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Creation of a WTO-Friendly Farm Safety Net

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Creation of a WTO-Friendly Farm Safety Net

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Bumper crops have quickly turned the corn and soybean price boom into a bust. New-crop corn and soybean futures contracts are down 40 percent and 35 percent respectively in just a few short months. Of course, those farmers that had the foresight to lock in at high prices are completely unaffected by the drop in price. For them, market volatility has created profit opportunities. But all is not lost for the majority of farmers who did not lock in at those prices. The farm safety net created by the 2002 Farm Security and Rural Investment Act will cushion the financial shock of lower prices.

It looks certain that Corn Belt farmers will receive substantial payments from all three sources of federal farm support in this coming crop year. Iowa farmers will definitely receive more than $512 million in direct payments because these payments arrive regardless of what happens to price or yield. In fact, direct payments arrive even if a farmer’s land remains idle. As indicated by mid-October price levels, Iowa farmers could also receive almost $700 million in countercyclical payments and about $900 million in loan deficiency payments. Nationally, corn and soybean farmers should expect to receive more than $11 billion in total payments, including $2.7 billion in direct payments, $3.8 billion in countercyclical payments, and about $4.6 billion in loan deficiency payments. There is a good chance that corn and soybean farmers will actually be made “more than whole” this year. At current prices, corn and soybean revenue from the market and the government is projected to be about $8.8 billion for Iowa farmers. In 2003, total revenue was about $7.5 billion.

Insulating farmers from market price fluctuations is at the core of complaints by some of our trade competitors. The basis for Brazil’s successful case through the World Trade Organization (WTO) against U.S. cotton subsidies was that U.S. cotton production is artificially propped up when prices are low because U.S. cotton farmers have no incentive to cut production even when they cannot cover their variable costs of production.

Most farm groups want to obtain a new WTO agreement in agriculture because much of U.S. agriculture stands to gain significantly from expanded export markets. But U.S. farm programs continue to be a roadblock to reaching an agreement. Is it possible to adjust the programs to make them more acceptable to the WTO while meeting congressional desires for a strong safety net? A close examination of what Congress wants in a farm bill and how current income support mechanisms work will demonstrate that the answer could be yes if Congress continues to be willing to base payments on historical rather than current acres and yields. If Congress were to make needed adjustments, then U.S. negotiators could once again take the lead as legitimate advocates of freer trade.

**PURPOSE OF U.S. FARM PROGRAMS**

Most people not on the receiving end of farm program payments would question the broad public purpose being served by them. But Congress keeps passing farm bills, so the legislation must be designed to meet some objective. If we assume that Congress was fully aware of the intended effects of their policy choices, then we can look at what farm programs actually do to discern why we have them.

The primary effect of farm programs working in tandem with crop insurance is to increase average incomes and to greatly reduce the financial risk of the shrinking subset of U.S. farmers who grow subsidized commodities and who own the land they farm. That is, Congress has created a web of programs that together enhance and protect farm sector income. Thus, determining whether farm programs can be modified to enhance the U.S. negotiating position at the WTO while continuing to meet the needs of Congress requires an understanding of each of the three primary components of the farm safety net.

**THREE KINDS OF PAYMENTS: DIRECT, COUNTERCYCLICAL, AND LOAN DEFICIENCY**

Direct payments evolved from AMTA (Agricultural Marketing Transition Act) payments in the previous (1996) farm bill. AMTA payments were supposed to assist farmers as they made a transition from reliance on subsi-
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be the case with one exception: those regions of the United States that truly should not be producing crops would no longer have any government incentive to remain in production.

**Effects of Replacing Loan Deficiency Payments with Countercyclical Payments**

Congress could replace the marketing loan program with an expanded countercyclical payment program by simply calculating the countercyclical payment rate as the difference between the effective target price and the season-average market price.

For farmers who grow about the same acreage of crops as was used to determine base acreage, such a change would have minimal effects on their farm finances. In major production regions, replacing loan deficiency payments with countercyclical payments would have little or no impact on planting decisions because the crops grown in these regions are most economical to grow even without government support. Furthermore, in these production regions, the variable costs of production per unit are well below loan rates, so elimination of the minimum guaranteed price would have little effect on production. If the effects are so small, why would anybody oppose replacing the marketing loan program with an expanded countercyclical payment program?

In major crop production regions, it is generally the case that low prices correspond to high yields. Thus, countercyclical payments—which are based on a fixed number of bushels—would likely pay out less on average than would loan deficiency payments. In addition, many farmers currently take loan deficiency payments when market prices are at their lowest, near harvest time. Thus, some upward adjustment in countercyclical payment rates would have to occur if total payment levels were to be held constant.

A seemingly larger concern is the impact on the safety net for those farmers who would respond to the change in policy by choosing to plant different crops. This would create a mismatch between payments and the price received for the crop that is actually grown. Thus, a farmer could be facing quite low prices with no countercyclical payment. Or, conversely, a payment could arrive but the farmer might, in fact, be enjoying a high-price year.

But the fact that farmers might choose to switch crops because of the change in policy indicates a positive impact on the safety net. That is, such farmers could expect to receive the same level of government payments, and the new crop should give them higher market returns: otherwise they would not have made the switch. Regarding the mismatch, Congress has already shown its willingness to live with a mismatch between payments and farm income levels. There is no connection at all between farm financial situations and direct payments. Most Iowa crop farmers have had two good years, but direct payments keep coming. And this year, cash receipts will be quite high because of high yields, but Iowa farmers will likely received large countercyclical payments. So a lack of coordination between farm finances and receipt of a countercyclical payment should not cause Congress too much trouble.

A potentially greater political hurdle to overcome would be if many farmers in a region decided simply to leave land idle and pocket the direct payment and the countercyclical payment. Landowners might decide to quit farming if there is no crop that could cover production costs, and this could occur for high-cost crops in high-cost regions. For example, some cotton land in parts of West Texas would likely go idle if cotton farmers were not guaranteed a price by the federal government. Low-yielding wheat areas in western North Dakota are another region where crop production might fall significantly. Members of Congress who represent these regions are the ones who would be most vocal in their opposition to replacement of loan deficiency payments with countercyclical payments.

Of course, such a transition is exactly what our trade negotiators want to see happen when they argue for a lowering of subsidies in the European Union and a lowering of tariffs and other trade barriers around the world. The U.S. negotiating position over the last 30 years could be summarized as follows: “Production that takes place only because of subsidies should be production that does not take place.” It only weakens our negotiating position when we make this argument to everybody but ourselves.

**A Realistic Policy Option?**

Farmers, farm leaders, and politicians all seem reasonably satisfied with current farm programs. This satisfaction suggests that basing a large portion of farm income support on past acreage and yields rather than on current production levels is generally acceptable. Farm groups would likely find the path to an export-expanding new WTO agreement significantly less bumpy if they would push the U.S. negotiating team to offer to complete the decoupling of U.S. farm program payments by replacing our marketing loan program with an expanded countercyclical payment program. Such a move would not significantly alter the financial conditions of U.S. farms and it would increase the credibility of U.S. negotiators when they argue that markets, not government, should determine what and how much farmers produce. ✦