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Agricultural Policy Update: Are FAIR's Payment Formulas Fair?

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Once again, Congress will provide U.S. farmers with emergency aid. On June 21, 2000, President Clinton signed a bill that authorizes $7.1 billion in farm assistance, most of which will be distributed according to existing payment formulas. The label emergency allows Congress to bypass its self-imposed budget restrictions on extra farm aid. In the Corn Belt this year’s emergency will be a big crop and low prices—and not, as previously feared, a small crop and high prices.

The Administration and most members of Congress are clearly not satisfied with either the current method of distributing payments to farmers or with the lack of consensus about what role government should be playing in agriculture. Secretary of Agriculture Dan Glickman’s statement at the signing of the assistance bill reveals the Administration’s thoughts: “For three years in a row now, U.S. taxpayers have provided billions of dollars in emergency farm assistance… the way Congress has decided to pay out this emergency money is seriously flawed. We should not make payments to farmers who have not planted a crop and who don’t need the help. Instead,… we should target assistance to family farmers who really are struggling. And assistance should be counter cyclical, with payments increasing as incomes decline, and vice versa.”

The reason Congress has chosen to continue following the payment formulas outlined in the 1996 FAIR (Federal Agricultural Improvement and Reform) Act is that there is still no consensus about how payments should be distributed or even why the payments should be made. To try to find a consensus, the House Agriculture Committee held a series of field hearings across the nation last spring. Representative Larry Combest, chairman of the committee, summed up the results succinctly, “The value of these discussions with producers is that in the absence of giving us a consensus for any specific policy change, they have signaled their confidence in the Ag Committee members’ efforts to work for a consensus.”

That they could not find a consensus during the hearings is not surprising given the diverse set of issues facing agriculture today. And working toward a consensus will be made even more difficult when the interests of all nonfarm groups are considered. The prospects for achieving consensus are so dim—at least in the short run—that Congress is left distributing farmer assistance through the FAIR Act payment formulas, which are unacceptable to many.

**Principles of the 1996 FAIR Act**

The bedrock principle of the 1996 FAIR Act is that farmers should look to the marketplace for signals about what and how much to grow, with the government providing transitional help through fixed payments. If the market signals, via high prices, that not enough of a crop is available, then farmers should respond by increasing production of that crop by either reducing the production of other crops or by bringing idle land into production. Similarly, low prices would signal that too much was being produced, and farmers would respond by decreasing production. Livestock producers and most other farmers in the United States use market prices as signals about what to produce; and Congress, in 1996, thought that this principle should be extended to producers of the government program crops.

But, in fact, this principle never really was implemented. Under the FAIR Act, farmers have little incentive to cut production of program crops when market prices are low—because the loan deficiency payment (LDP) program puts a floor under the price.”

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both by LDPs and emergency assistance (which seems to kick in whenever LDPs do). Thus, while the market is signaling them to cut production of program crops, the government is signaling farmers to continue producing. It is no wonder that the policy is in shambles.

**IMPACT OF NEW PAYMENT FORMULAS**
The difficulty with devising new payment formulas is that, inevitably, some farmers and some regions will be hurt by a revision, and some will be helped. To illustrate this point, CARD constructed a benefit index to show how each state’s farmers would fare under a recalibration of payment formulas to reflect current crop yields and acreage. Per-bushel payment rates were held constant in the index.

Figure 1 shows the impact if only acreage planted to corn, wheat, cotton, rice, barley, oats, and sorghum in 1999 is eligible for recalibrated payments and if only the fixed transition payments are updated. The index shown is the state’s share of recalibrated program benefits divided by the state’s share of program benefits actually received in 1999. Thus, an index value of less than one means that the state would be relatively worse off under a recalibration than under existing payment formulas.

As shown, Iowa farmers would fare relatively poorly under recalibrated payments, with the other major Corn Belt states of Illinois, Indiana, Minnesota, and Nebraska not far behind. Iowa’s share of program payments would decline by one third. This decline results from Iowa and the other Corn Belt states having moved substantial acreage out of corn and into soybeans. Thus, they would be harmed by a payment formula that was recalibrated and paid only on corn acreage. Figure 1 shows that the Great Plains states, the Pacific Northwest, and the Middle Atlantic states would receive a greater share of program benefits if the payment formulas were revised.

The implication of these results is that Corn Belt farmers would be interested in adding soybeans as a
new program crop. Precedents for the inclusion of soybeans are the large LDPs that have gone to soybean farmers in the past two years. Figure 2 shows the benefit index if LDP payments to program crops and soybeans are also included in the index. The general conclusions remain the same, although the differences between the winners and the losers are smaller. The dark blue states' share of program benefits would drop by more than 10 percent from a recalibration, and the dark grey states would gain by more than 10 percent. Figure 2 shows that Iowa and Illinois are two large farm states that stand to lose from such a recalibration, but their losses would be much smaller than if soybean marketing loan payments were not included in the recalibration.

**WHERE IS FARM POLICY HEADED?**
The emergency aid package and the new crop insurance legislation confirm that the long-term trend towards federal disengagement from management of farmers' decisions has reversed itself. With these actions, Congress has shown its willingness to transfer money to farmers directly via emergency aid and indirectly with expanded crop insurance premiums. And, in what many see as a sign of things to come, many farmers in 2001 will receive more aid through the crop insurance program than through price supports, conservation payments, or direct aid.

**SUPPORT FOR COUNTER CYCLICAL PAYMENTS**
As indicated by Secretary Glickman, there is growing support for counter cyclical payments, which are distributed only when income is low. The current set of revenue insurance products based both on area-wide revenue as well as individual farm revenue meet this criterion. And the federal government is encouraging their purchase by paying 50 to 75 percent of the premium that would be charged for the product by the private sector.

One might think that a new president and Congress in 2001 might mean a new direction for farm policy. However, neither of the presidential candidates has, to date, offered new initiatives for farm policy; and, if recent trends continue, more than 90 percent of the members of the new Congress will have come from the old Congress. So there is no reason to think that we will have much more in the way of new farm programs than a reformulation of current payment schemes.