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Local and Global Perspectives on the New U.S. Farm Policy

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The reaction of the U.S. farm groups and our trading partners to the new farm bill has been surprisingly frank and sometimes harsh. Many farm groups have given up the argument that farm subsidies are temporary measures needed until good times return. For example, Mississippi Delta cotton farmer Kenneth Hood (who is also chairman of the National Cotton Council) was recently quoted in the *Wall Street Journal* as saying, “The Delta needs cotton farmers, and they cannot exist without subsidies.” Five years ago, no farm organization leader would have used the subsidy word, and never would he or she have admitted publicly such a dependency on public assistance.

The international reaction has been more predictable and harshly negative. Typical comments from world leaders are that the new farm bill is protectionist, that it violates the World Trade Organization (WTO) agreement, and that it is a big setback to the world trading system. Because we are entering a new round of WTO agricultural negotiations, it will be useful to examine each of these charges. Are they true? And if so, what impact might they have on our ability to come to a new WTO agreement?

**IS THE NEW FARM BILL PROTECTIONIST?**

Argentine President Eduardo Duhalde told the daily *La Nación* that “…the United States promotes free trade only when it suits it, then becomes an obscene protectionist.” When a country is labeled as protectionist, it generally means that the country has adopted measures to reduce the quantity of imported goods flowing in. With the exception of sugar, peanuts, and dairy, the new farm bill does not restrict imports, so Congress and the administration can argue that U.S. borders are open to imports of most commodities.

Those who argue that the United States is becoming more protectionist do not necessarily mean that imports are being reduced. Rather, farm bill subsidies work to expand U.S. production and exports, which tends to reduce world prices and reduce


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production in other areas. Thus, the United States is protectionist not because it is restricting imports but rather because it is protecting its producers at the expense of unsubsidized producers in other countries. For example, Brazil argues that its farmers will lose more than $1.25 billion per year in revenue because of expanded U.S. soybean production. World Bank analysts estimate that U.S. cotton subsidies reduce cotton exports from West and Central Africa by $250 million per year. Do these arguments ring true?

Clearly, U.S. production of most subsidized commodities that are exported, such as cotton, rice, corn, soybeans, and wheat, would be lower than current levels without U.S. subsidies. And world prices would be higher. It is exactly these kinds of market-distorting effects that the WTO is working to eliminate. But is the new farm bill any worse than previous farm bills?

Subsidies expand production when a farmer’s decision to expand or contract production results in an increase or decrease in the amount of subsidy received. That is, subsidies are supply expanding when they are coupled to production decisions. The new countercyclical payment program in the farm bill is largely decoupled from production, so it should have only minimal supply-expanding effects. But the increased loan rates in the new farm bill will have noticeable supply-expanding effects. The accompanying table shows the extent to which the new farm bill is more trade distorting than the old farm bill.

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Old Loan Rate</th>
<th>New Loan Rate</th>
<th>Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn (bu)</td>
<td>1.89</td>
<td>1.98</td>
<td>4.8%</td>
</tr>
<tr>
<td>Soybeans (bu)</td>
<td>5.26</td>
<td>5.00</td>
<td>-4.9%</td>
</tr>
<tr>
<td>Wheat (bu)</td>
<td>2.58</td>
<td>2.80</td>
<td>8.5%</td>
</tr>
<tr>
<td>Cotton (lb)</td>
<td>0.5192</td>
<td>0.52</td>
<td>0.2%</td>
</tr>
<tr>
<td>Rice (cwt)</td>
<td>6.5</td>
<td>6.50</td>
<td>0.0%</td>
</tr>
<tr>
<td>Sorghum (bu)</td>
<td>1.69</td>
<td>1.98</td>
<td>17.2%</td>
</tr>
<tr>
<td>Barley (bu)</td>
<td>1.71</td>
<td>1.88</td>
<td>9.9%</td>
</tr>
<tr>
<td>Oats (bu)</td>
<td>1.14</td>
<td>1.35</td>
<td>18.4%</td>
</tr>
<tr>
<td>Minor Oilseeds (lb)</td>
<td>0.093</td>
<td>0.096</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

DOES THE NEW FARM BILL VIOLATE U.S. WTO OBLIGATIONS?

Under the Uruguay Round Agreement on Agriculture, the United States agreed to limit spending on domestic support programs that are considered trade distorting (amber-box spending) to $19.1 billion per year. Significant time was devoted to a discussion of our international obligations during the farm bill debate, which indicates that Congress took these obligations seriously. A significant portion of government payments varies with the level of market price; high prices lead to low payments and low prices lead to high payments. It is impossible to determine ahead of time what the total level of government payments will be in a given year because nobody knows what market prices (and crop yields) will be in the future. But futures markets give us some idea about what prices will be on average, options markets give us

Percentage Change

4.8%          | 4.9%              |
8.5%          | 8.5%              |
0.2%          | 0.2%              |
0.0%          | 0.0%              |
17.2%         | 17.2%             |
9.9%          | 9.9%              |
18.4%         | 18.4%             |
3.2%          | 3.2%              |
some idea about future price uncertainty, and the last 40 years give us some idea about the average level of crop yields and yield variability. Therefore, we can combine the information in the futures and options markets with historical yield data and put together probability statements about the level of the spending.

The graph on page 1 shows the probability distribution of amber-box spending for the next marketing year. The graph shows, for example, that there is about a 40 percent chance that amber-box spending will be $11 billion or less. And there is a 71 percent chance that total U.S. amber-box spending will be below the $19.1 billion limit. This means that there is a 29 percent chance that the United States will exceed its WTO spending limit in the next marketing year. (Congress has instructed the USDA to take steps to reduce payments if this limit is met or exceeded.)

**Does the Farm Bill Represent a Setback to the World Trading System?**

Domestic subsidies to agriculture around the world result in trade flows in agricultural commodities that do not follow free trade principles, whereby countries with comparative advantage are the exporters, and the importers are those countries without comparative advantage. Rather, domestic subsidies often support domestic production, and surplus production is exported. The United States has been at the forefront of the effort to include domestic agricultural support in international trade negotiations. This push led to the Uruguay Agreement where, for the first time, limits were placed on agricultural subsidies. Modifications of U.S. domestic farm policy lent support to this effort. The 1986 farm bill drastically lowered loan rates, starting the trend toward increased decoupling. The 1990 farm bill continued down this path and allowed farmers greater planting flexibility.

The 1996 farm bill adopted fixed payments for the first time, and the United States could rightly claim that its farm policies had small effects on world market prices. The consistency of U.S. farm policy with the U.S. negotiating position allowed U.S. negotiators to take the moral high ground when it came to agricultural subsidies, which put other countries in the position of having to defend their own subsidy stances.

Perhaps more importantly, by taking the visible lead on reforming its own agricultural policy, the United States empowered reformists in the European Union and importing countries, such as South Korea and Japan, to argue for more radical reform of their own domestic policies. Most observers felt that the Uruguay Agreement was simply the first step in reforming trade-distorting policies, an observation that was given credence by passage of the 1996 U.S. farm bill. The next step in trade negotiations was for countries to make even more radical cuts in subsidies. For example, EU officials began to think about policies whereby decoupled payments were made for rural development and environmental quality. Politicians in South Korea and Japan began preparing their farmers for less protection. And African leaders saw that domestic market reforms would pay dividends as international agricultural trade flows became dictated more by comparative advantage rather than by domestic subsidies.

On the surface, not much has changed in the U.S. negotiating posture. U.S. Trade Representative Robert Zoellick says that the U.S. commitment to the Doha agenda remains intact. This means that the U.S. is committed to substantial decreases in import barriers and import tariffs, a phasing out of export subsidies, and substantial reductions in domestic support programs that distort trade.

As previously noted, the new farm bill neither increases nor decreases import barriers, and the U.S. makes minimal use of export subsidies (a favorite tool of the European Union), so not much about those two items has changed. But the increase in some commodity loan rates implies a discrepancy between U.S. policy and the U.S. negotiating position. Will this discrepancy help or hurt future trade talks?

U.S. Department of Agriculture Secretary Ann Veneman and Mr. Zoellick claim that the new farm bill enhances their negotiating position because they can use the subsidies as bargaining chips to get other countries to reduce their subsidies and to increase access to their markets. Whether or not this optimistic view about the subsidies is correct remains to be seen, but clearly, when it comes to agricultural protection, the United States no longer holds the moral high ground. Consequently, its leadership position in the upcoming round of talks seems to be somewhat eroded.

**Future of U.S. Farm Policy**

Does passage of the 2002 farm bill mean that we will have a respite from policy debates? Not if recent events are any indicator. Many senators are trying to come up with another emergency spending bill for agriculture, this time to alleviate financial difficulties caused by drought. Will attempts to provide drought aid to crop farmers succeed when crop losses from drought clearly are covered by crop insurance?

By March 31 of 2003, the United States and other countries must present proposals for the structure of new WTO commitments that are consistent with the Doha agenda. How will U.S. proposals be made consistent with the new U.S. farm programs?

And, finally, it looks as though Congress and the Bush administration eventually will have to figure out how to limit current and future budget deficits. How will supporters of farm programs justify billions in annual aid to large farmers when Congress is looking for budget offsets to fund new priority programs such as a drug benefit for senior citizens? Stay tuned. The future looks bright for those who enjoy good farm policy debates. ☃️