Congress just can't say "no" to farmers

Agriculture Relief Legislation in 1998: The Bell Tolls for Reform

By Bruce L. Gardner

After debate extending over two sessions of Congress, the Federal Agricultural Improvement and Reform (fair) Act of 1996 introduced a fundamental reform of the main commodity price support programs. Proponents of the reform hoped it would provide a transition away from 60 years of U.S. federal regulation of farm commodity markets. Since the time of the New Deal, the government has taken steps to guarantee that farm prices received do not fall below a politically determined level that in most years has been above, and in some years far above, the free-market level.

Since 1973 the principal legislated price for grains and cotton had been the "target" price, fixed by Congress periodically. The guarantee to farmers was achieved by paying them a "deficiency payment" equal to the difference between the target price and the nationwide market price. Payment was made for a quantity administratively assigned to each farmer (and not affected by the quantity the farmer actually harvested). The nationwide price was not adjusted for the circumstances of any individual or area. Thus the growers of wheat in North Dakota, who received an average price of $5.05 per bushel in 1995, got the same payment per bushel as Illinois growers, whose price averaged $3.89. Deficiency payments totaled $30 billion, or $6 billion per year, from 1991 to 1995.

The deficiency payment program had been criticized by other grain-growing countries as a subsidy that was generating surplus production in the United States that then depressed world commodity prices, an effect exacerbated by U.S. agricultural export promotion programs (which cost $7.7 billion from 1991 to 1995). European governments paid even larger export subsidies to defend the even higher prices they guaranteed their producers, further depressing world prices and increasing the costs of the U.S. programs.

The budgetary costs of both price-support and export programs led to continuing pressure in Congress to regulate farm output in order to reduce U.S. production and thereby increase market prices and reduce deficiency payments. In 1990, 58 million acres—about a third of the grain and cotton acreage harvested—was idled under farm programs. Limited reforms of the 1990 Farm Act reduced idled cropland to 33 million acres by the end of 1996, most of it in the Conservation Reserve Program. In that program, farmers can enroll land that is considered highly erodible, but is also productive, in 10-year agreements under which crops are not grown. The

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farmer receives a rental payment each year in addition to any payments that are received from other programs. Those rental payments have averaged about $50 per acre, totaling $1.7 billion annually during the 1990s.

Idled acreage was the main element of the deadweight loss of several billion dollars annually that commodity support programs were costing the United States as a whole. Deadweight loss is the economic cost imposed upon our economy for which there is no gain to anyone. Acreage idling leaves a valuable resource unused and thus has deadweight losses much greater than, for example, those of the peanut program, which reduces output as a monopolist would do. Reduced peanut acreage goes into some other crop and thus provides some valuable output, even if less valuable at the margin than peanuts. Such alternative crop uses are not permitted in most of the grain and cotton set-aside programs, and the idled land generates negligible output. There are also deadweight losses for the United States from export programs that provide U.S. commodities at lower prices abroad while making commodities scarcer for U.S. consumers.

The 1996 Reforms

the fair act reforms of 1996 replaced deficiency payments with a fixed seven-year schedule of payments of $43 billion, starting with $5.7 billion for crops harvested in 1996 (just about the average annual level of 1991-95) and then declining gradually to $4.0 billion in 2002. Each farmer was assigned a share of the national total based on the level of payments to which that farmer had been entitled under the deficiency payment program. Fixed in dollar amount, these payments remove the pressure for supply management to reduce the budget costs of deficiency payments and therefore reduce the deadweight losses associated with holding productive land idle. (And in case the administration was tempted to impose acreage set-asides anyway, the fair Act removed the authority of the secretary of agriculture to impose them.) More important for the long term, the fair Act's payments were seen as a transitional measure leading to a permanent reduction or even elimination of commodity support programs after 2002.

Economists have generally supported the reforms because of the expected efficiency gains from reduced deadweight losses and the prospect for an end to the 60-year history of regulatory intervention in commodity markets after 2002. Budget-cutters saw few immediate gains but hoped for a longer-run reduction of federal spending. Farmers were initially mostly opposed. The Agriculture committees of both the House and Senate, and with majorities of Democrats and Republicans, resisted the reforms throughout many months of discussion and debate in 1995 and 1996.

Congress came to accept the measure only through a happenstance of market conditions. The initial budget scoring of a continuation of deficiency payments was done in early 1995 when commodity prices were relatively low, and continuation of the existing program was projected by the Congressional Budget Office (cbo) to cost $56 billion from 1996 to 2002. The budget resolution called for a cut of $13.4 billion over seven years, requiring a substantial reduction either in target prices or in the quantities for which payments would be made. In the 1990 Farm Act, required budgetary savings were achieved by eliminating payments on 15 percent of each farmer's acreage base. It was estimated that the 1996-2002 savings requirements could be achieved by a further 20 percent to 30 percent reduction in the acreage base. But by the fall of 1995 a sea change had occurred in world markets. Prices had risen substantially and it was considered likely (and futures prices confirmed the market's belief) that wheat and corn prices, at least for 1996 and 1997, would be high enough that deficiency payments would be small or even zero.

This rise in price expectations placed the fixed payments under the Agricultural Market Transition Act (amta, as the reform section of the fair Act came to be titled) in an entirely new light. Instead of exchanging an expected $56 billion of deficiency payments from 1996 to 2002 for $43 billion in amta payments, under the higher-price scenario it appeared that farmers would have to give up only $40 billion to $45 billion and would give up virtually nothing in 1996 and 1997, the first two years of the new program. By early 1996 the amta payment program that originally got credit for $13.5 billion in budgetary savings was now expected to spend *more* than the old program! It was nonetheless a difficult sell to get some farm groups on board. amta looked too good to be true. But after a persistent representation of the benefits of "capturing the baseline" by Representative (now Senator) Pat Roberts (R-Kansas), then chairman of the House Agriculture Committee, the reform regime became law in April 1996.

Retreat From the 1996 Reforms

commodity prices indeed remained high enough for the 1996 and 1997 crops that deficiency payments would have been quite small if the old program had been continued, so farmers duly pocketed about $11 billion more in amta payments than they would have received in deficiency payments. In 1998, however, commodity markets weakened, as the cbo had projected. In late summer corn and wheat prices fell even lower than had been forecast. At the same time, areas of the Southeast and Texas suffered from drought and wheat scab took a heavy toll in North Dakota for the third year in a row. There were calls for congressional hearings on what to do about this "economic emergency." By the time hearings were held, in late July, farm demands for action had built up to a high level. The Clinton administration, citing the removal of the "safety net" afforded by deficiency payments, had never been happy with amta and joined the chorus calling for congressional assistance. The Agriculture committees were pleased to oblige and the

congressional leadership went along by declaring farm assistance an emergency measure so that new spending could be undertaken without requiring the balancing reductions in other spending that the budget rules ostensibly require.

Notwithstanding the claims about the loss of farmers' safety net, the pre-1996 "marketing loan" program was maintained in the fair Act. That program makes farmers eligible for payments whenever market prices in their county fall below a "loan rate" price. That price is substantially lower than the target price and, unlike the target price, is adjusted for local market conditions. The marketing loan program has advantages for producers that are not available in the deficiency payment program. The farmer can obtain a payment for the whole quantity produced and has the opportunity to select the day in the season on which he believes the market price is lowest (typically in the harvest period), then collect a "loan deficiency" payment based on that day's price and hold the grain for sale at a higher market price later in the year. Since last July these payments have amounted to more than $2 billion. That is less than deficiency payments would have been, but combined with $5.5 billion in amta payments it still provides a sizable economic cushion for farmers at taxpayers' expense.

Nonetheless, in September 1998, Congress approved its Agricultural Relief Package. It has three main parts: disaster relief, market-loss assistance, and tax provisions. The disaster relief package consists of $2.6 billion made available to the secretary of agriculture to assist farmers who had suffered crop losses, including $875 million for special assistance to farmers who had crop losses in previous years when Congress had failed to provide relief and $200 million for assistance to livestock producers who lost crops and thus had to buy extra feed. There is also a special $200 million program of assistance to dairy farmers, despite the fact that dairy farmers did not share in the economic emergency and indeed were receiving record-high prices together with lower feed prices in the fall of 1998.

The market-loss assistance package is simpler. Congressional Democrats claimed that events had proved the fair Act a failure and that a restoration of market price-support regulation was needed. Republicans insisted upon maintaining the transition payment structure, and they prevailed. Consequently, the relief package delivers a one-time bonus payment of $3 billion, distributed as a supplement of about 50 percent of every farmer's amta contract payment.

The tax provisions provide full health insurance deductibility to farmers (phased in by 2003), income averaging, and a "loss carry back"provision according to which farmers can get a refund on taxes they had previously paid by deducting current losses from income earned up to five years earlier.

The overall cost of the relief package is $6.6 billion, of which $5.6 billion is to be paid in fiscal 1999. Together with ongoing amta payments, loan deficiency payments, and Conservation Reserve Program payments, government payments to farmers will total $14.5 billion this year, the largest sum of annual payments ever made under commodity programs.

That figure is a usda estimate as of October 1998. By the end of the year further troubles had come to the fore, most notably very low hog prices. Farm programs since World War II have not covered hogs, but in December 1998, Secretary of Agriculture Glickman announced several steps to boost pork prices and to assist hog farmers in other ways. The main steps are special usda purchases of $95 million of pork products, placing 50,000 metric tons of pork in a food aid package for Russia. Now, in Spring 1999, milk prices have fallen abruptly from their high levels of last year. Congress will be considering further assistance to farmers in 1999 and it would be foolish to bet against it.

Implications for Reform

the key question left unanswered in the fair act in 1996 was what policies will follow its expiration in 2002. Proponents of reform pushed for, and early versions of the legislation contained, a provision that would end all the traditional commodity programs at that time. But opponents of reform prevailed in their insistence that after 2002, if Congress enacts no further farm legislation, policy will revert to price-support measures of the late 1940s that establish price-support levels much higher than the target prices that expired in 1995. This strategic maneuver increased the likelihood that Congress will enact a payment or subsidy program of some kind in 2002. But one might still have expected the subsidy level after 2002 to be nearer the $4 billion level of payments with which the fair Act ends than the $6 billion level of 1991-95. And there remained an expectation that payments until 2002 would be limited to the pre-committed fair Act payment schedule.

The actions of Congress and the Clinton administration since July 1998 have dashed these expectations. They signal an increased likelihood that not only will farm commodity programs continue in 2002 but also their magnitude will not be significantly cut.

Moreover, it is now evident that earlier reforms of crop disaster assistance programs have not worked out as reformers had hoped. Flood-related and other crop losses resulted in $2.5 billion of usda budget outlays on disaster assistance for farmers in 1994. Following that episode Congress made a renewed effort, repeating attempts made periodically since 1980, to get farmers to buy subsidized but less costly crop insurance rather than to rely on ad hoc crop disaster assistance. The events of 1998 reveal that the effort has failed and again we are spending $2.5 billion in disaster assistance (in addition to several hundred million dollars in annual subsidies for crop insurance purchased by the farmers who bought it).

An issue in the 1998 Disaster Relief debate was how to treat farmers who bought crop insurance. The legislation authorizes the secretary of agriculture to "provide incentives to those who purchased crop insurance in 1998." This means presumably that producers will get disaster payments in addition to their crop insurance indemnity payments. There are precedents for that approach, which makes crop failure an economic bonanza for some producers. But many administrative decisions remain to be made in usda, which has been handed far more than enough money to spend than is needed to cover conceivably plausible crop-loss claims.

One element of reform seems to persist, namely the evolution of commodity programs toward forms that have less deadweight loss per dollar transferred to farmers. The reduced role of acreage idling, the most wasteful aspect of past programs, is an example. Under the deficiency payment programs we could have expected 20 million to 30 million more acres to be held out of production, at no benefit to anyone, in 1999. Another efficiency gain is the continued minimization of governmental purchase and storage of commodities, on which billions were spent to the benefit of no one but grain handlers in the 1950s and 1960s, and which reached heights that stimulated lasting policy changes in the mid-1980s. A less-discussed element of deadweight loss is the roughly $600 million spent annually in Washington, D.C., and by county offices around the country to administer the commodity programs. The staffs have to do substantially less monitoring when administering amta payments than they did when establishing and enforcing annual acreage idling requirements for seven different crops on over a million farms.

Although the 1998 events seem to offer very little positive news to those who favor reform, those who wanted to raise market price-support levels and essentially declare the fair Act dead did not prevail against (primarily) Republicans, who wanted to maintain the spirit of the amta payments by simply giving a one-time supplement to them. Maintaining the transition-payment structure may be only thin gruel to offer the forces of reform, but it is better than the alternative of explicitly restoring regulated market prices.

Future reform efforts, to be debated this year and probably every year until amta expires in 2002, are likely to address combining crop insurance and income protection against low prices in some form of revenue insurance or other all-risk management tool. The private sector indeed has developed several such tools. Put options that can guarantee their purchaser a selling price for a crop and crop yield options have both already been traded on futures exchanges, with substantial success for the price options (but not because they have been bought by farmers). Experiments are in progress with revenue insurance and, in Canada, even a net income insurance program.

The difficulty with all private-sector approaches is that farmers have to pay for these services. Many of them would prefer to receive even an inferior risk-management tool provided free of charge (or with a subsidy equal to the billions they now receive). Although many proposals and pilot programs have been tried since 1980, all have run afoul of this problem. It is a political problem, in the sense that farm commodity interests seem to have effectively acquired a proprietary right in about $10 billion of each year's federal budget (including commodity payments, subsidies on crop insurance and disaster payments, and Conservation Reserve Program rental payments). This redistribution to farmers, or more precisely owners of farm property who have grown the supported commodities, will not be given up in the absence of a reduction in agriculture's political power. That did not occur in 1996, as reconfirmed in 1998.

Indeed, agriculture gets as much in real terms from commodity programs now as in the New Deal of the 1930s or the New Frontier of the 1960s. In the 1930s farm people were 25 percent of the population and relatively poor, with the average farm income about half the U.S. average level. Today farm people are 2 percent of the population and relatively well off. According to usda's estimates, the average farm household in 1997 had an income of $52,350 compared with $49,700 for the average U.S. household.

Conclusion

how do agricultural commodity groups maintain their political influence? Many have attempted to answer this question, but a full explanation remains elusive. It seems clear that commodities with relatively few producers, such as sugar (where no significant reforms came close to enactment even in 1996), do as well politically as commodities with hundreds of thousands of producers, such as the grains. And, many commodities (e.g., vegetables, beef cattle, and chickens) get essentially no support. Events of 1998 suggest that a major reason for the political success of agriculture is the lack of interest-group opposition to the measures taken. Farmers have lost politically in several arenas when they have gone up against others who make their views forcefully known, such as environmental groups or the commodity futures industry. But consumers and taxpayers generally have not been coherent in opposition to farm commodity programs. Indeed, polls suggest that the general public support governmental assistance to farmers. In this context it is appropriate to answer the question of how long we will have commodity programs by saying: as long as we continue to want them.

Readings

- D. Hosansky. "Details of the 1996 Farm Bill." *Congressional Quarterly* (May 4, 1996).
- E. Young and D. A. Shields. "Provisions of the 1996 Farm Bill." *Agricultural Outlook* (April 1996, Supplement).