

The 2007 Farm Bill Drivers and Implications for Producers

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Introduction

The expiration of the 2002 Farm Bill next year is prompting discussions among agricultural producers, interest groups, and policy makers regarding the package that will replace the current legislation. As U.S. agricultural policy affects most in agricultural production, either directly or indirectly, the potential changes in this policy should be considered. While there are numerous factors that will influence the next Farm Bill, the primary driving factors can be broken down in four categories: 1) economic conditions, 2) the federal budget, 3) trade negotiations, and 4) politics.

Economic Conditions

Attention to recent conditions and events will often impact legislation in specific ways. While motivations to craft policies that will move the broader focus toward deeply held beliefs will impact the proposals that are brought forward; no one can deny that large-scale economic forces that have attracted national attention will also shape the farm bill.

Net farm income in the U.S. set a record in 2004 at \$85.4 billion. Official USDA estimates for Net Farm Income in 2005 are \$73.8 billion. However, recent forecasts by USDA predict that U.S. net farm income will fall to \$54.4 billion in 2006 – below the 10-year average nation net farm income average of \$57.2 billion. In addition, government payments are expected to contribute around 33% of net farm income in 2005 and 2006. These income estimates present mixed signals in terms of the impact they may have on the Farm Bill debate. Those who favor reducing or eliminating farm programs argue that the record farm income is evidence that farm programs are not needed. Those who favor a continuation of current farm programs point out the importance of government payments in contributing to income and the forecasted drop in net income in 2006.

Energy prices. We have seen massive increases in the prices of several inputs used in the production of agricultural commodities. The prices of diesel and fertilizer have not only been coffee shop fodder, they have been the subject of Congressional inquiries. Increased expenses and potential shortages of inputs can quickly alter the productivity and profitability of crop farms (Dhuyvetter; Midland Marketing).

In December 2005, Dhuyvetter, et al. at Kansas State University analyzed the expected impact on Kansas Farm Management Association (KFMA) farms of energy price increases for the components of an Energy Expense Complex (EEC). The EEC was comprised of the KFMA expense categories of: Fertilizer, Gas-Fuel-Oil, and Irrigation Energy (where appropriate). At that time, the estimated increase in costs per dryland acre in the KFMA Summary from 2004 to 2005 was \$6.33 due to expected prices of EEC components. The expected rise in per irrigated acre costs from 2004 to 2005 was \$34.15.

Subsequent analyses of farms in the 2005 KFMA summary showed that actual per-acre increases of the energy-intensive components of the EEC from 2004 to 2005 for irrigated farms was \$10.04. Energy-intensive inputs resulted in an estimated \$8.35 increase per acre in 2005 over 2004 for non-irrigated crop farms in the KFMA summary. Irrigated crop farms in this study have experienced a measured 44.9% increase per acre in the EEC from 2002 to 2005. Given the recent history of double-digit percentage increases in expenses due to energy prices, these topics are almost certain to come up in debates concerning the next Farm Bill.

While discussing energy, one would be remiss to leave biofuels out of the discussion of farm programs. Ethanol has a tremendous impact on the demand for U.S. crops and continued expansion of the entire biofuels sector appears poised to continue to move the price for U.S. crops higher. This impacts not only the prices received by grain producers, but also impacts government expenditures on price-sensitive farm programs and the economic fortunes of those who raise livestock. The economic and political impact of biofuels is ground for extensive analyses.

Stronger prices for some commodities, such as corn due to the ethanol outlook, have already resulted in calls for new mechanisms to support agriculture. The most prevalent calls are for programs that are revenue-based rather than price-oriented.

Targeting farm program payments. Several proposals came forward with the 2002 Farm Bill regarding the targeting of payments and the concept of further payment limitations. Although further payment limitation proposals have been defeated, additional attempts are expected to be brought forward and will likely gain momentum moving into the debate over the 2007 Farm Bill.

Recognition of the economic condition of farms given the increases in energy prices may dissuade some lawmakers who typically favor tighter payments limitations from pursuing such actions at this time. Furthermore, there are champions for “full access” to payments as they currently exist – from both sides of the political aisle. This is understandable as those who represent areas where the crop mixes are generally supported by higher payments do not want to risk angering producers in their home areas.

The Federal Budget

The recent record federal budget deficit has raised concerns among agricultural interest groups that farm programs could be cut in an effort to reduce deficit spending. Certainly, that concern is warranted in light of budget proposals from the Bush Administration for fiscal years 2006 and 2007. Both budget proposals called for 5 percent reductions in commodity program payments, a lowering of the payment limitation cap to \$250,000, and reductions in crop insurance premium subsidies. Although some reductions in agriculture programs were implemented in the fiscal

year 2006 budget reconciliation process, commodity program payments to crop producers remained virtually untouched. The President’s FY2007 budget proposal for agriculture met strong opposition from the House and Senate Agriculture Committees, and was not acted on.

Recent budget deficit projections for 2006 are significantly lower than previous estimates. Although there have been record deficits in recent years, when considered against the overall size of the U.S. economy, the expected deficit in 2006 is well within historical averages. Figure 1 shows the federal budget balance and balance as a percent of GDP in each year prior to passage of a Farm Bill from 1965 to 2007. Budget surpluses existed only twice during this time period—1969 and 2001. Also, the projected budget deficit, as a percent of GDP is lower than it was in four of the previous six Farm Bills. This would suggest that the current deficit may not play as big a role in the next Farm Bill debate as some are speculating.

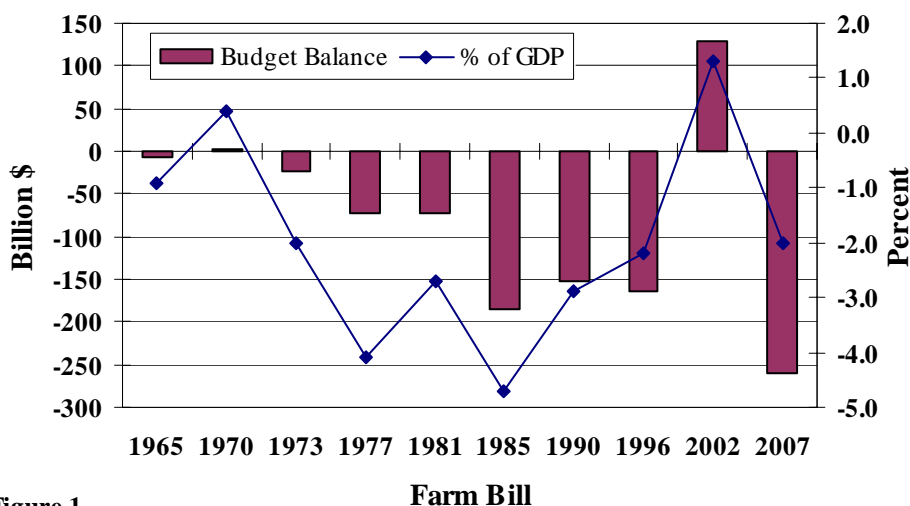


Figure 1

Some Members of Congress have indicated that massive reductions in farm programs are not in their plans. They expect the social programs such as food stamps to take their share of budgetary cuts along with any proposed for agriculture. A critical need is to determine what programs will materially contribute to the safety net for agriculture. Decision makers need to be provided available information regarding the impacts and implementation strategies for desirable programs. When the expected overall budgetary impact is calculated and agreed to, it is good to have your programs in the package already.

Trade

The World Trade Organization (WTO) is cursed by some, praised by others, and blamed by those on the losing side when rulings go against them. According to WTO Director-General Pascal Lamy, suspension of the Doha Round negotiations in July came about when difficulties in reaching agreement were seen to require “a period of ‘time-out’ for Ministers to consider how they can each contribute to breaking down the remaining obstacles, particularly in agriculture.”

Pressure to conclude a WTO agreement in 2006 had increased when the 149 member nations failed to reach a consensus in December 2005. In July 2004, the WTO members agreed to do

three things in regard to agriculture: 1) increase market access (i.e., reduce tariffs that discourage imports), 2) reduce trade-distorting domestic subsidies, and 3) eliminate export subsidies. The difficulty in reaching an agreement revolves around how these objectives are to be met. How much will tariffs and domestic subsidies be reduced? What is the timeframe for these reductions? The goal was to work these details out by the WTO summit in Hong Kong in December 2005. Since all 149 WTO members must approve any agreement, and there are often numerous competing interests within each nation, reaching a meaningful agreement has proved to be a difficult task.

The opening and expansion of markets is one of the primary objectives for the U.S. in participating in trade negotiations. While former and current U.S. Trade Representatives Rob Portman and Susan Schwab have offered proposals to reduce domestic farm program payments to secure progress from the European Union (EU) and others in opening markets, they have been repeatedly reminded by Congressional leaders of their expectations and roles.

For example, Senator Saxby Chambliss, Chairman of the Senate Committee on Agriculture, Nutrition and Forestry, and Representative Bob Goodlatte, Chairman of the House Committee on Agriculture, in an October 6, 2005 letter to Ambassador Portman wrote the following in regards to the current preparation for the next WTO round:

“..let us caution you that the negotiations and modalities should not preempt the responsibilities and prerogatives of Congress. The agriculture negotiations can set the broad parameters of spending limits, but they should not write the next farm bill which Congress will be reauthorizing in 2007.”

The focus of the letter from the leadership of the Congressional Committees with primary responsibility for agriculture was to secure a WTO agreement that would strengthen the ability of US farmers and ranchers to compete in a global market place. Citing improved market access, harmonization in trade-distorting domestic support, elimination of export subsidies, and greater certainty and predictability regarding WTO litigation, Chambliss and Goodlatte capsulated what have been major complaints by agriculture producers of the WTO for some time.

It may be more difficult to achieve on global international trade agreements soon. The reasons for this largely lie with the United States. First, the President's trade promotion authority (TPA), which gives the President power to negotiate trade agreements without amendments from Congress, expires in July 2007. Given some increasingly territorial rhetoric in Congress, it is doubtful TPA would be renewed prior to the 2008 Presidential election. As those in Congress represent varying interests both for and against more liberalized trade, the ability to make amendments to trade agreements increases the difficulty of passing those agreements. Second, the current U.S. Farm Bill expires in 2007, meaning that if an agreement is not reached, the U.S. may pass a new Farm Bill that would delay changes in agricultural programs and trade policies for five or more years.

A proverbial “cart and horse” situation has come around regarding the timing of a WTO agreement on agriculture and the next Farm Bill. The question facing agricultural interests is to determine if it would be more appealing to have a trade agreement in place and craft legislation that meets the requirements of that agreement, or if a new Farm Bill should be put in place prior to final negotiations on a WTO agreement. [See the *Politics* section following.]

Green Payments. The 2002 Farm Bill has been widely regarded as the “greenest” Farm Bill to date. In addition to existing conservation programs like the Conservation Reserve Program (CRP) program, funding was increased for the Environmental Quality Incentive Program (EQIP), and the Conservation Security Program (CSP) was established. With reductions in market-distorting subsidies being one of the objectives of the WTO negotiations, conservation (green) payments, like CSP payments are viewed as a means to transition from market-distorting programs. The U.S. has signaled the possibility of moving in such a direction. However, conservation program spending, especially for the CSP, has been a target for Congress when spending cuts have been required to offset disaster payments or as part of budget reconciliation. With the emphasis on green payments (not to be directly confused with WTO “green box” payments), many questions remain to be answered. For example,

- Will programs such as the CSP be funded fully throughout their duration in the Farm Bill, or will their earmarked dollars again remain accessible for support of other safety net programs?
- How will payments for as yet untested green programs be placed into service? What will be their requirements? How much will they cost?
- Will the Conservation Reserve Program (CRP) acreage cap be modified in subsequent sign ups?

General sentiment is that enhanced conservation payments in some form will be a hallmark of the 2007 Farm Bill. CRP acreage may be decreased somewhat as payments may be targeted for other environmentally sensitive areas and protective practices.

Politics

For any broad based policy, there will be criticisms. The 2002 Farm Bill is no different. However, it has been noted that there have been fewer national calls by agricultural groups to re-open this Farm Bill than others in recent memory (Hildebrant). Opening a Farm Bill before it expires is considered a “nuclear option” for many agricultural stakeholders. The fear of such an action is that massive changes in fund allocations, program offerings, and eligibility requirements could occur. This is also part of the reason that whenever it comes time for reauthorization of the Farm Bill, folks get excited and worried as to what will come.

Some have proposed extending the current Farm Bill for an additional year or two. This has been expressed for several reasons. Some argue that the U.S. should not be writing a new Farm Bill at the same time it is negotiating in the WTO, because we may weaken our negotiating position by unilaterally changing our programs. Others point to the recent WTO cotton case as a warning against passing a Farm Bill without first making sure it is compliant within the WTO. Also, those who have benefited from the current Farm Bill are more likely to want to keep the status quo, if for no other reason than out of fear of losing what is currently available. Finally, if you are a Democrat and you would like to have a fellow Democrat in the White House when the Farm Bill discussions come around again, waiting until the after the next Presidential election may be desirable.

Although there is growing support for extending the 2002 Farm Bill, there is not universal support. This reflects a larger issue in agriculture—the growing divisiveness of agricultural interest groups and commodity/geographic sectors. Different agricultural interest groups view farm legislation differently. Obviously, commodity groups that receive direct assistance are going to view those programs differently than those who do not receive direct payments. Likewise, the commodities that receive support have different opinions regarding the value of specific programs. Fruit and vegetable producers have made calls for increased spending on research & development that benefits them in return for increased competition they may face as changes are made in farm programs to come into WTO compliance. Those raising livestock have also expressed an interest in being included in some heightened fashion in the upcoming Farm Bill.

In recent Farm Bills, nutrition and food assistance interests have played a key role in developing a coalition to pass Farm Bills. Similarly, environmental groups have been generally supportive of the conservation aspects of Farm Bills. However, the willingness of some of these groups to be supportive of commodity programs in the Farm Bill to meet their own interests may be waning. For example, some in the nutrition arena are beginning to question why the U.S. is subsidizing food and feed grains and not “more nutritious” fruits and vegetables.

A much more vocal critic of current commodity programs is the Environmental Working Group (EWG). Although not opposed to government support of agriculture in general, EWG would like to see the money spent on commodity programs allocated to conservation. Other outspoken critics of U.S. farm supports include anti-poverty groups like the British-based Oxfam. These groups argue that domestic support for agriculture in the U.S. and other major subsidizing countries is a source of poverty in developing countries.

Certainly there is more negative coverage of the 2002 Farm Bill from non-agriculture interests than recent Farm Bills. However, although there are currently some differences among agricultural interest groups, there is still broad support among farmers for the farm programs in the 2002 Farm Bill. Because farm organizations still comprise a powerful lobby, it is likely that several of the programs that farmers favor will continue in the next Farm Bill.

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