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The 2002 Farm Bill: What It Does for Farmers

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In early 2002 the United States Congress enacted and the President signed into law a new six-year domestic farm bill, the Farm Security and Rural Investment (FSRI) Act. The new law replaced the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, known as the "freedom to farm" legislation, that received attention when it was enacted as potentially marking the end of U.S. farm subsidies. If Congress had adhered to and strengthened the 1996 law, both the level and the year-to-year variability of previous farm support outlays would have been reduced. But when crop prices collapsed in 1997-98, implementing the FAIR Act proved more costly than anticipated. Congress also began authorizing additional support payments on an annual basis. The 2002 FSRI Act continues or expands the FAIR-Act support programs that provide producer price guarantees and fixed direct payments for wheat, the feed grains, soybeans and other oilseeds, rice, and cotton. It also restores a third tier of counter-cyclical support for a large portion of farm output in place of the annual appropriations.

Loan Rates

Four key programs in the FSRI Act provide support to farmers and affect U.S. agricultural production to varying degrees. Direct production-stimulating effects come from price guarantees made to crop producers through "loan rates." The term "loan rate" is derived from the original price support programs of the 1930s in which farmers could forfeit crops under "loan" to the government at a rate that created a floor under market prices. Mechanisms are now in place for most crops that allow farmers to receive cash compensation from the government (a "marketing loan gain" or "loan deficiency payment") if current market prices are below loan rates, instead of forfeiting those crops into government-owned storage. Thus, the loan rates continue to support output prices for farm producers, but market prices can fall lower and the U.S. government is extricated from cumbersome commodity stockpiling.

Subsidy effect: farmers receive higher than average prices for their crops.
Insurance effect: farmers have reduced price variability for their crops.

Loan rate price guarantees truncate the distribution of revenue farmers expect to receive per unit of output of the eligible crops. This stimulates production in two ways: risk neutral farmers respond to the "subsidy" effect from the higher average price received, while risk averse farmers respond also to the reduction in price variability (an "insurance" effect). Loan rate levels were capped by the FAIR Act below market prices prevailing at the time, but provided subsidies again when market prices fell after 1997. Expenditures on loan rate price guarantees were $1.8 billion in 1998, then rose to $6.8 billion in 1999, $7.5 billion in 2000, and $6.2 billion in 2001. The FSRI Act raises loan rates for most crops and establishes rates for several new commodities. This set the stage for potentially higher budget expenditures in the future, although loan rate costs were reduced in 2002 when market prices increased.

Fixed Direct Payments

The second support program in the FSRI Act provides fixed direct payments to farmers. These direct payments were introduced as an innovation of the FAIR Act, and were known at the time as "AMTA" or "PFC" payments. Farmers are not required to plant any specific crop to receive these

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payments, nor can they be required to idle part of their land to be eligible. Instead, eligibility for the fixed payments is determined for each farm simply by past crop acreages and yields. The FAIR-Act AMTA (PFC) payments replaced earlier farm support that was counter-cyclical to crop prices—lower market prices being offset by higher "deficiency payments" to make up the difference with a "target price" for the eligible quantity of output. The earlier support program had required continued production of specific crops to maintain eligibility and USDA sometimes imposed limits on the acreage planted in order to reduce aggregate production. Other than these land-idling requirements, both the pre-FAIR Act deficiency payments and the fixed payments that replaced them are at least partially "decoupled" from farmers' production decisions because the quantity of output eligible for payments is predetermined. Thus, unlike loan rate price guarantees, the deficiency and fixed direct payments do not provide an explicit incentive for added production at the margin when prices are low. The FAIR Act innovations of 1996—to allow planting flexibility, eliminate any land-idling requirements, and introduce fixed instead of counter-cyclical payments—were hailed for furthering the decoupling of U.S. farm support from current production decisions. The FSRI Act maintains planting flexibility from the FAIR Act but allows farmers to update the acreage base that is eligible for payments to their 1998-2001 plantings. Acreage updating undermines the decoupling concept if farmers treat the possibility of additional updates in the future as an incentive to expand acreage or improve yields.

Counter-Cyclical Payments

The third support program provided by the FSRI Act restores counter-cyclical payments on a proportion of historical production, similar to deficiency payments from pre-FAIR farm bills. By restoring this third tier of support, the new law increases subsidies compared to those authorized in 1996, although not compared to actual expenditures during 1998-2001 if annual payments authorized by Congress (called "double-AMTA") are counted. Eligibility for the new FSRI Act counter-cyclical payments is again determined by past acreage and yields. Planting flexibility is allowed, which is different from the pre-1996 deficiency payments program. Thus, under the FSRI Act, farmers receive counter-cyclical payments when annual prices of their eligible crops are below the specified target prices, even if they choose to not grow those specific crops. The new counter-cyclical program retains an extra degree of decoupling from production for this reason, but the new payments are coupled to crop price movements. Under the FSRI Act, farmers were allowed to update not only their eligible base acreage but also to partially update their crop yields eligible for the counter-cyclical payments. If the eligible crop is produced, these payments reduce revenue variability, and thus have an insurance effect on risk-averse producers, even though (like the fixed direct payments) they are not made on all units of current output. Critics of U.S. farm policy are skeptical, and contend that the new counter-cyclical payments take a step backward toward production-stimulating policy instruments.

Conservation Reserve Program

The fourth key area of support under the FSRI Act addresses environmental issues and includes paid idling of farmland under a Conservation Reserve Program (CRP). The CRP has been in place since 1985 and has enrolled nearly 35 million acres, about 10 percent of U.S. cropland, in long-term land retirement. Over 20 million acres of land that once were eligible for production-related support payments have been taken out of production with the goal of achieving environmental benefits. Whatever the merit of these benefits, taking land out of production through the CRP reduces total U.S. farm output. The FSRI Act increased the land-idling authority of the CRP to 39.2 million acres, which will add marginally to its output-reducing effect. The FSRI Act also increases funding available to assist crop and livestock producers adopt production practices that reduce environmental damage.

Support Programs

In addition to these four programs for the main agricultural crops, U.S. farm policy includes special programs for sugar, peanuts, and dairy products. The domestic markets for these commodities have been highly protected from imports. Under rules of the World Trade Organization (WTO), this protection has come since 1995 from restrictive tariff-rate quotas (TRQs) that limit imports allowed with low tariffs applied and impose high "over-quota" tariffs, essentially precluding any additional trade.

Under the FSRI Act, the support programs for sugar, peanuts, and dairy products diverge more than they have in the past. The traditional program of restricting internal production to keep domestic market prices of peanuts above world levels is eliminated in the FSRI Act. The TRQ remains in place for peanut imports, but the FSRI-Act domestic peanut support program parallels that of most other crops. A new lower loan rate is set near the world price level and is backed by cash payments instead of forfeitures of peanuts into government storage. Direct fixed and counter-cyclical payments are made based on past peanut output and are independent of current production, with additional cash compensation to former holders of quota rights to sell peanuts in the high-priced domestic market. The traditional domestic

Peanuts

Under the FSRI Act, any peanut producer is eligible for loan rate price support of $355 per ton on all current production. Those who qualify as historic producers of quota or "additional" (non quota) peanuts are also guaranteed a direct payment of $36 per ton and a target price under the counter-cyclical payment program of $495 per ton for output from 85 percent of their 1998-2001 peanut acres. Thus, if a traditional producer continues to grow peanuts on 1998-2001 average acreage and has yields at exactly 1998-2001 average levels, he receives minimum market returns and government payments of $474 per ton [(0.85*$495)+(0.15*$355) = $474]. For five years, the former quota holder (often not the producer) receives a payment of $220 per ton, giving a total guaranteed revenue for this amount of peanuts of $694 per ton to the farmer and former quota holder, compared to a loan rate for quota peanuts of $610 under the FAIR Act. Under planting flexibility, the traditional peanut producers can receive the direct and counter-cyclical payments while growing another crop if that is deemed more profitable.

peanut producers and former quota holders are compensated by these direct payments for the lower market prices that will prevail under the FSRI Act, and the producers attain planting flexibility, while foreign producers who had gained access to domestic market under the peanut TRQs are not compensated for their loss of revenue. For dairy products, import restrictions under TRQs remain the primary instrument for sustaining domestic prices above world levels. The FSRI Act continues a complex loan rate program for dairy products in the event that domestic production drives prices below legislated values and adds new direct payments for part of dairy output.

Studies of the production and market impact of the FAIR Act and FSRI Act show loan rates have the most direct effects among the commodity support policies. One study (Westcott and Price) found that the FAIR Act loan rate expenditures raised aggregate acreage of eight major crops by 2 to 4 million acres (about 2 percent) during 1999-2001. This study took into account only the subsidy effects of loan rates; related studies suggest the insurance effects can create additional impacts of similar magnitude. The production-stimulating effects attributed to fixed direct payments under the FAIR Act are smaller.

Only limited additional impacts on production are found from enactment of the 2002 FSRI Act despite the heated political rhetoric that has surrounded the new farm bill. One study comparing projections under the FSRI Act to continuation of the FAIR Act (Westcott, Young and Price) shows the loan rates in the FSRI Act leading to at most a 1 percent additional short-run increase in aggregate planted acreage. An increased enrollment of land in the CRP more than offsets the production-stimulating effects of the changed loan rates in the longer term, so the new farm bill results in less aggregate output after a few years. This study again accounts only for the subsidy effects of higher loan rates, ignoring the insurance effects that result from reduced price variance. With both effects accounted for, the net effect is likely to be slightly higher crop production under the FSRI Act. Likewise, if world prices turn out lower than projected by the study, loan rate expenditures and effects on production would be larger, as they were during 1998-2001. Total support expenditures could possibly exceed limitation commitments of the U.S. under the WTO Agreement on Agriculture.

Conclusion

The 2002 U.S. farm bill has been widely criticized for providing subsidies that drive down market prices, with detrimental effects on competing agricultural producers abroad including those in many poor countries, and for undermining U.S. leadership in achieving liberalized world agricultural trade. A careful assessment shows that the 2002 FSRI Act has effects that are complex in at least four respects. It raises expenditures compared to 1996 legislation but not compared to actual 1998-2001 outlays. It maintains planting flexibility, but extends support to new crops and undermines some of the decoupling of subsidy payments from production and market prices that had occurred. It violates the spirit of U.S. trade liberalization rhetoric but probably will not be found to violate the letter of U.S. WTO commitments. And it continues the policies of wealthy countries that collectively distort agricultural production and world prices but only marginally worsen the net effects of these policies.

Selected Reading

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