marketing loan costs and CCPs expected
  - Loan costs projected at only $8.8 billion, CCPs only $11.2 billion for 10 years

- Shift of $7.8 billion to conservation within overall cost projections under the 2002 farm bill provisions for commodities, conservation and crop insurance

- Decoupling/Recoupling
  - Current instruments
    - Lower loan rates (especially cotton); higher direct payments; reauthorize milk producers income support; cap on income of payment recipients
  - Revenue insurance
    - Nationally calculated revenue-based CCPs lowers projected cost $3.7 billion but builds in yield increases
  - Environmental payments
    - Expand EQIP, water enhancement, wetland reserve; maintain CRP at projected funding level but allow perennial biomass crops with reduced rental payments
  - Ethanol
    - Supported

- WTO Considerations
  - Permit fruits and vegetables to be grown on base acres; revise CSP slightly
  - Allow 25 percent of food aid funding for local/regional purchases
  - Maintain sugar and dairy support programs
  - Administrative support for dispute cases

Source: Author’s summary from January 31, 2007 USDA proposal.

The early administration proposal is also just one of the opening bids in the farm bill debate. Others are emerging—some with quite different perspectives. The chairman of the House agriculture committee, Colin Peterson, is a farm support traditionalist from the upper mid-west, where subsidies provide an above-average share of farm income. Many farm groups are expressing support for continuation of something like the 2002 farm bill. Peterson wants to append a permanent authority for disaster relief payments, not even winking at this being an oxymoron. The American Farmland Trust seeks to link direct payments more explicitly to environmental criteria and to inaugurate a new revenue insurance program available to a wide spectrum of farmers.

**Prevailing and Anticipated Prices**
One of the ironies of farm policymaking is that low prices make a shift of instruments more feasible in terms of an anticipated baseline of budget expenditures, but make it less attractive to change the status quo. Conversely, higher prices will generally spark a search for new ways to spend money on agriculture as price-linked commodity payments decline. Unless there is a squeeze out, budget discipline has to erode. This would not be surprising in 2007. Early on, more than 90 diverse interest groups expressed their concern that the budget projections based on the 2002 farm bill would not allow enough of an investment in agriculture, and they called for additional spending. Much is being made of new constituents at the spending table—for one, fruit and vegetable growers who feel threatened by expansion of the production options on base acreage; for another, livestock producers facing higher feed costs. Budget deficits will be touted as a constraint on agricultural spending, but the federal budget deficit, while high in nominal terms, is not too high as a percentage of national income. In addition, offsets to further farm spending may be sought in other areas, including by lowering oil-sector tax breaks.

Does continuation of the much maligned 2002 farm bill represent a reform-oriented outcome in 2007, at least in terms disciplining subsidy levels? Its authors must be laughing in their boots at this thought, which requires that prices remaining high.

There is also a serious issue that arises in a WTO context from high prices. Are other negotiating parties prepared to accept the U.S. meeting new subsidy reduction commitments not by changing parameters of its programs to reform policy, but simply because of favorable market projections? If markets are strong enough, the U.S. might comply with an AMS of $7-8 billion without lowering loan rates, let alone resorting to box-avoidance maneuvers such as eliminating the sugar or dairy administered prices (while retaining tariff protection). Convenient WTO compliance along this line seems to be what the administration has in mind with its 2007 proposal.

Meanwhile, farm groups are wary from their experience with the 1995-96 price spike and then 1998-2001 collapse. They are not sure yet whether they should hold firm to the current programs (which may not pay much) or gamble on new instruments. Unlike 1995-96, higher prices are already built into the baseline budget projections. Thus, there is little opportunity for “capturing” projected expenditures that everyone can see will not really materialize (this is what made the proposal for direct payments decoupled from prices both lucrative and consistent with budget projections in 1996). In 2007, new instruments can only deliver higher spending if their cost is approved by the Congress or wrongly evaluated in budget scoring.

Decoupling versus Recoupling

In addition to the question of the overall level of spending, there are questions about the specific instruments of farm policy. The longstanding strategic path of movement toward increasingly decoupled instruments could be under more threat in 2007 than has occurred in some time. With this risk, one can ask whether the policies that might be adopted will pass the MAAPP study-group test of how U.S. agriculture would feel if they were adopted by other countries.

Ethanol
As noted above, ethanol is a driving force in the 2007 farm bill. The ethanol fuel tax exemption (although not part of farm bill legislation) is itself a highly coupled policy instrument reinforced by a very high tariff. Arguably the ethanol tax break, which is headed toward a net cost on the order of $6 billion, should be included in the amber box (Blandford and Josling 2007). So might other ethanol investment incentives the farm bill could provide. Including ethanol tax exemptions in the Amber Box would force a trade off that does not now exist between traditional AMS spending and the new ethanol subsidies. In contrast, the ethanol markets have evaded much WTO discipline so far and it is not certain how they would fare under greater scrutiny.

The consequences of these alternative support policies are quite different. A lot of concern has been expressed about trade liberalization with subsidy reductions modestly raising world food prices to the detriment of low-income food importers. Ethanol policies are pushing up world prices to a much greater extent. Are we in a brave new world where instead of farm commodity exporters seeking relief from price suppression due to U.S. subsidies, poor food-importing countries will need to try to seek relief through the WTO (for impairment of gains they should have received) because of much higher prices induced by U.S. farm (bio-fuel) policy?

Current Support Instruments

In the 1970s, a cost-price squeeze on farm returns attributed in part to high energy costs led to ratcheting up of the nominal levels of price support loan rates and target prices. The Democratic Party has generally been more inclined toward such market interventions than the Republicans. So with the Democrats in control of Congress, one can anticipate at least some effort to raise, not lower, these program parameters. The argument will be that higher energy prices (and related production costs) have rendered inadequate the safety net that was good enough, indeed lauded by many farm groups, from 2002 to 2006. Raising loan rates or target prices would be a move back toward coupled payments. A constraint on such movement will be that many farm groups will be only modestly supportive of raising the support parameters unless it comes at no cost to other subsidies they receive.

Revenue Insurance

Subsidy spending on crop and revenue insurance has been growing in the United States and some of the new policy instruments being touted expand revenue insurance substantially. There remain unresolved questions about the mechanics but some very good minds are working hard in this area. Calls for universal revenue insurance require either diminished benefits for traditional subsidy recipients or expanded expenditure levels. Moreover, while revenue insurance can be designed to minimize its production stimulating effects, in its cruder forms it can be highly coupled. The National Corn Growers Association (NCGA 2006) has suggested a design that pays out more than the LDPs and CCPs they propose to replace when corn prices are anticipated to be more than $2.25 per bushel (2006). Payouts are tied to local yield levels, so the revenue insurance provides an incentive for corn production in marginal areas by protecting farmers from downside risks.2 Various schemes are being discussed to cascade revenue insurance, with some

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2 A recent analysis at North Dakota State University illustrates this effect if similar revenue insurance were applied to other crops. Spring wheat production is about evenly divided between four regions of the state. But in the marginal western region, the standard deviation of yields is 42 percent of average yields of 28 bushels per acre,
parts falling under Green Box criteria, while other parts are counted in the Amber Box. The net effect could be quite a production-distorting full program, even if it has low amber-box cost.

*Environmental Payments*

The future use of CRP land is going to be under question if commodity prices remain strong. To the extent that CRP acres represent supply control with little environmental benefit, reduction of the CRP would represent movement away from a production-distorting coupled policy (albeit, one of production restraint not stimulus). To the extent that CRP acres provide environmental benefits (less environmental detriment or positive environmental goods), the environmental cost is an offset to whatever environmental gains might be claimed from bio-fuel production if ethanol is the proximate reason that the CRP declines.

Reduced CRP expenditures would free up budgetary resources for other initiatives. There is strong interest in environmental programs for “working lands” which were authorized and funded on a limited basis (the Conservation Security Program) in the 2002 farm bill. The WTO Green Box allows environmental payments to compensate for increased costs or lost revenue, but farmers generally want more return from these programs. Environmental payments related to production practices can easily become coupled to production levels. So again, as for revenue insurance, movement toward working-lands environmental policy instruments poses a risk of reversion away from increasingly decoupled payments.

*Role of the WTO*

It now seems unlikely (although still possible) that the uncertainty about the 2007 farm bill will be narrowed significantly by a WTO Doha agreement. Under the price levels that were prevailing prior to the recent boom, the proposals being discussed for Amber Box limits of $7-8 billion potentially implied some constraints on existing U.S. policy. This would have been a position that the United States has generally not been in from past negotiations—the Uruguay Round proposals, for example, put more pressure on the pre-1992 CAP than they did on the 1990 farm bill. It would be quite remarkable if U.S. Doha-Round negotiators returned with an international agreement that required significant cuts in U.S. loan rates or an end to the traditional dairy or sugar price support programs, measures that U.S. farm interests would be reluctant to accept.

Having perceived this possibility, one can ask whether the U.S. will take preemptive steps to align its policies more closely to future WTO consistency? The EU and some other countries might argue they have shown leadership in taking such steps. It seems to be the stated “beyond challenge” objective of the Secretary of Agriculture, and is endorsed as an explicit strategy by the Agricultural Task Force cited above. Robert Thompson argues as well that the adjustments are not as severe as some farm groups anticipate (even under early 2000s market price levels); that such realigning of policy is desirable for U.S. agriculture in the long term; and that there is whereas in the more productive Red River Valley the standard deviation of yields is only 20 percent of yields averaging 50 bushels (Taylor and Koo 2007). Under a revenue insurance program based on local yield variability, production would be stimulated in the western region as farmers were protected from losses in relatively common low-yield years.

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much room under the Green Box for various farm programs, including income support subsidies. Moreover, farm groups can be reminded of some tangible benefits from the WTO. Even without a Doha agreement, there are gains from China’s accession, the potential accession of Russia, and from a number of dispute settlements that have gone in the U.S. favor.

Despite these arguments, the historical record is one of very little preemptive movement of U.S. policy in order to be consistent with anticipated WTO constraints. Throughout the Uruguay Round, lack of progress in the negotiations became a trigger for creating and maintaining policies such as the Export Enhancement Program. That changed somewhat with the Uruguay Round agreement. The multilateral agreement was not the cause of the 1996 domestic farm policy reforms, but the 2002 farm bill that raised subsidy spending included a WTO circuit breaker to allow the Secretary to make adjustments if necessary to maintain U.S. compliance. In the current debate too, there is further talk about remaining WTO compliant. But there seems little appetite for explicit changes to U.S. policies designed to re-position U.S. policies so that conflict with a potential agreement is minimized.

Under the higher market prices now prevailing, that potential conflict largely evaporates even if a new Doha agreement is reached. Likewise, in the absence of an agreement, existing programs can be challenged under dispute settlement (such as the new corn case) but prospects for winning significant new disciplines are probably reduced by strong world prices driven by bio-fuel production (see Schnepf and Womak, 2006, for discussion of dispute case-related issues).

These considerations do not diminish the value of new subsidy constraints. If only a modest reformulation of the marketing loan programs is achieved in the 2007 farm bill, a tight Amber Box spending limit would be a valuable check to have in place in the event that prices fall. Particularly germane to this conference as well, if U.S. policy inches toward recoupled instruments with insurance or environmental dimensions, scrutiny along Green Box lines will be an essential bulwark against new forms of production and trade distortions.
References


