[The 2007 Farm Bill in Context]

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Context

The 2007 Farm Bill represents the latest effort in a long line of reauthorizations of farm legislation dating back to the Great Depression. First passed in 1933, what has come to be known as the Farm Bill has remained relatively focused for several decades on price supports and production control, with further emphasis on soil conservation and research. Just as the agricultural economy changed rapidly in the 1980s and 1990s, farm legislation has changed considerably as well. At its core, however, Farm Bill legislation has reflected the central mission of U.S. agriculture policy: that American farmers can be profitable. The profitability of American agriculture, and the place agriculture plays in our society and culture, remains significant touchstones for the current debate on federal farm policy.

Some of the most dramatic changes have occurred in the most recent reauthorizations, including the end of production controls and direct price supports and shifts toward payments not tied to production or price. In part, these shifts have been mandated by a desire to better align U.S. farm policy with more liberalized trade policy. As a leading actor in the Global Agreement on Tariffs and Trade, and later in the World Trade Organization (WTO), the United States has long promoted more open trade across sectors. A component of this leadership has meant a gradual departure from domestic farm programs which distort trade, primarily those which encourage overproduction or allow for production below cost. Other items witnessing expanded support in recent Farm Bills include conservation, rural development, trade, and research, among others, reflecting the growing complexity of the farm sector.

Freedom to Farm, as the 1996 Farm Bill is known, represented a revolutionary change in U.S. farm support. With it, support began to shift away from traditional price support and production control and toward less trade-distorting support. Freedom to Farm also was intended as a transition for American agricultural producers from a protected market to a market completely free from government intervention. Farmers were to receive fixed payments in exchange for foregoing program crop support—known as AMTA payments after the Agriculture Market Transition Act, which was the first title of the 1996 Farm Bill. AMTA payments were to decline each year to wean farmers slowly from government payments as they adjusted to market signals. While in the years following the passage of the act, price declines and weather volatility forced a retreat from the commitment to this goal. It remains a matter of discussion whether agriculture can operate efficiently in a completely free market.

Price pressure in agriculture is largely driven by supply issues with oversupply forcing prices down and scarcity resulting in higher prices. Unlike producers in other sectors of the economy, however, farmers are unable to alter production quickly in response to market signals. Indeed, in the short run, when prices are low, farmers may attempt to increase production in order to reap a larger return at harvest, even though collective action along these lines would result in further oversupply and lower prices. While in the long run farmers shift production out of poorly performing crops after several seasons of poor returns, any shift in crop will not inevitably affect the overall production picture, since farmers will, in general, produce to the fullest extent possible on the greatest possible portion of their land holdings. Also, unlike many other sectors of the economy, consumption is relatively inelastic. Low prices do not necessarily cause increases in consumption, just as high prices do not reduce food purchases. Because people need food, and because most families do not have the capacity to purchase food stores in bulk, food prices do not strongly affect food purchasing patterns.

The current farm bill reauthorization takes place in an environment more heated than any in recent times. Trade and budget concerns combined with growing domestic fiscal policy demands will make the 2007 Farm Bill a very difficult piece of legislation to craft. Public and political engagement in agriculture has declined as the number of Americans living

on farms has steadily dropped over the past several decades. This translates into a considerably weaker political position for agriculture as farm policy competes at the table with numerous other sectors of the economy. To make sense of some of the complexities associated with the crafting of the 2007 Farm Bill, this document will explore a few of the major forces shaping the Farm Bill debate.

Budget

When the 2002 Farm Bill was drafted, the U.S. economy had experienced an extended period of tremendous growth which moved the federal budget from deficit to surplus. Under these circumstances, the legislation was in many ways the most generous Farm Bill ever, extending a number of programs and creating new ones. The Farm Bill only authorizes funding, however, and appropriations for discretionary programs have seldom met the authorized limit as the economy slowed and funds were not available from the federal coffers.

In the years following the passage of the 2002 Farm Bill, the U.S. economy experienced sluggishness and a slow and uncertain recovery. This, combined with government obligations to cover rising Medicare and Medicaid costs, pay for wars in Afghanistan and Iraq, and to pay for tax cuts, has reversed the fortunes of the federal budget, with the United States budget deficit now exceeding $400 billion. In light of this, it is clear that there will be considerably less money for farm programs in the upcoming Farm Bill. Looking forward from 2007, most, if not all, growth in federal spending in the short run will be committed to healthcare, Social Security, defense, and interest payments on the national debt. Savings to reduce the deficit likely will be sought from domestic programs, including agriculture. While agriculture programs account for less than 2 percent of the federal budget, the growth in mandatory spending for entitlement programs, defense and debt service will put considerable pressure on the rest of the budget for relief. Because the Farm Bill includes a massive nutrition title, which provides for food stamps, school lunches, and a host of other food programs, only half of the total $71 billion in annual spending in the Farm Bill is for actual farm programs, and of this amount, less than 20 percent is discretionary spending.

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Trade and the WTO

Export growth is seen as a necessary component of the future of the U.S. agricultural economy. There are several reasons for concern on this front, however. A trade strategy that has historically focused on mature markets—particularly the developed economies of Europe and Asia—has left the United States in many ways poorly positioned to break into new markets in underdeveloped regions of the globe. Furthermore, the global market is much more competitive today than it was a decade ago. Brazil is the dominant world player in soybeans, a commodity in which the United States had, until very recently, reigned supreme, and some of our traditional trade partners have begun to move more aggressively into the export market in a wide range of commodities.

Negotiations aimed at opening global markets for U.S. goods have been set back by a breakdown in talks specifically on agriculture during ministerial discussions in Mexico in 2003. While the Doha round of WTO negotiations (which began in November, 2001, with a meeting of the organization in Doha, Qatar) seems to be back on track, serious questions remain as to the extent to which developing countries will open up their food and fiber markets to foreign imports. Recent history, furthermore, indicates that there may be very little room for significant gains in foreign markets. Growth in production over the past several years is more often absorbed by domestic market growth, driven primarily by population growth and only slightly by dietary changes. In the long term, American agriculture's ability to export its way to prosperity is being seriously challenged on a number of fronts.

A serious issue for the upcoming Farm Bill debate will be compliance with international trade agreements, most significantly our obligations to reduce trade-distorting subsidies under the World Trade Organization (WTO). The 2007 Farm Bill will be the first debated following the Doha Round of negotiations for the WTO, which are being conducted as a "single undertaking" in which agriculture is just

one of many sectors under consideration in what will eventually be one comprehensive agreement on trade. Furthermore, recent rulings by the WTO calling into question the status of "decoupled" payments as found in current federal policy.

The WTO assigns subsidies one of three categorical labels (known as boxes) depending on their capacity to distort trade: green (permitted); amber (to be reduced); and red (not allowed). Agriculture does not have a red box category, although amber box support in excess of agreed-to levels is not allowed. Agriculture enjoys a blue box designation as well, for subsidies tied to programs that limit production. All subsidies that distort production and trade fall under the amber box label, including price supports and subsidies directly related to production. Blue box support is essentially amber box support with conditions designed to reduce distortion. Amber box restrictions are placed in the blue box category if the support also requires farmers to limit production. Green box subsidies, which explicitly include environmental and decoupled payments, are allowed without limits.

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Signatory countries to the WTO agree to reduce their support for all industries to a determined level on a set schedule. In recent years, the United States has transferred a considerable portion of its agricultural support into the green box category through decoupled payments, known as AMTA payments (for the Agricultural Market Transition Act which established them in the 1996 Farm Bill), were available to commodity producers but not linked to price or production. A decision in a case brought before the WTO by Brazil over cotton has caused considerable concern. Brazil filed a complaint with the WTO against the United States over eight measures or subsidies provided to producers, users and exporters of upland cotton in March 2003. Eighteen months later, the panel set up by the WTO's Dispute Settlement Body decided largely in favor of Brazil's complaint. Much of this decision was upheld on appeal by the United States, an outcome with significant implications for all sectors of U.S. agriculture.

The immediate impact of the decision will be to mandate a scaling back of support for U.S. cotton, including Step 2 payments and export credit guarantees, which were held to be above the approved 1992 levels. Once the final decision is adopted by the Dispute Resolution Board, it is legally binding, requiring the United States to bring the offending subsidies into compliance. What will have the most sweeping impact will be the Board's conclusion that the decoupled payments to U.S. cotton farmers were not so-called green box, or non-trade distorting. Principally, U.S. direct payments were held to be in violation because they excluded fruit and vegetable production on contract acreage—land on which farmers were receiving direct payments. Because these decoupled payments are a component of the farm program for most major commodities, they are vulnerable to further challenges at the WTO.

The next round of negotiations under the Doha round are set to resume in 2006, about the same time as the 2007 Farm Bill will be occupying Congress. Because of this, and the need for the United States to meet mandatory reductions in support, the 2007 Farm Bill will be more focused on trade and trade agreement compliance than its predecessors. With trade talks essentially stalled, the United States may be asked to accept difficult restrictions on agricultural support to get other countries to lower trade barriers on a range of goods. While agriculture is a significant sector in the U.S. economy with respect to trade negotiations, it is one of a host of industries involved—a fact not lost on agricultural producers.

Farm Sector Conditions

The farm sector has undergone a massive transformation in the past 50 years. Mechanization, technological advances and changes in capital markets have redrawn the farm landscape, with fewer farms, and fewer individuals actively involved in production agriculture. At the end of the Second World War, 16 percent of Americans were directly engaged in farming, a sector which accounted for 6.8 percent of the United States' gross domestic product. By the 1970s, the percent of the population engaged in farming had shrunk to 4 percent, and agriculture enjoyed a 2.3 percent share of GDP. In 2001, less than 2 percent of the population was engaged in farming, a sector that has shrunk to less than 1 percent of GDP. Farm household income surpassed the national average in 1996 and has remained higher than average ever since. This is principally because off-farm income

now plays a considerable role in the finances of a great number of farm households

In part, the shrinkage of agriculture's share of GDP is related to changes in the U.S. economy as a whole, including the rise of the technology, finance and service sectors, but there has been a marked shift in the nature of farming from when the federal government first became engaged in farm policy. Rural economies are now less dependent on farming for their prosperity and tend to show greater vitality to the extent to which they have diversified economies.

Another change in the farm sector has been in farm size. Large, very large and corporate farms constitute a small percentage of the total number of farms (less than 10 percent) but produce more than two-thirds of the total value of production. By contrast, small family farms (those with sales under $250,000) represent just fewer than 30 percent of farms but only about one-quarter of the value of total U.S. production.

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Federal support for agriculture comes primarily in the form of commodity payments—nearly two-thirds of all non-nutrition spending of the Farm Bill, an amount equal to about .5 percent of the total federal budget. Because large farms produce the preponderance of U.S. farm output, the largest farms receive the majority of commodity payments—along with the related, but decoupled, planting flexibility payments. This contributes to the pressure for farms to increase in size to remain competitive. A related outcome of the commodity programs has been to support the rental price of farmland as farmers seek more land for production. This in turn raises barriers to entry for new farmers and increases the capital needs for expanding farmers, but at the same time protects valuable equity for farmland owners.

Increased farm size, disproportionate production, and dependence on off-farm employment all point to shifts away from the conditions in place when farm programs were first conceived. Commodity programs and related payments, which are based principally on either production or farm size, can be viewed as either wisely rewarding efficient, productive farms or unwisely promoting an industrial-scale model of agriculture at the expense of small, family operations. Commodity programs historically were a central component of a two-pronged price support and production control strategy intended to improve farmers' incomes. Today, with farm household income above the national average, the commodity program is considered to be less central to farm income support. At the same time, the fact that the majority of farm households are dependent on off-farm income is indicative of the inability of many farmers to support themselves from the produce of their farms. While the original purpose of farm legislation was, in part, to increase and support farm income, the above average income for farm households cannot be entirely seen as a victory for federal farm programs, given the shift of income away from production agriculture.

In this sense, the current Farm Bill reflects a continuation of a discussion of the purpose of federal farm legislation. There have emerged two distinct camps in agriculture policy: one focused on policies to support families and farms, the other focused on the health of the sector as a component of the U.S. economy. While these two policy biases have many interests in common, they differ in the manner in which policies are implemented.

Increasing Societal Demands

Agriculture exists, obviously, to produce food and fiber for consumers. For millennia, farmers' principal concerns were raising crops and finding markets. Consumers demanded more food for less money, but consumer preferences were in many ways limited by the small range of consumer options. In the 20th century, transportation, communications, technology, and increased wealth in industrialized nations led to a revolution of consumer choices.

The advantages of this for consumers are clear. Thanks to a global food network, fresh fruits and vegetables are available year round at prices within the reach of most American consumers. Production from other countries extends the length of seasonal vegetables and fruits and increases the overall variety of foods available.

At the same time, consumers have begun to demand more from farmers than the delivery of food to the market. Increasingly, farmers are being asked to provide environmental services—some of them historically a component of agricultural systems, some of them new—that provide a public benefit, but for which the farmer is not compensated. Increased concerns over water quality, wildlife habitat, and green space among the general public have placed pressure on farmers and agricultural landowners to adopt new practices and adjust current ones to meet new demands and government regulation. These are not without their costs, which have been in some cases compensated for by conservation funding from the federal government. As demands continue to increase, however, landowners and producers will bear uncompensated costs which do not exist among our trading partners and for which there is little opportunity to pass on to consumers. Farm policy in this area also has shifted, from traditional soil conservation and fertility activities designed to improve farm output, to water quality and habitat restoration.

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In addition to demands for environmental services, a growing range of consumers are making new demands on both farmers and the food industry with respect to concerns over biotechnology, food safety, and animal welfare. The growth of the organic sector of the U.S. food system is one outcome of this. Recent efforts to mandate particular livestock practices is another.

Internationally, a number of key trading partners have resisted biotech products, with consumers in Europe and Japan both solidly opposed to a technology that American farmers have widely adopted in a number of commodities. While the United States Trade Representative's Office has diligently opposed the imposition of trade restrictions based on unfounded phytosanitary concerns, in an open market consumer demands trump producer preferences. With the genie out of the bottle with respect to transgenic foods, the costs of assuring foods as free of genetically modified organisms, or GMOs—including those for separate storage, handling and processing—will fall on producers, processors and shippers. These costs will be difficult for any of these parties to recover fully from consumers. With the successful cloning of sheep and cattle, and the approval of cloned beef by the FDA as identical to naturally bred beef, a new challenge to domestic production is on the horizon for the United States.

Simultaneously, outbreaks of BSE in Canada and the United States have highlighted the need to improve the traceability of food that is in the system. The BSE disaster that struck Europe in the 1990s shook confidence in the ability of the government to ensure that the food supply was safe. The response to the BSE outbreak in the United States was open and transparent, and American consumer confidence remains strong. Nonetheless, the United States now has a commitment to animal identification and increased surveillance that will come at a cost. While the additional associated cost per pound of meat on the grocery shelf may amount to pennies, the impact on individual producers could be huge. Small livestock producers would be at a considerable disadvantage in trying to absorb the initial costs of many of the technological solutions currently under consideration, placing them at further disadvantage in a sector of agriculture that is swiftly consolidating.

A further issue that remains unresolved is country of origin labeling (COOL). Established in the 2002 Farm Bill but as yet not implemented, many advocates view COOL as a response to consumer demands for more information about their food. Opponents have raised a number of objections, including the costs and complexity of implementing the plan and the likelihood of such labeling being viewed as a violation of international trade agreements. Resolving the outstanding implementation and enforcement issues for COOL will be an issue for consideration in discussions of the 2007 Farm Bill.

Conservation programs were greatly expanded in the 2002 Farm Bill, although funding for several initiatives was either slow in coming or did not materialize. Alongside many of the traditional programs aimed at soil conservation, wetland restoration, and land retirement (including the vast Conservation Reserve Program) was a new approach focused on working

lands. While still in the pilot phase, the Conservation Security Program is intended to provide farmers with funding to offset the costs of beneficial environmental programs. While somewhat hampered in its early stages by slow funding and complex record-keeping, the promise of this approach is that it is exceedingly WTO-friendly and provides a mechanism for all farmers, regardless of their crop, to share in federal farm programs. While the amount of money farmers receive for their varying levels of commitment are unlikely to cover the full costs of the measures, the payments do provide a cushion for the impact of those costs and shift the burdens back toward the end recipient of the benefits—the general public. The focus on working lands is a popular one in farm policy discussions and promises to be an idea that will receive considerable attention in the next round of debate on the Farm Bill.

It is somewhat counterintuitive, then, that at the same time society is demanding more of farmers, ranchers and agricultural landowners, the resources available for research, development, education and extension in the sector is shrinking. In part the research and development component has shifted to the private sector, in which massive investment in life sciences has resulted in remarkable advances in technology for agriculture. Much of this technology is privately held, however, which increases the costs of basic inputs for farmers, and raises ethical concerns about the patenting of living organisms and the transparency of the process by which new varieties are introduced. While research and development have been picked up by the private sector, extension and education—two critical needs for farmers in the current environment—lack a private-sector analogue for the most part. As extension services are reduced, farmers become more self-reliant on information they can gather from sources at hand, a practice made more complicated by the explosion in both the amount of information available and the complexity of the changes underway in agriculture.

Rural Development

Federal farm policy has been a proxy for rural policy for most of the history of what we understand as the farm bill, although rural development only entered the legislation as a separate Farm Bill title in 1970. In 1950, a large number of counties in the United States were dependent on farming for their economies and thus the health of rural places was closely tied to the agriculture economy. By 2000, the number of counties in which farming played a dominant economic role had shrunk to a small number mostly concentrated in the Great Plains. During this period of transition, the Farm Bill saw remarkable advances in efforts to promote rural prosperity outside of the food and fiber sector.

As off-farm income has increased in significance, so has the importance of a healthy, diversified off-farm rural economy. It is perhaps unsurprising that rural areas in commuting distance of metropolitan areas tend to fare better economically. But these areas also are under the greatest development pressure, in general, which makes agriculture near large towns increasingly difficult. For farmers living in isolated rural areas who need off-farm income to survive, the vibrancy of the local rural economy is of tantamount importance.

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United States rural policy as implemented through the Farm Bill (and it bears noting that rural policy is spread across an array of federal and state agencies and offices) consists of services, loans and technical assistance to rural communities. These programs provide rural areas with much needed capital as well as many important services that otherwise would be unavailable. Additionally, there is an economic assumption implicit in farm payments in particular that these funds percolate through rural economies, enriching others who are not directly linked to the farm. To an extent, this assumption is likely true. Farm-related industries employ a considerable number of people in rural areas, and businesses providing goods and services in rural places also have strong economic ties to the well-being of farms in the area. As farms consolidate and integrate into larger agribusiness chains, however, this effect is diminished to a degree, with funds flowing out of some areas and into others.

All of this raises the question as to whether the Farm Bill is still an appropriate vehicle for guiding rural policy. Rural advocates often are engaged in farm

policy debates because both the identity and the economies of rural places are deeply affected by changes in the farm sector. A particularly important reason for retaining the rural component of the Farm Bill is the absence elsewhere of omnibus legislation addressing rural needs or of an apparatus focusing policy for rural areas at the federal level.

The importance of off-farm income to farm household economic survival would seem to make the health of rural communities (which is where the farms are, after all) a necessary concern of farm policy. A relevant issue to consider is whether the current components of farm policy serve the interests of rural communities well. Rural places have access to tailored programs through a range of federal agencies—including the Departments of Health and Human Services, Transportation, Education and others—but historically only the Department of Agriculture has had a rural focus to its activities.

Recent Farm Bills have been more extensive in their efforts with respect to rural development, although as with a number of other initiatives, funding for these often has been delayed or reduced. Significantly, a number of initiatives passed as part of the 2002 Farm Bill never have been fully funded, and a handful have been discontinued. The expansion of rural programs in recent Farm Bills in many ways reflects a desire to have a coordinated, consistent policy for rural places. This being said, the debate over how to best serve rural communities is an active one, as has been underscored by the ongoing discussion over the Strengthening America's Communities Act. A particularly important element of this debate is whether the Farm Bill is the best vehicle for conducting rural policy.

The Future of the Safety Net

Federal farm policy has at its core a safety net for the agriculture sector of the U.S. economy. Initiated in the Great Depression at a time when U.S. farm failures were reaching a critical level, federal intervention in the farm sector was intended to provide farmers with security to weather poor harvests, bad markets, and financial disasters. While federal farm policy now extends well beyond this, the central issue at hand in most farm policy debate is over the nature of, and the necessity for, a farm safety net.

Farms are unlike any other form of production. When prices rise, the farmer is unable to quickly bring more product onto the market to increase profits; when prices dip, farmers cannot slow down production until markets improve. Except in rare circumstances, farmers do not take land out of production when prices drop. Indeed, low prices may spur farmers to put more land under the till, or to shift production into another crop. This in many ways can drive prices further downward and produce conditions in which farm failures soar.

This particular aspect of the agriculture sector has led to the persistence of farm policy as a safety net. A significant portion of the $20 billion annual federal expenditure on agriculture programs is in many ways a farm security program. Food production and food security are central to this policy. For the entirety of our history, the United States has been a net exporter of agricultural products. Producing sufficient food for our population with adequate quantities to send around the world has been a component of our domestic and international policy—and strength—since before the creation of federal farm policy.

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On the surface, at least, the food and fiber sector continues to produce well. But federal farm policy as a farm safety net is not functioning for a huge number of farms. The majority of farms earn more from off-farm income than from farm gate receipts. A minority of large farms, responsible for the majority of U.S. agricultural output, receive the lion's share of farm support payments. A sizeable number of farms receive no federal support at all. While this does not, *prima facie*, indicate a problem with federal policy, it does highlight the inadequate reach of federal farm programs as a farm safety net.

The question then remains: Is federal farm policy intended to provide a safety net for producers? If so, how can this be done in such a manner to satisfy budgetary constraints, trade agreement obligations and social demands? If not, what will constitute the safety net for the next generation of farms and rural communities?

[The 2007 Farm Bill in Context]

The Farm Bill is the periodic national legislation that guides agriculture, rural, and food policy for the United States. Highly complex, the Farm Bill includes authorization for everything from payments to farmers under decades-old commodity programs to school nutrition funding and more.

The Farm Bill has undergone radical changes in the past few cycles, beginning with the 1996 Freedom to Farm Act's proposed elimination of commodity payments, through the 2002 expansion of conservation programs, extension of non-cyclical payments, and creation of an energy title for the Bill, reflecting the growing importance of energy production to the future of agriculture in the United States.

The 2002 Farm Bill is due for reauthorization in 2007. The economic and policy backdrop against which this legislation is being developed could not be more different from the previous iteration. In the years leading up to the 2002 Farm Bill, most forecasters were predicting generous growth for U.S. producers from overseas markets and a steady rise in the national economy leading to budget surpluses and ample amounts of funding for farm and nutrition programs.

As a result, the 2002 Farm Bill was the largest in history, expanding farm conservation programs, continuing many of the commodity payment instruments that were originally intended for elimination after the 1996 Farm Bill expired, and extending the scope of many rural development programs. As Congress gears up to renew this piece of legislation, budgetary, trade, farm sector, and social pressures all are pointing toward a radically different kind of Farm Bill.

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