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[The 2007 Farm Bill in Context]

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What is a Farm Bill?

The Farm Bill is periodic legislation that replaces the Agricultural Adjustment Act (AAA), permanent legislation from the 1930s which set in place the original farm policy. The AAA, which is still technically in force, reflects a 1930s market and world that are incompatible with the current conditions. The permanent legislation has been amended twice, most recently in 1949, but much of it remains an anachronism. The regularly authorized Farm Bills cover numerous areas that are not included in permanent legislation and would not be addressed should the permanent legislation be allowed to expire.

At its heart, the Farm Bill is concerned with farm income support and, indirectly, support for America's rural communities. From the very beginning this was accomplished through production management (mostly through land idling in exchange for payments) and price supports (in the form of marketing loans and deficiency payments), a policy that remained relatively unchanged for nearly 60 years. Farm support is extended to producers of specific storable commodities which are known as program crops.* Other commodities that generally receive no support include meats, hay, poultry, nuts, vegetables, and nursery products.

The periodic reauthorization of the Farm Bill allows U.S. farm programs and policy to be adjusted to reflect current needs and conditions. Thus, what was initially legislation focused on farm production—marketing loans, subsidies and production controls—and soil conservation expanded over time to include rural development, nutrition programs, research, trade and, very recently, energy.

Farm Bills developed slowly for decades with modest changes until the nature of the political and global economies confronted the new realities of the 1980s. Among the forces pushing for changes to farm policy were increased bilateral trade, a growing desire for shrinking the size and purview of the federal government, and a long period of high interest rates and low commodity prices. While these pressures took time to build up, they were compounded by the increasing integration in both the global economy and farm sector. Importantly, the Global Agreement on Tariffs and Trade (or GATT, which later became the World Trade Organization, or WTO) began to shift its focus from strictly tariff activities to trade promotion and reducing market barriers. Furthermore, there were calls from within Congress to end government agriculture subsidies or at the least to reform how

* Program crops are corn, sorghum, barley oats, cotton, rice, soybeans, sunflower seed, canola, rapeseed, safflower, flaxseed, mustard seed, dry peas, lentils, small chickpeas, and peanuts along with milk, beet and cane sugar, wool, mohair, and honey.

the government supported farmers. Adding to all this was the farm crisis in the 1980s, which piled on evidence for even casual observers that something was not entirely right with U.S. agricultural policy. By the end of the 1980s, the concept of reforming farm policy was gaining considerable momentum.

Recent History

Given this background, it is not surprising that there was considerable willingness to effect some changes to U.S. farm policy in the 1990s. When the 1996 Farm Bill was drafted it took a new approach. The Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (known more universally as Freedom to Farm) represented a major shift in farm policy away from government intervention and toward a strictly market-based system. In part, Freedom to Farm promised to end government commodity payments, easing the transition to an open market with a set of declining payments that were not attached to planting decisions. These Agricultural Market Transition Act (AMTA) payments were available to farmers according to their "base" acreage in program crops. Producers were free to shift production into other crops (except fruits and vegetables), or to idle the land. These are known as decoupled payments because the payment has been decoupled from planting decisions. In this way, farmers were to move from a protected market to an open, global one and, in so doing, it was expected they would be able to prosper or choose to get out of farming.

Freedom to Farm was written at a time when prices for program commodities were very high. This led to some assumptions about the ability of U.S. agriculture to export its way to prosperity that were built into the economic models that underpinned the AMTA component of Freedom to Farm. It was assumed that a growing global economy, with an increasing number of middle class consumers eating higher on the food chain, combined with continually declining trade barriers, would create boom times for American agriculture.

Unfortunately, in the late 1990s a few, mostly unrelated, events undermined the assumptions built into the 1996 Farm Bill's intended transition away from a managed market. The booming southeast Asian economy went bust, throwing millions of emerging middle class consumers back into the ranks of the poor. Trade talks, while not stalling, did not proceed swiftly toward global integration and, where they moved forward they often had unexpected and often deleterious effects on U.S. agriculture. And globally the United States got more company and thus competition in the commodity markets, most particularly from Brazil and Australia.

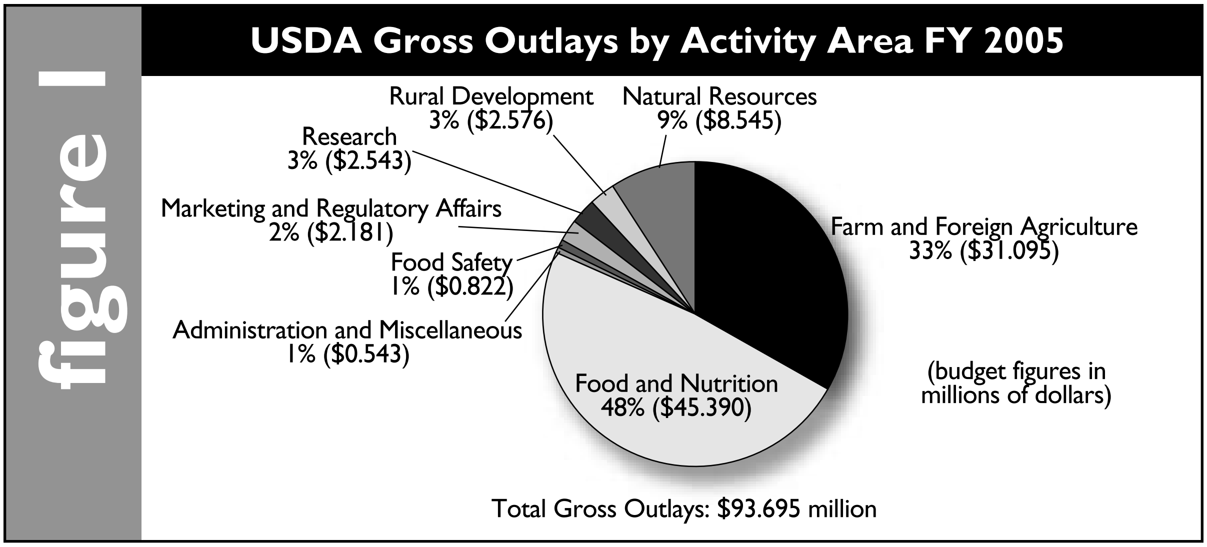
As a result, agriculture producers saw their incomes plummet in the late 1990s and were facing a financial catastrophe. Congress stepped in and provided a series of emergency payments to farmers to make up for "market deficiencies." These emergency payments initially were $5.5 billion in 1998 rising to nearly $9 billion in 2001. As a result of these emergency payments, instead of declining government payments to farmers, farm payments reached record levels in the run-up to the reauthorization of the Farm Bill in 2002.

Modern History

When the 2002 Farm Bill was being debated, the U.S. economy was booming and the federal treasury was flush with funds. It also had become politically expedient to build the emergency payments into the structure of the program. In part this was an acknowledgement that the annual ritual of lobbying for increasing emergency appropriations was fast becoming politically untenable. Perhaps as significant was a dawning awareness of how the mercurial nature of global agricultural markets conflicted with the political realities of standing idly by as America's agricultural and rural economies declined markedly.

Against this backdrop, the 2002 Farm Bill (the Farm Security and Rural Investment Act of 2002) was the most generous in history, authorizing an 80 percent increase in spending on farm programs. The legislation maintained much of the structure of Freedom to Farm, including traditional program support mechanisms as well as the AMTA payments (now renamed "decoupled" payments as the transition to a market was no longer a component of the purpose of the payment). Significantly, the 2002 Farm Bill codified the emergency payments of the previous several years in the form of countercyclical payments, which commodity producers are eligible to receive when market prices drop below set target levels. Furthermore, the program expanded considerably the amount of funding authorized for conservation activities, particularly those on working lands, increasing the amount of money available in the Environmental Quality Incentives Program and creating a new conservation entitlement program—the Conservation Security Program—which rewards producers for their beneficial activities on working land.

The core of the 2002 Farm Bill remained true to the historical roots of the legislation by supporting farm income through commodity price support,



Source: Congressional Research Service, using USDA Data

but Farm Bills have grown over time through the addition of new titles to address new needs not within the original scope of the bill. The 2002 Farm Bill included titles on Commodity Programs, Conservation, Trade, Nutrition Programs, Credit, Rural Development, Research, Forestry, Energy (which was new for 2002) and a miscellaneous title for a wide range of unrelated matters. (The SLC Regional Resource *Finally, the Farm Bill* details the provisions of the 2002 Farm Bill; available online at *http://www.slcatlanta.org/Publications/AgRD/FinallyTheFarmBill.pdf*.)

Appropriations for many of these programs lagged, however, as the U.S. budget surplus evaporated following the dot.com bust, the downturn in the economy related to the September 11 terrorist attacks and associated costs of the global war on terror, as well as reduced revenues due to tax cuts passed by Congress in 2001 and 2003. Because nutrition and commodity payments are entitlement programs, most of the limitations on spending have come from the 19 percent of the USDA budget that is discretionary. Figure 1 provides an illustration of the USDA budget by activity area.

Most provisions of the 2002 Farm Bill will expire in 2007. The USDA and Congress have been seeking input on a new Farm Bill through a series of public hearings throughout the end of 2005 and early 2006. The 2007 Farm Bill will be crafted at a time unlike that of any other in the legislation's long history. A host of factors will affect discussions and deliberations on the future of the Farm Bill and U.S. farm policy. Among them are the growing federal deficit, ongoing negotiations of the Doha round of the World Trade Organization, political and leadership situations in Congress, and current farm sector conditions, among many others. These four major influences provide some context for understanding the debate that is ahead on the Farm Bill.

Context for the 2007 Farm Bill

The Federal Deficit

The federal deficit is now as large as it has ever been, $352 billion for fiscal 2005, with a total federal debt of more than $8 trillion. Given the size of the U.S. economy, these numbers alone are not entirely cause for concern; last year's debt represents only about 2.7 percent of gross domestic product. On the other hand, there are a number of observers, including those within the Congressional Budget Office, which helps to set spending benchmarks for legislation like the Farm Bill, who are beginning to raise concerns over what is viewed as a structural deficit. The continued spending on military activities in Afghanistan and Iraq, the costs of rebuilding the Gulf Coast following Hurricanes Katrina and Rita, and the decline in revenue associated with recent tax cuts all provide downward pressure on spending for federal programs, leading to a presumption that farm spending may shrink in the next Farm Bill.

The last several times the Farm Bill was crafted under the shadow of federal deficits, this was the case. The decline was due in part to more modest authorizations, but principally through reconciliation and deficit reduction legislation. The huge expansion of the Farm Bill in 2002 corresponded with a large federal surplus which no longer exists. While projections of the federal budget deficit looking forward vary, some estimates place the deficit as high as $300+ billion annually when the cost of the war in Iraq, fixing the Alternative Minimum Tax, and debt service are included. Even more optimistic outlooks assign a point when deficits return to surpluses around 2011, but these calculations do not fully consider many outlays that are "off books" in the current budget, including those just enumerated.

As a gauge of how a tight budget may affect the 2007 Farm Bill, consider the fiscal 2006 budget reconciliation legislation (passed in late 2005) which cost agriculture $2.7 billion, including large (proportionate) cuts to conservation (roughly $1 billion), energy and rural development ($400 million) and research ($600 million). Only about $700 million in cuts from reconciliation came from commodity programs.* Because the Milk Income Loss Contract (MILC) was extended for two years (at a cost of nearly $1 billion), reconciliation actually cost other programs $3 billion. While budget reconciliation mostly is a snapshot of how Congress reacts to the immediate need to reduce spending, and reflects a desire to do so with the least degree of disruption, many of the key voices in this discussion, including Senator Saxby Chambliss of Georgia, Chair of the Senate Committee on Agriculture, Nutrition and Forestry, have noted that reconciliation afforded agriculture little more than a short term respite from more significant cuts to crop support in particular.

Finding cuts in agriculture is complicated in no small part by the fact that so much of the actual price tag of the Farm Bill is in entitlement programs—commodity program payments and nutrition programs. Discretionary spending, typically the outlays which Congress prefers to cut first, is a small slice of the farm spending pie. While everything is on the table when the Farm Bill comes up for reauthorization, the ability of commodity programs to avoid the deep cuts taken by conservation, rural development, energy and research took in the 2006 Budget Reconciliation Act highlights a looming political challenge.

WTO Trade Negotiations

The United States has been a net exporter of agricultural products since 1959, an unbroken stretch of more than 46 years. Within the portfolio of U.S. exports, agriculture is alone in the duration and scope of its positive trade balance. However, the trade surplus in agriculture has been shrinking steadily for some time (in 2002 the trade surplus was $11.2 billion; in 2005 the surplus was down to $3.7 billion). This is not due to a decline in exports, but an increase in imports. In fact, exports have risen annually, although they have flattened out some in recent years, but imports have grown twice as fast as exports, resulting in a shrinking trade margin for U.S. agriculture.

> ***[Now in the latter half of the Doha round, WTO negotiations are in serious risk of collapsing. …There is now slim hope that Doha will remain on schedule.]***

Our export partners also have changed over the past decade. China is now our largest market for soybeans and, in general, the industrialized world represents a shrinking share of our exports, with fast growing developing economies taking ever-larger shares. These countries are not content with this situation, however, and are working diligently to build up their own production capacity to temper their dependence on imported food and fiber.

International trade agreements have been a consideration for the Farm Bill for several reauthorizations, but they carry significantly more weight with the 2007 Farm Bill for several reasons. The current round of negotiations—known as the Doha round for the city in Qatar where they were initiated—is intended to bring developing countries more fully into the world trade system.

From the earliest days of the post-war trade discussions, much of trade talks has revolved around reducing tariffs and opening markets for products from and among developed nations. With the Doha round, as the attention has shifted to the developing world, poorer nations have demanded better access for products they produce in abundance and at lower costs—principally raw materials and agricul-

* Because of a WTO ruling that will be more fully discussed in the next section, cotton programs were eliminated for Step 2 subsidies (which support domestic purchases of cotton by U.S. manufacturers), although other programs were left intact.

tural products. Because world trade rules have for decades allowed rich countries to protect their agriculture and natural resource producers from lower cost competitors in the developing world, this round of negotiations has been particularly difficult.

Now in the latter half of the Doha round, WTO negotiations are in serious risk of collapsing. The Cancun Ministerial Round in 2003 was essentially a failure for the negotiations, owing in no small part to the new and vigorous activism of the Group of 22 developing nations (organized by Brazil), which caused the talks to break down. It was hoped that the recently passed Hong Kong Ministerial Round in 2005 would get the trade talks back on track and save the Doha round, but very little of substance was accomplished, highlighting the difficulties ahead in securing a comprehensive trade deal and increasing the pressure on all parties by leaving much more work to be accomplished before the 2007 working deadline for the current round.

While there is still time on the clock for Doha, the missed April 30 deadline for agreements on agricultural subsidies and July 1 deadline for tariff and trade barriers constitute further likely missed opportunities for the WTO. As of this writing, discussions on subsidies were ongoing but showing little progress, with even less progress on tariff and trade barriers. There is now slim hope that Doha will remain on schedule.

One reason why the Doha negotiations have such relatively firm deadlines is the expiration of the president's Trade Promotion Authority (TPA—commonly known as "fast track" authority) in July 2007. Under TPA, the president can present trade pacts to Congress for a straight up or down vote. Without TPA, Congress can alter trade pacts, which would then have to be returned to our partners for agreement. Essentially, without TPA, negotiations on the WTO would grind to a halt. Former-U.S. Trade Representative Robert Portman made it clear that the Administration would seek reauthorization of this authority, but given the recent close vote on the Central American Free Trade Agreement (CAFTA) in the Senate, approval would seem to be less than assured. The United States' negotiating partners are very aware of this dynamic, a fact that brings some pressure to bear in areas, but affords for countries seeking deeper concessions from the United States and Europe the luxury of waiting out the negotiations in favor of a new round under terms less favorable to the industrialized world.

Since policymakers in Washington, including Senator Chambliss and Secretary Johanns, are

Brazil, Cotton and the WTO

The WTO currently classifies farm support into three categories or "boxes": amber for those that are considered trade distorting; blue for those that are less trade distorting; and green for those that are not at all trade distorting. What constitutes an amber, green or blue support is partly a component of the negotiating process, and partly determined by WTO hearings, as was learned to the detriment of the United States in the recent case with Brazil. Each box has an allowed level—determined on a county-by-country basis—which establishes the amount of support that countries can provide in each category. For the United States, the current allowances call for a $19 billion cap on amber box support, with a $10 billion cap for blue and green boxes. It is important to note, however, that since what is known as the "peace clause" expired in 2003, the boxes are technically no longer in force, although they are the likely basis for future negotiations.

The Brazil case before the WTO rightly got a considerable amount of attention in the United States. As Celso Amorim, the Brazilian Foreign Minister, crowed in July of 2005, "This is the end of agricultural subsidies. Export subsidies are now gone and trade distorting subsidies are on their way out."

What the Brazil case means for agriculture is less than clear, but within the WTO, pressure to reduce agricultural support is being applied to the agriculture sector from both our trading partners and from within the United States. Agriculture is roughly 1 percent of U.S. GDP, with services making up about 79 percent, and industry making up about 20 percent. As the United States enters the "homestretch" in trade negotiations, the 99 percent of the economy that is outside the agriculture sector is very interested in making sure that the 1 percent that is agriculture does not hold up increased access to key markets. Brazil is exploiting this by targeting its WTO-authorized $3 billion in sanctions not against agricultural products and commodities, but intellectual property, including pharmaceutical patents, software and industrial design. Testifying to the wisdom of this strategy, cracks are beginning to appear in the U.S. trade resolve. Stephen Biegnum, Vice President of Ford Motor Company, noted in October last year, "Agriculture is sucking all the energy out of the [trade] debate right now."

attempting to get ahead of the WTO negotiations, the anticipation of the outcome of talks will set the agenda in many ways for the 2007 Bill. Senator Chambliss has insisted that he will write a WTO-compliant piece of legislation, and that the 2006 reconciliation provided only a "short-term reprieve" from cutting crop payments. Indeed, advocates of vigorous reform in farm programs view WTO negotiations as a valuable tool in their box for forcing shifts in farm policy.

In the end, the United States basically has three options at the WTO as it relates to the Farm Bill. It can accept cuts and reduce Farm Bill subsidies by perhaps $26 billion. It can avoid these cuts by shifting "boxes" around, moving decoupled payments from amber box to blue box (although there is scant reason to hope that the rest of the world will go along with this plan), or shifting more funding into the green box category. Or the United States can convert all of its subsidies into WTO-compliant programs, such as rural and business development, energy and conservation. In all likelihood what will happen is a mix of these, should the Doha round reach an agreement on agriculture, although given opposition to payments to farmers by the Group of 22 and the agriculture sector's opposition to just accepting cuts, WTO-compliance would seem to point to a prevalence of subsidy shifting.

Politics/Leadership

While not directly related to the Farm Bill, the political and leadership dynamics of this debate warrant mentioning. On the political front, the 2007 Farm Bill will be debated in a Congress that is decreasingly rural, decreasingly connected to agriculture, and increasingly divided. Historically, the Farm Bill has not been particularly partisan, at least not overall. There are certainly ideas that have or have not gotten a hearing because of who was advancing them but, at the end of the day, the Farm Bill usually passes with comfortable majorities (in 2002: 280-141 House; 64-35 Senate). While much of the Farm Bill is not a partisan issue, Congress has become more polarized, and the nature of Washington politics has changed. This inevitably will make reaching a compromise on the Farm Bill more difficult.

Possibly complicating this is the fact that neither Senator Chambliss nor Representative Goodlatte, Chair of the House Committee on Agriculture, has written Farm Bills before. Both have been diligent about seeking public comment, however. The process of building a radically new Farm Bill, which is what Secretary Johanns and Senator Chambliss both have said would be the outcome, is a considerable undertaking. In years past, the House and Senate Agriculture Committees had the advantage of a number of experienced hands in leadership positions.

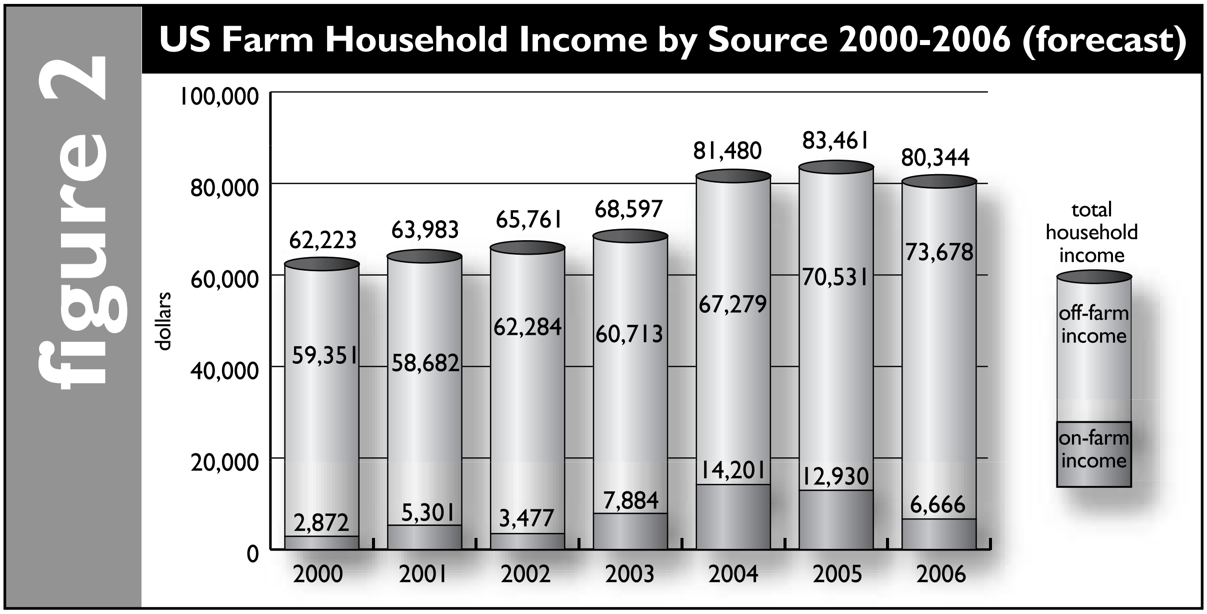
A further note on the leadership dynamic is the splintered nature of the coalition that is needed to formulate a Farm Bill. Rural groups, conservation organizations, commodity groups, farm groups, and agricultural producers all are represented at the national level by myriad organizations that present often conflicting or confusing messages. The absence of any consensus from the sector most affected by the Farm Bill is problematic in building support outside the sector for the legislation. In the short run this affects the outcome of discussions on the Farm Bill, although historically these groups have been able to work together as the deadline approaches in order to reach something of a consensus.

Farm Sector Conditions

The Farm Bill principally is intended to do one thing: improve farm profitability. Because the market changes over time, it is necessary to adjust the manner in which the government engages in the agriculture sector to achieve this public and national benefit. Thus, when thinking about the Farm Bill, both current and future, it is imperative to consider farm sector conditions.

Two recent USDA reports lay out the current condition of farming in relatively stark terms. The first, *Economic Well-Being of Farm Households,* outlines how well farmers are doing in the current market and policy setting. Among the findings:

» Very large commercial farms (those with at least $250,000 in annual sales) represent just 7 percent of U.S. farms but command about 70 percent of total farm sales.
» These large farms are profitable, but the remaining 93 percent of farm households, who control roughly two-thirds of all farmland in the United States, earn most of their household income from off-farm sources.
» As farm size decreases, so does the share of its income derived from on-farm sources.
» 85 percent of U.S. farms generate income of less than $100,000 a year. These farms generate just 15 percent of total U.S. farm sales and earn negligible income from farming.
» Off-farm sources of income (including employment earnings, other business activities, other investments, and transfer payments) provided 85-95 percent of household income



Source: USDA, Economic Research Service

over 1999-2003, up from around 50 percent in 1960.

» Farm household income is above the national average, a fact that is almost entirely due to off-farm income.

Figure 2 illustrates the average share of on- and off-farm income for farm households between 2000 and the forecast income in 2006.

The other report, *Growing Farm Size and the Distribution of Farm Payments*, discusses farm payments. In particular the report notes that:

» Small farms (those with sales of between $10,000 and $99,000) have an operating profit margin of negative 24.5 percent.
» More than 30 percent of operators in this category were at least 65 years old by 2003, as compared to only 13 percent of the operators of very large family farms.
» Farms with less than $250,000 in production value received 63 percent of commodity payments in 1989; by 2003, they received 43 percent of payments.
» Farms with at least $500,000 of production received 32 percent of all commodity payments in 2003, up from 13 percent in 1989.

What this demonstrates is up for interpretation. America's large farms are highly efficient at delivering a safe, nutritious product that most American's can afford. Americans enjoy the most stable, abundant, safe, and affordable food supply the world has ever known. That these farms account for the lion's share of farm income and federal farm support should be little surprise, considering they also produce the greatest portion of the food we eat. On the other hand, critics of farm policy contend that farm subsidies, and not market forces, have encouraged this degree of concentration. The inability of most farmers to earn a living (or even approach it) on the farm points to a structural imbalance in the national farm economy which could lead to a catastrophic loss of farms and farm production if not addressed. Furthermore, it is easy to conclude by reviewing these (and other) statistics about the American farm sector that our farm policy is doing a poor job of achieving its principal objective: to support farm income.

Regardless of this debate, the decline in on-farm income for most farmers and the increasing size of farms, particularly in the grain belt, have had profound impacts on rural communities. If farm households are dependent on off-farm income to survive (and in many instances subsidize their farm production), the rural communities in which they live need to have healthy, vibrant economies in order to provide the jobs these individuals need. Unfortunately, the situation in rural America is one of great unevenness in the opportunities available. Rural entrepreneurs and companies have particular difficulty in attracting investment capital. Furthermore, rural communities often lack many of the essential services to grow the kinds of businesses that provide appropriate and sustainable employment.

Outlook for 2007

Given all of this, the outlook for the 2007 Farm Bill is less than clear. Several issues complicate any discussion of what a future Farm Bill will look like. Among these are calls for an extension to the current legislation to a point beyond WTO negotiations. Another uncertainty is the extent to which the Bush Administration and Congressional leadership are able to move priorities within farm programs away from crop support to more trade neutral options.

An extension?

A number of agriculture groups, including most of the major row-crop associations, have called for an extension of the current Farm Bill for one or two years. The logic behind this is that while the United States is still in discussions with its trading partners at the WTO, it makes little sense to try to negotiate a Farm Bill as well. The obvious worry is that the WTO negotiations would be the stick that could be used to threaten commodity groups into giving up support. A further concern is that the United States would "unilaterally disarm" in the 2007 Farm Bill prior to a finished global trade agreement, perhaps giving up more than is necessary and providing little incentive for our trading partners to give up much at all. An extension beyond the Doha round would mean that the Farm Bill would be 100 percent WTO-compliant and ensure that U.S. negotiators had a "full quiver," as it were, to negotiate with, and would only have to give up what was essential to getting an agreement.

Secretary Johanns in particular has been very specific in his strenuous opposition to any extension of the Farm Bill. His reasons for this are numerous, but they boil down to two basic concepts. The first, which appeals to a domestic audience, is that the United States should not negotiate domestic farm policy in foreign capitals. This is what Secretary Johanns has observed the message would be if the Farm Bill was extended until after the Doha round is completed. The second, which appeals more to an international audience, is that the United States is going to use the occasion of the 2007 Farm Bill to transform farm policy anyway, and any agreement reached at the WTO would be unaffected by our farm policy. The secretary was clear when he told the Agriculture Outlook Forum in February that the new U.S. farm policy, as built into the Farm Bill, would be good as both trade policy and farm policy.

For those who are hoping to transform farm policy, an extension is unwelcome because it would both extend what they feel is bad policy and would take the pressure off Congress to make what they view as necessary changes and trade negotiators to hold the international communities feet to the fire. Advocates from across a broad spectrum of agriculture—including specialty crops, small farm organizations, environmentalists and rural communities—all tend to view the concurrent negotiations of the Farm Bill and WTO as positive pressures to achieve a Farm Bill that serves a broader segment of agriculture than current law. Furthermore, if the Farm Bill as it now stands is not achieving its main purpose, opponents of an extension argue, it little benefits American agriculture to wait any longer to fix the system.

Congress will inevitably decide on an extension. In order for the Farm Bill to be extended, however, a majority of the Congress will need to see a decided benefit in such an action. While a number of farm community legislators may join the host of agriculture groups in support of such a move, urban and suburban legislators with an interest in adjusting nutrition programs will need to see such an action in their interest as well, something which is not entirely apparent.

Changes in priorities

The Bush Administration has been relatively consistent in stating that the United States will sharply reduce or eliminate agricultural subsidies at a "date certain," generally within a decade, or sometime earlier. What the Bush Administration intends with these statements is somewhat unclear, however.* The Administration may want to shift money into conservation programs in order to be revenue-neutral (to an extent) to producers. It is equally possible that cuts to commodity programs would be counted as savings against the national debt. The president's call last year to ratchet down on payment limitations, and the recent *Economic Report of the President* that cited the total value of farm payments as 8 percent of the federal deficit (instead of the perhaps more accurate .8 percent of the federal budget), indicates a willingness on the part of the Administration to figure cuts to agriculture as budget savings.

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* As a bargaining position, reductions in U.S. commodity support is understood to be a huge lever to open up closed markets in services and insurance, but the United States has had very little luck eroding European intransigence on this issue. The United States proposal from last December called for a 53 percent cut in trade-distorting support by the U.S. and a 75 percent cut from the EU, with higher cuts in so-called amber box support and would cap decoupled payments as a whole at 2.5 percent of the value of agricultural production.

The USDA released three possible options for farm subsides, based on field hearings the agency held in 2005. Among the options are maintaining the existing structure of farm programs with adjustments to make them trade-compliant and targeting payments to smaller and mid-sized farms. A second option would replace the current system with a revenue insurance model that provides payments to farmers who fall short of a yearly revenue target. The USDA's third option would eliminate the marketing loan component of the commodity program and transfer these funds to expand crop insurance, rural development, conservation, and farm savings accounts.

With the 2002 Farm Bill, there was a sense in Congress that due to budget surpluses there would be room to try out some of the new models for farm support alongside traditional programs. Thus the Conservation Security Program, which had been intended as a *replacement* for the Farm Bill, became a component of it. Equally, the legislation folded in emergency payments, decoupled payments and countercyclical payments, along with establishing new loan rates and target prices. While talk of a transition to an open market retreated with the 2002 Farm Bill, there is renewed interest in such an idea.

A serious inspection of farm conditions indicates a need to support rural communities in a major way. If 93 percent of farmers rely on off-farm income to essentially subsidize the American food supply, there is a need to make sure that there are jobs available for them.

But market approaches to food systems do not have much to recommend them. Agricultural producers have long suffered from a lack of power in the marketplace. Farmers selling their goods at market have difficulty setting prices because they are many and have only a small portion of the market. Consumers (in this case processors and retailers) have a great degree of power, particularly given how few options are available to producers. Agricultural land and livestock are not like other products that are sold on the market. While a market solution presumes that farmers and ranchers should "be allowed to fail" like any other business, letting producers shutter their farms and ranches would not seem to be in the national interest. Furthermore, food production, with it's considerable fixed assets, dependence on outside elements (weather, exchange rates, access to markets, global production values) for profitability, and essential nature is a very different product than those of the manufacturing and service sectors. Another weakness with free market assumptions for agriculture is that, while economic forces are presumed to reward innovation and efficiency, in agriculture, there is little evidence of a lack of either among U.S. producers.

It is possible that this need not be the case. Australia and New Zealand both unilaterally cut subsidies in the 1980s and remain economically viable, although Australia is facing a farm income crunch that is very similar to that in the United States. When government farm support is measured as a percentage of total farm income, Australia scores a low 4 percent (only New Zealand is lower, the United States scores at about 18 percent). Australian farmers do receive support from the government in the form of income support, which is considered an efficient way to transfer funds to producers as it generally does not affect trade or production, although it raises concerns when floated in the United States of providing no spur to poor farmers. Comparatively, however, Australia proportionately spends significantly more money than the United States on rural policy. Both New Zealand and Australia spend substantial sums on both research and extension, and provide environmental payments that offset some subsidy losses. Indeed, 96 percent of Australia's arguably modest agricultural support is in the form of "green payments" for conservation and environmental. Furthermore, the transition came with considerable payments to farmers (similar, it should be noted, to AMTA payments mentioned earlier), indicating that there is a cost to such a shift.

A serious inspection of farm conditions indicates a need to support rural communities in a major way. If 93 percent of farmers rely on off-farm income to essentially subsidize the American food supply, there is a need to make sure that there are jobs available for them. While dependence on off-farm income is not a solution for declining farm profitability, the reality is that off-farm employment is key for those individuals who choose to remain in agriculture even when the market tells them they should get out. Investments in rural infrastructure—including rural water systems, rural governance and rural broadband—represent opportunities to realize real returns in rural areas. Farm program funds in these areas are very WTO-compliant, which should make them appealing to Farm Bill authors. Again, the challenge to expanding farm support into rural programs is that this would most likely limit the funds available for commodity programs. A splintering of support for a Farm Bill along commodity-rural community lines would severely weaken any legislation's chances in Congress.

A different approach?

Are there other ways to support agriculture without distorting markets or encouraging market concentration? One of the biggest changes with respect to the 2007 Farm Bill could be a transition from payments based on production to payments based on practices. An example of this approach is the Conservation Security Program (CSP), which rewards good agricultural practices and provides incentives for improving the stewardship of the land. CSP has not been fully funded (indeed, it was only marginally funded at first after a lengthy delay in establishing rules), but it is popular among farmers across a wide range of crops and geographic areas, although many producers view it as a supplement to, and not replacement of, program payments. CSP and similar programs (such as EQIP, which provides cost-share incentives for conservation improvements) set the stage for maintaining a government role in farm policy while getting the government out of agricultural production decisions.

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The problem this model faces is clear. Even if the amount of direct payments to farmers in a practice-based system remains constant (roughly $22 billion last year), the distribution of this money would be radically different from how it is under a production (and thus commodity-focused) model. While row-crop producers would be able to participate (as they have with both CSP and EQIP), they will have company in any expansion of these programs from livestock and specialty crop producers and forest land owners, which would essentially dilute any given commodity producer's payment in order to spread the available funds over a wider number of recipients.

This poses several problems. The first is that this could have very negative consequences for commodity producers who are dependent on farm payments for staying in business. Also, spreading the available money out over a wider pool could lead to negligible payments for farmers, which would create disincentives for participation. While it is difficult to gauge the extent of this, it is unlikely that creating a (potentially large) group of disaffected farmers is what Congress wants from a new Farm Bill. Also, a shift into practice-based payments would increase the uncertainty, and thus the risk, for the (risk averse) farm credit system, which is very comfortable and familiar with the status quo of price guarantees built into the current system. Finally, given current producer experiences with the USDA record-keeping and reporting requirements for CSP and EQIP, practice-based programs could face real and significant paperwork barriers to participation, particularly for small farmers with diversified operations and little or no office support.

A second, and equally interesting, part of the debate will be how Congress approaches counter-cyclical payments, which provide farmers benefits only when markets are low. They probably are the least WTO-friendly element in the U.S. farm policy toolbox. Because of this, many observers anticipate a slow retreat from these, with pressure from producers of some key commodities, most notably cotton, to maintain them as an acknowledgement that the market is perhaps too mercurial in selected commodities to be reliable for producers. The same transition is possibly in the future for marketing loans and loan deficiency payments—the other principal components of commodity crop support—for much the same reason as countercyclical payments. The problem with all of this is that farm programs are interrelated, and changing one aspect of federal farm support can have dramatic, unanticipated consequences elsewhere in agriculture.

Pressure also is building for a specialty crop title in the 2007 Farm Bill. Specialty crop producers are essentially shut out of most farm programs, with most having access to some of the conservation funding, pilot risk management subsidies and, indirectly, to market promotion and research funds. In 2004, President Bush signed the Specialty Crops Competitiveness Act to promote increased consumption of specialty crops and the competitiveness of specialty crop producers. With a $54 million authorization, the program is modest enough to be rolled into the Farm Bill but possibly is too modest to be particularly effective. It utilizes block grants to states, an innovation that also has been floated for a number of Farm Bill programs, as well as increased attention to research and export promotion activities. With planting restrictions for decoupled payments on program crops very unlikely to withstand a WTO challenge following the Brazil cotton case, specialty crop producers are justifiably concerned that they will face unfair domestic competition from subsidized producers entering their market.

Another idea that was circulated with the 2002 Farm Bill and is a part of one USDA proposal for replacing commodity payments is Farm Savings Accounts. Essentially tax-deferred savings accounts, these allow farmers to save profits in flush years for withdrawal in lean years. Canadian farmers have had access to this option for a number of years, with some success. Of course, Farm Savings Accounts are predicated on the idea that a farmer will have sufficient good years to cover the bad years, which is not always a safe bet for producers. Furthermore, the accounts inevitably will complicate tax filing for producers to some extent. Regardless, it seems possible that the 2007 Farm Bill will authorize some piloting of this concept.

Energy programs have been identified as likely to see increased support in the 2007 Farm Bill as well. The inclusion of an Energy Title in the 2002 Farm Bill has contributed to the development of a burgeoning renewable fuels industry in the United States. While the industry remains somewhat limited in its reach, the potential for the United States to replace a significant portion of its fossil fuel consumption with renewable sources offers benefits to producers, American consumers, rural communities, and the environment that are unlikely to be ignored. There is broad support in Congress and among the general public for public funding for renewable energy research and development, which would seem to indicate an opportunity for expansion within the Farm Bill.

Finally, the Farm Bill will provide Congress with an opportunity to revisit rural development and rural policy. In the 2002 Farm Bill, Congress called upon the Administration to convene a National Rural Summit to review and focus U.S. rural policy. Rural Development is not the sole purview of the USDA or the Farm Bill (indeed, rural policy is highly distributed at the federal level, with no fewer than 88 programs over at least seven agencies having some rural responsibility). The Farm Bill has served as a proxy for rural policy for years, however, with the assumption being made early on that strong farm policy will support rural communities. Today the reverse is as likely to be asserted: strong rural policy will support agricultural communities. The 2007 Farm Bill affords a good opportunity for further investments in rural areas, particularly in the areas of infrastructure (the 2002 Farm Bill made significant grants to rural areas for water and sewer in particular) and access to capital, both of which are understood to be critical to the health and success of rural economies.

The End of the Farm Bill?

The Farm Bill debate is just beginning, with an early proposal from the USDA recently released and proposals from the respective committees still to come. Barring any unforeseen shifts in either the players or the farm sector, the new Farm Bill will very likely be quite different from previous iterations, possibly an even more radical transformation than the 1996 Act represented. As the pressures of trade obligations and the federal budget deficit build, Farm Bill authors will be seeking innovative ways to continue to support agriculture and farm income, while adjusting to farm sector conditions. Given the nature of the early debate, and the calls to end farm subsidies from within and outside the Bush Administration, it is easy to predict an end to the Farm Bill. The Farm Bill is, however, much more than a vehicle for commodity crop and nutrition program support. It serves as the central pillar of America's food and fiber policy, the driving vehicle behind agricultural research, rural policy, and conservation on private land, and a necessary tool for ensuring that America continues to enjoy a safe, abundant and affordable food supply.

[The 2007 Farm Bill in Context]

Summer 2006 Update

The Farm Bill is the periodic national legislation that guides agriculture, rural, and food policy for the United States. Highly complex, the Farm Bill includes authorization for everything from payments to farmers under decades-old commodity programs to school nutrition funding and more.

The Farm Bill has undergone radical changes in the past few cycles, beginning with the 1996 Freedom to Farm Act's proposed elimination of commodity payments, through the 2002 expansion of conservation programs, extension of non-cyclical payments, and creation of an energy title for the Bill, reflecting the growing importance of energy production to the future of agriculture in the United States.

The 2002 Farm Bill is due for reauthorization in 2007. The economic and policy backdrop against which this legislation is being developed could not be more different from the previous iteration. In the years leading up to the 2002 Farm Bill, most forecasters were predicting generous growth for U.S. producers from overseas markets and a steady rise in the national economy leading to budget surpluses and ample amounts of funding for farm and nutrition programs.

As a result, the 2002 Farm Bill was the largest in history, expanding farm conservation programs, continuing many of the commodity payment instruments that were originally intended for elimination after the 1996 Farm Bill expired, and extending the scope of many rural development programs. As Congress gears up to renew this piece of legislation, budgetary, trade, farm sector, political and social pressures all are pointing toward a radically different kind of Farm Bill.

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