Possible Consequences of the 2002 Farm Bill
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Congress passed and the President signed a new farm bill in May 2002. The 6-year farm bill will provide commodity producers with additional support in times of low prices, much like the marketing loss assistance payments of 1998 through 2001. This farm bill adds a new counter-cyclical payment program that essentially makes marketing loss assistance payments automatic when prices are below target levels. As the USDA begins to work out the details for implementing the new farm bill, attention turns to some of its likely consequences. This paper provides information on some of the key questions surrounding the 2002 Farm Bill.

What Is This Farm Bill's Estimated Cost?

Recent rhetoric about the 2002 Farm Bill suggests an increase in spending for agriculture of about 80 percent. However, the 80-percent increase depends on how you look at it. During 1999, 2000, and 2001, the government provided agriculture with an average of about $5.65 billion\(^1\) in market loss assistance payments in each year, which was in addition to the payments made to producers as part of the 1996 Farm Bill. If you compare the estimated spending levels of the 2002 Farm Bill to the 1996 Farm Bill and ignore the market loss assistance payments, you would get an 80-percent increase in spending. However, the increased spending in the commodity title of the farm bill averages $5.75 billion per year, which is only slightly higher than market loss assistance payments of the last 3 years. Thus, while the media is touting this bill as a huge increase in agricultural spending, the reality is that spending is about the same as it was from 1999 through 2001, at least for the commodity title, when you include market loss assistance payments passed in each of the past 3 years.

The 2002 Farm Bill is budgeted at approximately $180 billion over a 10-year period. This is approximately $73.5 billion more than would be spent if the 1996 Farm Bill were left in place with no supplemental market loss assistance payments. The budget resolution act of 2001 provided the additional $73.5 billion to agriculture from a share of the budget surpluses that existed in April of 2001. The commodity title of the bill, which covers price and income supports for commodity crops such as corn, soybeans, wheat, cotton, rice, peanuts, wool, mohair, honey, and sugar, received $49.7 billion of the additional $73.5 billion. The environmental title of the bill received $17 billion of the additional money. The remainder of the additional spending was used to increase money for food aid and research, to provide for additional rural development activities, and to create an energy title, which encourages the development and use of renewable energy sources such as ethanol and biodiesel.

\(^1\) 1998 was the first year producers received market loss assistance payments, which totaled $2.857 billion.
How Much Is the 2002 Farm Bill Really Going to Cost?

Much of the $180 billion of budgeted cost for the 2002 Farm Bill is dependent on a baseline that forecasts considerable improvement in the economic situation for commodity production in later years. If this improved economic condition (i.e., higher prices) does not materialize, the actual cost of the bill could be much higher than estimated. This is due to the counter-cyclical nature of the programs, where larger payments are made when farm economic conditions are bad. When economic conditions improve, payments under counter-cyclical programs decline. The basic assumption of the projected budget is that prices will be high enough in the later years (beyond year 4 of the farm bill) that counter-cyclical type payments would be almost non-existent. This may be a questionable assumption because the payment mechanisms used in this farm bill will likely encourage additional production that will depress prices, unless an unforeseen weather event reduces production and stocks. Thus, it is likely that the actual cost of the farm bill could be much greater than the projected $180 billion. How much greater we don’t know, but the difference could be substantial.

What Might Happen to Land Values and Land Rents Under the New Farm Bill?

The 2002 Farm Bill will likely maintain or increase current land values and farmland rents. Land values are determined based on the income stream received from the land. As such, the income support provided in the new farm bill will likely be bid into land values and land rents in traditional program crop producing regions of the country.

Figure 1. Returns to Land Under Alternative Farm

Figure 1 shows the expected returns to land for a typical farm in Carroll County Indiana. Returns to land are often used as an indicator of land rental rates. The bottom line on the graph indicates what returns to land would be over the 2000 to 2007 period if the provisions
of the 1996 Farm Bill, without emergency market loss assistance payments, were maintained. The middle line on the graph, indicated by square markers, indicates the returns to land when the 1996 Farm Bill is combined with emergency market loss assistance payments. The top line on the graph indicates the expected returns to land under the 2002 Farm Bill.

Clearly, the returns to land are substantially higher than they would be under the provisions of the 1996 Farm Bill alone. In fact, the difference averages approximately $21 per acre over the life of the 2002 Farm Bill. If this $21 per acre were compounded at 5 percent, the estimated increase in the value of land would be $421 per acre. Comparing the 2002 Farm Bill to the 1996 Farm Bill with emergency payments, the difference in returns to land is only $6 per acre on average over the life of the farm bill, which would translate to about a $122 per acre increase in the value of land.

There are two critical questions about the actual direction of land rents and values in response to the 2002 Farm Bill. One, are the emergency payments of the last 4 years already bid into land rents and values? Two, do current land rents and values reflect anticipation of the 2002 Farm Bill being passed? Current land rental rates in Indiana suggest that at least part of the supplemental market loss assistance payments has already been bid into land values. Thus, if the answer to either of the two questions is yes, then land rents and farmland values may not increase much as a result of the 2002 Farm Bill. Nevertheless, the evidence suggests that land rents and values are not likely to decline and may increase.

Increasing land values can be a double-edged sword. For those producers who own the majority of their land and for retired producers who are renting their land, this increased land value support can be a big boon to their balance sheets and/or cash flow streams. However, tenant farms are likely to be in a worse position as rising rents squeeze out any margins gained by increased government support. With large amounts of the nation’s farmland being rented, there are a substantial number of producers who may find little real increase in their incomes from this farm bill as land rents rise to take away any possible gains.

**What Does This Farm Bill Do for Trade Negotiations?**

The 2002 Farm Bill increases the legislated level of government support for agriculture. Much of the increased support comes in the form of counter-cyclical payments and increased loan rates. Both types of additional support jeopardize the U.S. position in trade negotiations. The U.S. currently has a spending limit on trade distorting government support—the so-called amber box—of $19.1 billion annually. Given the current outlook for commodity prices, spending limits may be breached, substantially degrading U.S. negotiating power in the World Trade Organization (WTO). A study by FAPRI suggests that there is almost a 20-percent chance of exceeding the spending limit in 2002, even assuming the rising prices of the baseline. In addition, the updating of base acreage is technically contrary to the 1994 Uruguay Round agreement, bringing into question whether direct payments, which are typically classified as green payments (legal support), would now be considered amber box payments that are subject to the WTO limits.
U.S. negotiations in the latest round of the WTO have focused on reducing trade-distorting payments for all countries. This farm bill is clearly heading in the opposite direction. Other countries, including the European Union, Canada, Australia, and Brazil, may view this new farm bill as a breach of the spirit if not the actual rules of the WTO agreement. Thus, this farm bill, despite the latest rhetoric from Capitol Hill and the White House, is not very trade friendly and could jeopardize any progress that has been made in recent trade negotiations. While Trade Promotion Authority (formerly known as Fast-Track), if passed by Congress, could help the administration to some extent in trade negotiations, the actions of Congress on domestic farm policy likely undermine most if not all of the momentum that Trade Promotion Authority would bring.

What Are the Likely Impacts of the 2002 Farm Bill on Production?

The 2002 Farm Bill has two mechanisms that trigger more support for producers when prices are low. The counter-cyclical and loan deficiency payments both have a tendency to isolate the producer from the market signals when prices are low. Low prices generally reflect the market's opinion that stocks and production of a commodity are large. Therefore, the natural economic response would be to cut back on production, since the market does not want the commodity. However, the price support mechanisms provided by the farm bill send a different signal to producers.

Table 1 (p. 5) shows the per bushel value of the various government program payments per bushel of corn. The table provides three different price scenarios, assuming a producer plants his or her corn base acres in corn. After adjusting direct and counter-cyclical payments (CCP) for payments on a historical production basis (for example $0.28 per bushel direct payments are adjusted down to $0.19 per bushel to reflect a payment base that is lower than current production levels), the price the producer receives for the commodity is substantially above the price in the market place. In fact, the lower the market price, the more pronounced the difference between the price the producer receives and what the market is signaling as the value of the commodity. Thus, rather than having producers respond to the market signals by curbing production (or more likely, by having the less efficient producers go out of business or having some less productive land not farmed), the price supports and income subsidies signal producers to keep producing the commodity despite low prices, which increases stock levels, further reducing the price2.

2 Some argue that counter-cyclical and direct payments are not tied to current crop production so they should not provide an incentive to overproduce. However, lenders and producers both recognize the payments as additional income that could be used to increase planted acreage and/or input expenditures that would increase output.
Table 1. Government Payments for Corn Under Three Market Price Scenarios

<table>
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<th></th>
<th>Target Price</th>
<th>Loan Rate</th>
<th>Market Price</th>
<th>LDP</th>
<th>Direct</th>
<th>CCP</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$2.60</td>
<td>$1.98</td>
<td>$1.69</td>
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<td>$0.28</td>
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<td>$0.00</td>
<td>$0.28</td>
<td>$0.04</td>
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<tr>
<td>Market Price</td>
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<td>$1.98</td>
<td>$2.60</td>
<td>$0.00</td>
<td>$0.28</td>
<td>$0.04</td>
<td>$2.79</td>
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<tr>
<td>LDP</td>
<td>$2.60</td>
<td>$1.98</td>
<td>$2.60</td>
<td>$0.00</td>
<td>$0.28</td>
<td>$0.04</td>
<td>$2.79</td>
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<tr>
<td>Direct</td>
<td>$2.60</td>
<td>$1.98</td>
<td>$2.60</td>
<td>$0.00</td>
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<tr>
<td>CCP</td>
<td>$2.60</td>
<td>$1.98</td>
<td>$2.60</td>
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The recent analysis by FAPRI indicates an additional 2 million acres of commodity crops will be grown in 2003 as a result of this farm bill. Much of the additional acreage will be in corn and wheat, with reductions in soybean acreage because of the lower loan rates. This increased acreage results in crop prices that are 3 to 4 cents per bushel lower for corn and wheat than they would have been if the 1996 Farm Bill (without emergency payments) had continued. Because of the reduction in soybean acres, soybean prices would be about 5 cents higher on average. This analysis clearly shows that increased loan rates (for corn and wheat) and counter-cyclical payments provide an incentive for producers to produce more despite prices that are at or near historically low levels. The disconnect between commodity prices and production behavior is juxtaposed to the Congress and President’s claim that this farm bill is market oriented. This bill clearly will distort market signals and have producers making decisions based on government programs and not market signals.

Does This Farm Bill Help Deter Foreign Competitors from Producing?

The strategy of buffering U.S. producers from market prices, using government payment mechanisms, might make sense if the U.S. were trying to outlast its foreign competitors in a marketplace price war. However, this plan (which was started with the 1996 Farm Bill) has been very expensive to the U.S. taxpayer, with little if any visible impact on competitors production levels or any expansion in long-term market shares of commodity products.

Figure 2 (p. 6) shows how Brazilian production of soybeans has increased despite very low U.S. soybean prices over the last several years. The middle line is an index of Brazilian acreage of soybeans, where 1996 would represent an index of 100. The bottom line is an index of the U.S. price of soybeans, where 1996 would represent an index of 100. From 1996 to 2000, the U.S. soybean price dropped almost 40 percent. Yet, over the same period, Brazilian soybean acreage increased by almost 14 percent. Brazilian growth in soybean acreage is in response to the in-country price of soybeans in Brazil increasing almost 20 percent during the period due to devaluation of the real and high inflation in Brazil. This graph indicates that the strategy of buffering U.S. producers from low market prices to try to outlast our foreign competitors was not very effective over the life of the 1996 Farm Bill. Yet the U.S. experienced some of the largest government payments in history over this period to try to buffer producers from low prices, while also encouraging U.S. producers to
plant more acres of soybeans. The 2002 Farm Bill is likely to have the same impact of keeping U.S. producers buffered from market signals, keeping incentives for overproduction high, depressing market prices, and still having little effect on foreign producers’ production levels.

Figure 2. Index of Brazilian Soybean Acreage, Brazilian Soybean Price and U.S. Farm Price, 1996-2000

Will This Farm Bill Help the U.S. Producer Remain Competitive in World Markets?

Being isolated from markets puts less pressure on producers to become more efficient. Certainly, all producers strive to be as efficient as possible. However, when facing the full pressure of lower prices, producers are likely to be more creative about the ways in which they try to achieve efficiency. To the extent that producers in places like Brazil, Argentina, Canada, and Australia have to face true market prices, they have a stronger incentive to become relatively more efficient than U.S. producers who are buffered from those true market prices. From this perspective, it seems the current farm bill may do more to reduce U.S. competitiveness than to improve competitiveness.

Do Government Payments in the 2002 Farm Bill Benefit All Types of Producers?

The 2002 Farm Bill transfers large amounts of money to traditional program crops. The payments come in the form of Direct Payments and Counter-Cyclical Payments that are not tied to current production and price supports that are tied to current production. The various payments all contribute to supporting farm incomes and asset values for traditional program crops at substantially higher levels than without these payments. Nontraditional crops, like
vegetables, fruit, and livestock, have not received income and price supports in the past (aside from some small emergency payments made to pork, apple, and specialty crop producers in recent years). These nontraditional crops will not receive support under the new farm bill either.

The distribution of government payments to small versus large producers has been a subject of controversy recently. The general argument is that a relatively few, large farms receive the bulk of government payments under current farm programs. However, a recent publication by the USDA Economic Research Service (ERS) indicates that those with less than $250,000 in gross cash income actually received as much or more government payments, as a percent of their gross income, than larger producers did in 1998. The results of this study also suggest that government programs were more important in the financial performance of mid-size family farms.

The 2002 Farm Bill may maintain, or prolong at least, the current structure of production agriculture with respect to small, mid-size, and large producers by providing substantial income support and relatively more income support for mid-size family farm operations that may not have the economies of scale of large operations or whose owners or tenants are unable to earn off-farm income. The lower payment limits included in the 2002 Farm Bill, while not very effective, may reinforce the results of the ERS report and reduce the support for the very largest farms. Thus, the 2002 Farm Bill does not treat all producers equally because only commodity crop producers receive price and income supports, larger crop producers receive more absolute dollars of support than smaller producers, and smaller producers receive more government support than larger producers relative to their revenue levels.

**Does This Farm Bill Maintain Planting Flexibility?**

Planting flexibility is maintained in the 2002 Farm Bill, depending on who you are and where you are. If you grow corn and soybeans and want to continue growing corn and soybeans or add some other program crop to your rotation, then you may do so without losing government payments. If, on the other hand, you want to consider growing tomatoes, potatoes, or some other fruit or vegetable (i.e., non-program crops), you will find that this farm bill is not that flexible.

Fruits and vegetables are considered restricted crops under this farm bill, as they have been in past farm bills. The difference is that producers in the Midwest now have a base for soybeans. In the past, producers in Indiana, for example, would have an option of growing tomatoes on soybean ground without losing their direct government payments. Now that producers have a corn, wheat, and soybean base, if they choose to grow tomatoes on a portion of that ground they will lose their direct and counter-cyclical payments for that base and will likely be subject to a fine. These fines and losses of government payments were part
of past farm bills, but they did not affect many producers because a portion of their land did not have a base. Now that most, if not all, farmland has a base, this farm bill has become less flexible than the 1996 Farm Bill.

The reduction in flexibility is especially true for producers who may just now be considering expanding into specialty crop production. Producers who have been growing tomatoes (or another specialty crop) over the last 4 years will not have program crop base on that land. Thus, continuing to grow specialty crops on that non-base land will be allowed without penalties. Of course, these producers past decisions to grow specialty crops preclude them from capturing farm program payments on that land that they could have received if they had planted corn or soybeans instead of the program crop over the last 4 years. For producers considering growing specialty crops for the first time, the loss of government payments and the possibility of additional penalties may be enough to deter production of specialty crops. Thus, while the crafters of this farm bill tout its flexibility, it is clear that this bill does more to promote the production of program crops than it does to promote production of a diverse set of products valued by the marketplace.

Concluding Thoughts

The 2002 Farm Bill is essentially a continuation of current policies, adding more support from old program mechanisms. Prior recipients, honey and wool, are again included, and the peanut program is changed to more closely resemble other commodity programs. Little attention is paid to foreign trade agreements, and substantial amounts are added to existing conservation programs. This bill will likely have the following impacts:

- Exceed its anticipated spending levels;
- Maintain or enhance asset values, particularly land;
- Undermine the U.S. position in trade negotiations;
- Encourage overproduction and reduce market prices;
- Hamper the U.S. producer s ability to remain competitive in world markets;
- Continue to treat producers differently with respect to level of government support; and
- Reduce the flexibility that some producers had to diversify their crop production from program crops to other specialty crops.

Clearly, some of these consequences are not what Congress had intended. Other consequences are counter to the publicly stated positions of the administration or Congress. While each person can judge for him- or herself the merits of the legislation, one cannot question the fact that the most expensive farm bill in U.S. history takes us further away from market-oriented agricultural and freer trade in agricultural products.
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