July 2015

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Farm Programs, Fuel Mandates, and Agricultural Prosperity

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The future looks bright for corn, soybean, and wheat farmers. Corn farmers can lock in a price on the Chicago Board of Trade of $4.00 per bushel for their 2008, 2009, and 2010 crops. Soybean farmers can lock in $9.00 per bushel for 2008 and 2009, and wheat farmers can lock in $5.50 for the same two years. After adjusting for basis, this corn price is 65 percent greater than the average price received by corn growers for their 2002 to 2005 crops. The soybean price is up 42 percent and the wheat price is up 51 percent over the 2002 to 2005 levels. If futures contracts traded out even further, there is no doubt that these high prices could be locked in for an even longer period.

Three factors help explain why traders in Chicago believe that crop prices seem poised to remain at such high levels. The dollar is down 15 percent on a trade-weighted basis relative to its level during the 2002 to 2005 crop marketing years. A weaker dollar increases demand for U.S. goods, thereby raising their prices. Continuing strong income growth in China, India, and other Asian countries combined with rapid urbanization has led to strong demand for meat and dairy products, which in turn has resulted in strong demand for feed grains and oilseeds. And finally, U.S. ethanol production from corn has doubled in the last three years and is poised to double again in the next two. This has led to sharply higher demand for corn, higher corn acreage, and relatively smaller soybean and wheat acreage. Wheat prices have also been strengthened by short crops in major producing areas.

The value of the dollar and world income growth are beyond the direct control of U.S. policymakers. But Congress is currently considering what to do with U.S. ethanol policy and U.S. farm policy. The Senate recently passed legislation that would increase the renewable fuels standard from its current level of 7.5 billion gallons (to be achieved by 2012) to 15 billion gallons by 2015. The House seems poised to go along with this increase.

Because 15 billion gallons of biofuels would have a direct effect on U.S. and world agriculture, we might expect the House and Senate to consider how best to modify current farm bill programs so that they work in concert with higher biofuels production. However, there is no evidence that such coordination is happening. For example, the subcommittee of the House Agriculture Committee with responsibility for farm programs voted 18–0 for a continuation of the current set of farm programs, which were developed to counter the effects of low commodity prices. This vote sent a signal to reformers that changes in farm policy will be difficult to obtain.

Why do many House Agriculture Committee members believe that agriculture needs both traditional farm programs and higher biofuels mandates? What are the needs of agriculture in this new era of expanded biofuels production, and can commodity programs be improved to reflect the new era of expanded biofuels production? Insight into these questions can be obtained by first looking at the number-one driver of the farm bill this year: new congressional budget rules.

Pay-Go and Farm Programs
One of the first actions that the House of Representatives took this year was to restore “pay-go” (pay-as-you-go) budget rules. Under these rules, any new legislation that increases spending above projected levels with existing programs must pay for the spending increase through new tax revenue or spending reductions elsewhere in the budget. House Democrats passed this legislation in an attempt to differentiate themselves from their Republican counterparts who oversaw a large expansion in federal expenditures.

The table provides an estimate of program expenditures under existing legislation for a five-year
Projected program expenditures under existing commodity programs

<table>
<thead>
<tr>
<th>Crop</th>
<th>Direct Payments</th>
<th>Marketing Loan plus Countercyclical</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>Corn</td>
<td>2,116</td>
<td>6</td>
</tr>
<tr>
<td>Cotton</td>
<td>633</td>
<td>1,409</td>
</tr>
<tr>
<td>Rice</td>
<td>431</td>
<td>107</td>
</tr>
<tr>
<td>Soybeans</td>
<td>608</td>
<td>288</td>
</tr>
<tr>
<td>Wheat</td>
<td>1,151</td>
<td>6</td>
</tr>
</tbody>
</table>

Farm bill beginning in 2008. These estimates are based on Congressional Budget Office projections of crop prices and acreage. For corn, soybeans, and wheat, high crop prices translate into very low projections of program expenditures for the marketing loan and countercyclical payment programs. For these three crops, projected expenditures from the two programs total about $200 million per year. In contrast, these three crops received a total of about $14 billion from these two programs under the 2002 farm bill. Looking at the table, it is evident that, with the notable exception of cotton, direct payments are projected to deliver much more agricultural support than would the other programs. Over these five years for these five crops, direct payments are projected to total $24.7 billion whereas marketing loan and countercyclical payments are projected to total about $8 billion.

Now consider the problem of writing a new farm bill under pay-go rules. Almost all proposals for changes to commodity programs would involve higher expenditures than are projected for marketing loans and countercyclical payments. Thus, if Congress decides to make changes to commodity programs, it will have to pay for them with decreases in direct payments or find reductions in spending in other parts of the farm bill, such as in the nutrition or conservation titles. However, many farm groups strenuously object to reductions in direct payments, and there is little appetite in Congress to cut conservation and nutrition programs to increase payments to large and wealthy farmers. Thus, we should expect few changes in commodity programs unless the ag committees can find funds in other programs in their jurisdiction. As pointed out in previous issues of Iowa Ag Review, one ready source of funds that some in Congress propose to tap is the crop insurance program. Reductions in the proportion of taxpayer support for the program that flows to companies and agents could contribute to modifications of commodity programs or to additional funds for other program areas.

The pay-go rules thus have reinforced the tyranny of the status quo: after all, by definition, Congress can always extend existing programs under its new budget rules. But a simple extension of current programs may not be possible. There are many groups working to increase funding for farm bill programs that fall outside of the commodity title. Advocates for expanded programs in conservation, research, energy, nutrition, and trade are pushing hard for additional funds for their programs. The only viable agricultural sources of funds for any such expansion is to be found in cuts in direct payments or crop insurance. The big uncertainty with this year’s farm bill is whether advocates for reform or advocates for continuing existing farm supports have the votes to pass a farm bill.
Role of Biofuels in Commodity Programs
Congress seems poised to ask agriculture to supply up to 20 percent of the nation’s transportation fuel supply. The only way that U.S. agriculture will supply adequate feedstocks to meet this objective while continuing to supply abundant food is through continued high commodity prices. Because the only justification for our current set of farm programs is to protect farmers against low prices, biofuels policy seems to eliminate the need for farm programs.

One reason why this topic has not been ripe for discussion is that it is quite difficult to defend any payments at all when farmers have such a golden opportunity to lock in very profitable price levels. A reasonable person could conclude that the farm bill should focus on areas other than support of commodities because the price and profit problems for programs are solved through biofuels policy. For example, high crop prices will pull a significant number of acres out of the Conservation Reserve Program unless USDA dramatically increases per-acre payments. These high crop prices may also induce farmers to apply more fertilizer and, in general, farm their land more intensely. A reasonable argument can be made for increasing funding for environmental programs that keep the most environmentally sensitive land out of production and that reduce the environmental impacts of farmed land rather than to continue payments to profitable farmers. High crop prices brought about by biofuels policy will also have a modest impact on food prices. Again, it is reasonable to conclude that reducing the burden of higher food prices on low-income families by increasing funding for nutrition programs makes more sense than maintaining payments to program crop farmers who already receive the benefits of energy policy.

Because the only justification for our current set of farm programs is to protect farmers against low prices, biofuels policy seems to eliminate the need for farm programs.

One practical argument about why Congress might keep the marketing loan and countercyclical programs is that their elimination would not generate substantial funds that could be used to increase funding for other priority programs. Why give up tried and true programs that would protect farmers against low prices (who really knows what the future holds?) when there are no real funding benefits that could be obtained for other programs? Of course, the same political calculation does not hold for direct payments. Their elimination would generate substantial funds for other priority programs.

High prices, though, mean little to farmers if they do not have a crop to sell. And yield variability remains a big problem for almost all U.S. farmers. If Congress wants to solve a continuing need in agriculture with commodity programs, then it should reorient farm programs to offer protection to farmers against low yields. One step in this direction is the push for permanent disaster legislation, which could easily be paid for through a reduction in direct payments or through savings in the crop insurance program. A more ambitious approach would be to pay for a new risk management program by transferring the systemic risk from the crop insurance program (systemic risk affects many farmers in a region in the same year) into the farm bill, leaving the nonsystemic risk for the crop insurance industry. This type of program would automatically protect the nation’s farmers from the effects of low yields, and its costs could be paid for using savings from crop insurance and a reduction in direct payments.

Which Path for Farm Policy?
Biofuels policy seems poised to keep program crop farmers prosperous for the foreseeable future. Given these circumstances, Congress and farm groups could focus their farm bill writing efforts on problems not previously addressed by farm bills (low yields) or on problems caused by high crop prices (possible environmental degradation and higher food prices). However, most efforts seem focused on either maintaining status quo programs or increasing commodity payments to farmers despite the promise of farm prosperity from high crop prices. Perhaps we should not expect anything else in our representative form of government. After all, if groups do not pursue their own self-interest, who will pursue it for them?

Given tight public funds and knowledge that passage of a status quo farm bill will do little to address the future needs of farmers, consumers, and the environment, momentum could build for a reform bill. However, legislative inertia is a powerful weapon in the hands of those who benefit from the status quo. Given the short period of time that Congress has to work on farm legislation and the natural desire to do no harm through unintended effects caused by adoption of new programs, it is likely that much of what we currently have in the farm bill will be with us in the new farm bill.