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21st Century Farm Policy: Challenges and Opportunities

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Executive Summary

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CONFERENCE PROGRAM

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Roger Johnson - North Dakota Agriculture Commissioner

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Kent Conrad - U.S. Senator (ND)

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SUMMARY

U.S. Senator Kent Conrad and Dr. Won Koo, Director of the Center for Agricultural Policy and Trade Studies, organized a conference on future farm policy and its effects on U.S. agriculture. This event was held October 30-31 at the Fargodome in Fargo, North Dakota. One objective of the conference was to discuss key issues influencing agricultural policy in the future, including the World Trade Organization (WTO) and regional free trade negotiations, federal budget deficits, public perceptions of agriculture, market influences, structural changes, and food industry expectations. Another objective was to identify farm policies that recognize the changing agricultural policy environment, provide for prosperous and vibrant rural communities, are politically and environmentally sustainable for producers and rural communities, and make U.S. agriculture more competitive. **Senator Conrad remarked that we are not going to reach conclusions at this conference, but what we can do is identify the challenges facing U.S. agriculture as we go forward.** Speakers at the conference included politicians, government officials, agricultural economists, and members of farm and conservation groups.

The Importance of the Farm Bill

The farm bill is an important piece of legislation for producers across the United States, and it is especially important for North Dakota. The current farm bill was written in 2002 and a new bill is expected by 2007, when the current one is scheduled to expire. North Dakota Lieutenant Governor Jack Dalrymple remarked that the next farm bill will probably affect the future prosperity of North Dakota more than any other thing we will do in the next five years. North Dakota Agriculture Commissioner Roger Johnson stressed that agriculture is the single largest part of the North Dakota economy and that as agriculture is important to the state, so too is the farm bill. Robert Carlson, President of the North Dakota Farmers Union, presented data that illustrated the importance of farm programs to net farm income. Without government payments or insurance, net farm income in North Dakota would have been negative or close to zero in most years since 1997. Writing the new farm bill, however, will be difficult as a number of pressures are expected to affect the shape of the new legislation.

Challenges and Constraints Facing the New Farm Bill

Senator Conrad remarked that we are in a different environment than the one which existed when the 2002 farm bill was written. **Two major challenges that we now face are the WTO negotiations and budget circumstances**. These and other issues create constraints for legislators in forming new farm policy.

The Doha Round of WTO negotiations are at a critical stage. Success at the Hong Kong ministerial meeting in December 2005 could lead to a new WTO agreement within a short period, but failure could halt WTO negotiations for many years. Tim Josling, Professor Emeritus from Stanford University, called 2005 a significant year for U.S. agricultural trade policy. He noted that **the push for a WTO agreement in the Hong Kong ministerial meeting, the implementation of changes as a result of the WTO cotton ruling, and the continued**

negotiations for regional free trade agreements will impact the U.S. farm bill. As part of the WTO negotiations, the United States has proposed a 60 percent reduction in the limit on trade-distorting domestic support categorized in the amber box. Commissioner Johnson remarked that this offer would lead to significant cuts to the current farm bill and would affect the ability of members of Congress to write provisions that are going to provide a safety net for agriculture. Senator Conrad and former Chairman of the House Agricultural Committee Larry Combest both expressed their opposition to the concessions in agriculture made by U.S. trade negotiators.

The other major constraint is the federal budget deficit. **Senator Conrad noted that the last time we wrote a farm bill the country was facing budget surpluses and had additional resources available, but that the country is now facing very significant deficits.** As a result, the President and Congress are hoping to make spending cuts. Conrad remarked that agriculture, unfortunately, is asked to take the biggest share of the cuts when funds get tight. Robert Young, Director of Economics for the American Farm Bureau Federation, agreed that agriculture tends to be high on everyone's list for cuts. Young noted that five major expenses - defense, social security, medicare, medicaid, and interest - consume $1.6 trillion of the $1.9 trillion federal budget, and spending for health care, social security, and interest is projected to increase $93 billion per year. He concluded that agriculture is but one of many forces competing for federal dollars, and most would choose to cut farm programs before cutting social security or medicare.

Other factors affecting farm policy include structural changes in agriculture and public support for farm programs. William Heffernan, Professor Emeritus of Sociology from the University of Missouri-Columbia, described how the food and agricultural sector has changed significantly in recent years through increased concentration, greater vertical and horizontal integration, and the development of more strategic alliances and joint ventures. Mary Bohman, Director of the Resource Economics Division at the Economic Research Service, showed how large farms continue to expand and profits increase with size, although, she noted that farms of all sizes earn profits and losses. Neil Harl, Professor of Agriculture and Professor Emeritus of Economics from Iowa State University, suggested that the benefits of federal farm programs must be shaped to eliminate the advantage of the largest operations in using their economies of scale to bid up cash rents and land values, to the detriment of midsize and smaller operators. Robert Carlson remarked that farm policy should not be developed for multi-national corporations, processors, exporters, integrated livestock producers, and all similar firms who profit from low commodity prices. He added that the decline in the number of family-sized commercial farms must be reversed.

According to Joseph Molnar, Professor of Agricultural Economics and Rural Sociology at Auburn University, Americans believe that farm policy currently favors large farming businesses, but they want subsidies to favor small businesses. Molnar remarked that public views on farm policy are changing because there is a diminishing fraction of Americans with personal experience with farming, farm votes have become less important politically, and other issues overshadow agriculture in getting the public's attention. Despite these changes, Molnar attested that **results from various national studies show that Americans do, in fact, support farm subsidies by wide margins, but a majority of survey respondents oppose giving**

subsidies to large-scale farms. Commissioner Johnson remarked that we need to be cognizant of public confidence, and that the issue of payment limitations will be significant.

In the European Union (EU), consumer concern is a driving force for policy reform. According to Jean-Marc Trarieux, Agricultural Attache at the European Commission Delegation, a survey found that the top three expectations for farm policy among Europeans are that it ensures agricultural products are healthy and safe, promotes the respect of the environment, and ensures that the well-being of farm animals is respected. Trarieux concluded that farm policy should be designed as a contract between farmers and society to translate citizens' demands beyond food production, and that it is key for farm policy to be economically, environmentally, and politically sustainable.

Options for New Farm Policy

As indicated by Bill Gillon of the National Cotton Council, Dale Thorenson of Gordley Associates, and Robert Young of the Farm Bureau, **the preferred option for most producers seems to be to keep the current farm program structure. However, as many of the speakers remarked, change is inevitable.** WTO limits on trade-distorting amber and blue box payments would probably require changes. Patrick Westhoff, Program Director for International Affairs at FAPRI, stated that the degree to which policies would have to change depends on future commodity prices. If prices are high, the proposed limits would require only small changes in current policies, but large changes might be required when prices are low and current programs yield large loan deficiency payments and counter-cyclical payments. Westhoff indicated that the current basic structure of programs could be kept, with reductions in loan rates, target prices, and milk and sugar price support levels. Gillon estimated that loan rates would have to be cut 10-15 percent under the U.S. WTO proposal. Direct payments, which qualify as green box subsidies, could be increased to compensate for these reductions since they would not be limited by the WTO.

Alternatively, the United States could make a more fundamental shift in farm policy. Demcey Johnson from the Market and Trade Economics Division of the Economic Research Service suggested that **comprehensive reform could include full decoupling or buyouts.** He also mentioned that other, less likely policy options include a return to supply management or the devolution of policy to the states. David Orden, Professor of Agricultural Economics at Virginia Tech and Senior Research Fellow at the International Food Policy Research Institute, discussed the feasibility of farm program buyouts, while Bruce Babcock, Professor and Director of the Center for Agricultural and Rural Development at Iowa State University, envisioned an effective new approach to providing an agricultural safety net that meets WTO and budget objectives. Daryll Ray, Professor and Director of the Agricultural Policy Analysis Center at the University of Tennessee, discussed the reasons for agriculture's chronic problems and advocated for the return of supply management.

Orden commented that a farm program buyout is a policy option that the United States might utilize to reduce the long-run fiscal cost of subsidies and facilitate agricultural trade liberalization, while providing substantial transition support to farmers. He concluded that **if certain obstacles can be overcome, a buyout might be a good deal for farmers, taxpayers, and an improved global agricultural system**.

Babcock investigated the possibility of redesigning the U.S. safety net to meet WTO and budget objectives while improving the effectiveness of the existing program. He commented that a revenue safety net makes more sense than a yield or price safety net because it avoids over or under compensation. Yield and price safety nets, on the other hand, do not always work. **Babcock envisioned a revenue insurance program that would qualify as WTO green box coupled with new amber box and blue box programs.** According to Babcock, such a policy could provide an effective safety net within WTO limits proposed by the United States while consolidating crop insurance, commodity programs, and disaster aid.

Ray suggested we take a different approach. According to Ray, the United States has lost its way with agricultural policy. He said that chronic problems exist in agriculture because, on average, supply grows faster than demand, and unlike other industries, agriculture cannot right itself when capsized by low prices. **From Ray's perspective, the 2007 farm bill needs to include provisions for buffer stocks to provide a reserve supply of grains and seeds in the case of a severe production shortfall and supply management to manage acreage utilization in the same way that other industries manage their capacity.** Ray also envisioned a long-term solution to chronic price and income problems that includes international supply management.

Many of the speakers supported a bioenergy or renewable fuels program in the farm bill. Ray remarked that a bioenergy policy would keep the land in production so that we do not pay farmers not to farm, and it would provide a needed energy source. Commissioner Johnson said that we should be thinking about adding on to victories that recently came out of Congress in the energy bill and carve out a major part of the next farm bill that involves renewable energy. He expressed his belief that we could be more aggressive in producing renewable fuels and that the public would probably support this, especially with recent gas prices. Senator Conrad, former Representative Combest, and Representative Collin Peterson expressed similar views. Robert Carlson proposed that a Renewable Energy Reserve should be established for crops that can be dedicated to fuel production.

Some presenters also supported the use of conservation programs. These programs would qualify as green box, and the public is likely to support them. Lynn Tjeerdsma, Initiatives Manager for the Theodore Roosevelt Conservation Partnership, commented that the most effective conservation programs are the ones that are conceived and carried out at the local level by the people who live and work on the land. He said that through increased utilization of farm bill conservation programs, expensive inputs can be focused on the farm's most productive soils. Carlson noted that the Farmers Union encourages innovative conservation practices, including the Conservation Security Program (CSP).

Ralph Grossi, President of the American Farmland Trust, provided **a plausible alternative structure for agricultural support that consists of three components: risk management, land stewardship, and new market opportunities.** New market opportunities include energy, pharmaceuticals, niche markets, and others. He remarked that there should also be a renewed commitment to research, extension, and technical assistance, and there needs to be a transition mechanism to help farmers move from the current farm program structure to a new one. Grossi commented that farmers are anticipating change, and they want to be a part of the change, but they have a high level of anxiety driven by concerns of economic disruption.

There was some skepticism among conference participants regarding the benefits to U.S. agriculture from increased trade liberalization. Daryll Ray, Robert Carlson, and Representative Peterson questioned the strategy of exports as a solution. They referenced data which show that U.S. crop exports have stagnated over the last several years while exports from developing countries have increased substantially. Carlson expressed his belief that analysis of current trade agreements is needed to determine if they are accomplishing their stated goals before our government negotiates any new ones.

Other participants, on the other hand, held a more positive view of trade negotiations. **Tim Josling and Neil Harl argued that U.S. agriculture is competitive in the world market.** Josling commented that with increased trade liberalization, the United States will have access to wider markets, and U.S. producers could take advantage of their efficiency. Robert Young added that trade agreements are needed to settle trade disputes. Harl emphasized the benefits of globalization to both developing countries and the United States. He argued that globalization leads to better incomes in developing countries, which is good for U.S. farmers because it leads to increased demand for food. Harl advocated a global food and agriculture policy and the support of economic growth in the developing world. He remarked that even if one's interests go no further than national security, in a world of disharmony, eliminating world hunger is a worthy goal.

Conclusions

The current farm policy seems to be popular among U.S. producers and policy makers, but change is inevitable due to pressures from the WTO and the federal budget deficit, among other factors. Neil Harl noted that changes in agriculture over the last 80 years were driven by the technology of power and the technology of seeds and genetics; he stated that changes over the next 80 years could be driven by the economic forces of trade and globalization. If WTO negotiations lead to an agreement, U.S. policy may need to change significantly to meet the likely reductions in permitted amber box and blue box subsidies. Litigation could also force the reform of U.S. policy. The current farm program structure could be maintained with reductions in loan rates, target prices, and milk and sugar price support levels. Alternatively, more comprehensive reform could be enacted, which could include a shift in payments to non-trade-distorting green box subsidies or a farm program buyout.

Regardless of what happens with the WTO, the federal budget deficit will be a major constraint in writing the new farm bill. During the creation of the last farm bill, the country was facing budget surpluses and had additional resources available. This time, the Congress and the President are pursuing spending cuts to curb the growing deficit, and agriculture tends to be high on everyone's cut list. These forces will create a challenge in writing the next farm bill. Despite these challenges, there are still opportunities to write an effective farm bill that could benefit U.S. farmers and rural communities.

Won Koo remarked that this conference is the first discussion of the new farm policy under several economic and political constraints and concluded that we must continue this debate to develop a new farm bill which will make our agriculture more competitive and provide sustainable farm income.

OPENING REMARKS

Jack Dalrymple - North Dakota Lieutenant Governor

This looks to be a very dynamic and productive conference. Part of my job, being in the governor's office, is to look after the state budget and agricultural issues on behalf of the governor. This next farm bill will probably affect the future prosperity of our state more than anything else that we will do in the next five years. This is a tremendously important piece of legislation, and we will be working very hard on it. The 2002 farm bill has been a very successful piece of legislation for North Dakota. Former Representative Larry Combest, who will speak later in this conference with Senator Conrad, was probably the key to the 2002 farm bill. He guided that bill when many powers were working against him. Senator Conrad was also a key player in producing the final bill. Bipartisanship is essential in any farm bill negotiations.

Roger Johnson - North Dakota Commissioner of Agriculture

This purpose of this conference is to begin the dialogue of what the new farm bill should look like. Agriculture is the single largest part of the North Dakota economy, and as agriculture is very important to this state, so too is the farm bill. The 2002 farm bill was a good piece of legislation, and we hope to do just as good this time. This bill is a good place to start when writing the new farm bill. However, there are a number of challenges as we attempt to write the new farm bill and a number of differences from the last time the bill was written. This time, the federal government is facing large budget deficits instead of surpluses, there are more interests at the table fighting for funding, and the WTO has become an enormous challenge.

We saw a significant emergence during the last farm bill of the conservation issues. A good piece of the current farm bill involves some of those conservation issues. Unfortunately, conservation is the first place we go when we have to find money for disaster assistance. One of the challenges for this bill is to do the right thing with conservation.

The WTO will be an enormous challenge. U.S. negotiators are offering significant cuts to the current farm bill, which will affect the ability of members of Congress to write provisions that are going to provide a safety net for agriculture. We need to make sure we have a safety net like in the previous farm bill.

We need to be cognizant of public confidence. We are seeing more editorials about some of the problems with farm policies, such as payments going to wealthy individuals and people that the general public may think do not need the money. Public confidence is going to be an enormous issue, as will the issue of how to deal with payment limitations.

One of the enormous challenges and opportunities we have this time is to do something with energy. We should be seriously thinking about adding on to victories that recently came out of Congress in the energy bill and carve out a major part of the next farm bill that involves renewable energy. Our sights have been set too low. There is a movement with the slogan "25 by 25" to get 25 percent of our energy from renewable sources by 2025, but I think we can be even more aggressive. We can move more quickly than the renewable energy standard in the energy bill. I think the public opinion, especially with recent gas prices, would support this.

BUDGET IMPLICATIONS FOR U.S. AGRICULTURE

Kent Conrad - U.S. Senator (ND)

We are not going to reach conclusions at this conference, but what we can do is identify the challenges facing U.S. agriculture as we go forward. We are in a different environment from when the last farm bill was written, and we need to understand all the pressures that are on us, all the things pushing us in different directions, and all the limitations and challenges that we face. During this conference we can begin to get an understanding of what it is going to take to emerge successfully.

The budget circumstance is one of the major challenges that we face as we go into this farm bill debate. The last time we wrote a farm bill we were facing budget surpluses and we had additional resources available. The situation is much different this time, as we are facing very significant deficits. The size of the deficit does not even show the true seriousness of our fiscal condition because the debt of the country is increasing by much more than the size of the deficit. The major reason for this is that money is being taken from social security funds and used to pay for other purposes. This increases the size of our debt but does not get counted in the calculation of the deficit.

There has been a significant increase in federal spending since 2000, but virtually all of this increase has been for defense, homeland security, and rebuilding New York. But even with this increase in spending, we are still below the spending levels of the 1980s and part of the 1990s when measured as a share of gross domestic product. Revenue peaked in 2000 and has decreased significantly since. This leaves a significant gap between spending and revenue even before the baby boomers retire. We are now in the process of budget reconciliation, which consists of spending cuts, tax cuts, and increasing the debt limit of the United States. The combination of the spending and tax cuts will actually increase the deficit because taxes are being cut more than spending.

We anticipate the debt to increase $600 billion per year over the next five years, and this debt is increasingly being financed by foreigners. This is an unsustainable course. The baby boomers start to retire in 2008, which will exacerbate the problem. It will fundamentally change the budget circumstance in a way that is hard for us to grasp at this moment. I believe the debt will have a profound impact on the discussion of agricultural policy in the next farm bill.

The largest share of USDA spending is for nutrition programs (52 percent). Only 23 percent of spending is for the commodity programs. We have an education job to do across the country with respect to where these dollars are going. Since 1999, farm program spending has been decreasing. Farm program spending has not been a contributing factor to the growing deficits. Agriculture accounts for a small share of federal spending. Commodity and conservation program spending accounts for less than one percent of total federal spending. The President's budget calls for $51 billion in total cuts with $8.4 cuts coming from agriculture, which is 17 percent of the cuts. The Senate has proposed $39 billion in cuts with agriculture taking $3 billion in cuts, or 8 percent of the cuts. This is the pattern from administration to administration. When funds get tight, agriculture is asked to take the biggest share of the overall cuts. We need to be prepared to defend agriculture's small share of the federal budget.

PANEL DISCUSSION:
THE POLITICAL ENVIRONMENT FOR FARM POLICY - THEN AND NOW

U.S. Senator Kent Conrad and former Chairman of the U.S. House of Representatives Agriculture Committee Larry Combest participated in a panel discussion, answering questions from the audience. Combest and Conrad were both influential in writing the 2002 farm bill. Combest stressed the importance of working together in a bipartisan effort when writing the farm bill. He stated that continuation of the current bill would be his choice. Conrad remarked that the major differences in writing this bill are the WTO, the budget, energy issues, and the personalities involved in forming the new farm bill are different from those that wrote the current bill. Conrad stressed that we need to think about what our strategy will be. Combest agreed that strategy is important and that we need to bring together common interests and goals.

One question was posed regarding concessions in agriculture given in WTO negotiations by the United States. Conrad and Combest both stated their opposition to these concessions. A question was also asked about the issue of payment limitations. Combest remarked that this is a difficult issue. He noted that there are differences between commodities, and producers of some commodities would likely not support limitations if they are set too low. He also remarked that we do not want to penalize growth and we should look at what the family farm needs to survive. Conrad said that he will argue for tightening limits but that we must also recognize that cotton and rice are more capital intensive. He commented that there is some tension between agriculture in the north and south and that we must try to compromise.

A question was asked about the Conservation Reserve Program (CRP) and the possibility of putting it into renewable energy production. Combest thought this was a good concept. He stressed the importance of value-added agriculture and the need to become more self-reliant. Conrad said that he does not think CRP will be reduced and that energy is a big opportunity for agriculture. Combest noted that Brazil is a huge trade threat to the United States and the country is not dependent on importing foreign oil. Energy was stressed during the discussion as being a national security issue, and many conference participants commented about the problems from rising energy costs and the opportunities for agriculture from bio-fuel production.

Conrad remarked that no state has more at stake than North Dakota. He said that farm groups must resolve their differences and speak with one voice. Combest encouraged farmers to work with their local groups and let them know their opinions.

IMPACT OF TRADE NEGOTIATIONS AND DISPUTES ON U.S. FARM POLICY

The Perfect Storm?

Tim Josling - Professor Emeritus, Stanford University

2005 is proving to be a critical year for U.S. agricultural trade policy. The push for a WTO agreement in the Hong Kong ministerial meeting in December 2005, the implementation of changes as a result of the WTO cotton ruling, and the continued negotiations for regional free trade agreements will impact the U.S. farm bill. Compared with 10 years ago, the U.S. influence on world trade negotiations has diminished. The U.S.- European Union (EU) influence on trade agenda is now being circumscribed by developing countries. China, India, and Brazil are taking a more active role in trade discussions. We are in a period of significant change in agricultural trade relations. Based on both negotiation and litigation, things are looking very different than they did a few years ago. Trade relations with developing countries will be a major focus for the future.

WTO talks are on a “knife’s edge.” Tough political decisions are still needed to reach an agreement. The United States and the EU must decide that the next step in WTO agricultural reform is compatible with domestic objectives, but developing countries may yet resist market opening and demand too much of developed countries by way of cuts in domestic support. A stalemate at the Hong Kong ministerial meeting in December 2005 could halt the WTO negotiations for many years.

Market access is key for progress in the WTO negotiations in agriculture. The U.S. proposal is fairly aggressive on tariffs. It calls for sharp cuts, with few exceptions, and a low tariff cap (75 percent). The EU has improved its initial offer, but it still wants exceptions for sensitive products. The G-20 (a group of developing countries) has proposed a compromise, but the G-10 (a group of 10 developing and developed countries including Japan) still balks at deep cuts and tariff caps and they want many exceptions.

Domestic support is also proving to be a difficult issue. The United States energized talks in October with an offer of 60 percent cuts in domestic support if the EU and Japan cut more. The EU has laid out plans for significant cuts in its own domestic support. The G-20, however, is demanding deeper cuts from both the United States and the EU. The question remains how to cut “headline” support but keep programs intact and also how to convince others that these cuts are worthwhile.

Export competition is less of an issue. The EU has agreed to end export subsidies if other export programs are curbed. The United States has agreed to modify export credit guarantees and appears willing to modify food aid programs. Canada has yet to agree to change operations of the Canadian Wheat Board, but they may eventually have to agree to some changes.

WTO litigation on agriculture is also playing an important role. Additional pressures from WTO challenges are being put on the United States and the EU to modify agricultural programs. Significant rulings have been made against the U.S. cotton and the EU sugar regimes. The impact of these ruling are not restricted to these commodities but could influence other aspects of U.S. and EU farm programs. Other cases also have implications for agricultural trade.

Regional agreements may be boosted by slow progress in the WTO. The United States could expand its agreements in the Americas and Africa, along with those in Asia and the Middle East. An Asian regional FTA, on the other hand, could exclude the United States and set up discrimination of U.S. exports. The results of regional FTAs could be a weakening of the multilateral trading system and increasing tension among regions. A successful Doha Round would slow these developments.

Agriculture is at the heart of most of the trade policy negotiations. Pressures to reduce tariffs will continue. Export subsidies are on the way out along with some export programs in the United States and Canada. Domestic support programs will continue to be under international scrutiny to see that they do not impede other countries. New trade issues, such as geographical indications, health restrictions and standards, and biotechnology, will become increasingly important.

U.S. trade policy can accommodate to these pressures if it keeps in mind the ultimate goal of a global market that allows U.S. agriculture to take advantage of its efficiency. Bilateral, regional, and multilateral trade agreements are broadly, mutually complementary, and each offers possibilities for wider markets. Domestic policy is slowly evolving to become less obtrusive in trade relations, whether through negotiation or litigation. Integration of the food and agricultural system will continue on a global scale to the considerable advantage of U.S. agriculture and the world's consumers.

Boxed In? Implications of WTO Rules and Rulings for Farm Policy

Patrick Westhoff - Program Director, International Affairs, Food and Agricultural Policy Research Institute (FAPRI)

Current WTO rules limit certain policies that support farm prices and income. Farm programs are divided by the WTO into the green box, amber box, and blue box according to how they distort trade. Green box policies are those that have at most a small impact on production and trade. The WTO does not restrict green box subsidies. Examples of green box programs include the Conservation Reserve Program (CRP), the Environmental Quality Incentives Program (EQIP), and other conservation programs; food stamps and other nutrition programs; and agricultural research. The United States has argued that Production Flexibility Contract (PFC) and direct payments belong in the green box, but a recent WTO ruling says that direct payments do not belong in the green box.

The amber box policies are those that do affect production and trade. Examples include marketing loan benefits and milk and sugar price supports. Under current WTO rules, the United States is limited to $19.1 billion in amber box payments per year. The blue box was created as a place to put subsidies that are somewhere in between green and amber. There is no limit on the current blue box, but proposals call for limiting the new blue box. No U.S. policies are in the blue box as currently defined. However, the 2004 WTO framework agreement appears to make counter-cyclical payments eligible for a redefined blue box. Reforms by the EU in 2003 are intended to shift many EU subsidies from amber and blue to green.

The United States has proposed a 60 percent reduction in the amber box limit. Counter-cyclical payments would be shifted from the amber box to the blue box under this scenario. Limits on amber and blue box subsidies would probably require policy changes. U.S. amber box support with current policies, assuming direct and counter-cyclical payments are not in the amber box, is projected to total $11.0 billion in 2006, while the U.S. proposed limit on amber box support after the phase-in period is $7.6 billion.

The U.S. proposal would limit the new blue box to 2.5 percent of agricultural production, which is about $5 billion for the United States. Actual counter-cyclical payments between 2002 and 2004 were below this proposed limit, but if all crop prices were low at the same time, payments could exceed the proposed limit. The United States also proposes to limit support to each commodity to the 1999-2001 average. This could prove important for some commodities in some years.

If the U.S. proposal was adopted, it would probably require some policy changes. How much policies would have to change depends on future commodity prices. If prices are high, the proposed limits would require only small changes in current policies, but large changes might be required when prices are low and current programs would yield large loan deficiency payments and counter-cyclical payments. There are many options for changing policies. The current basic structure of programs could be kept with reductions in loan rates, target prices, and milk and sugar price support levels. Direct payments could be increased to compensate for these reductions. Alternatively, the United States could make a more fundamental shift in farm policy.

This discussion assumes that other countries accept the U.S. proposal and Congress approves legislation implementing the agreement. However, many countries want even deeper cuts, and some also want to prohibit “box shifting,” which means we could not offset reduced marketing loan or counter-cyclical payments with increased direct payments or other green box support.

STRUCTURAL ADJUSTMENTS AND COMPETITIVENESS UNDER A GLOBALIZING TRADE ENVIRONMENT

Competitiveness in Production of Agricultural Commodities: What Not to Consider

Neil Harl - Professor Emeritus, Iowa State University

Competitiveness is a complex issue. Non-land production costs are important. Exchange rates are involved, and tax policy also plays a role. Land costs, however, are irrelevant. The debate on international competitiveness needs to be focused on non-land costs, comparative transportation costs to importing ports, and shifting exchange rate differentials, but not on land values. U.S. agriculture is competitive. In every country producing agricultural commodities in a market economy, investors and land-owning producers will capitalize much of the profitability remaining after payment of non-land costs into the land, one way or another. From a policy perspective, that segment of profitability may merit attention, particularly to the extent that amount includes the present value of expected government subsidies, but it is improper and inappropriate to consider land costs in determining levels of international competitiveness. It is also clear that altering the tax structure to improve competitiveness needs to be done very carefully, with more care than was given to the 2004 change.

Changes in agriculture over the last 80 years were driven by the technology of power, which set the stage for larger and larger farms, and the technology of seeds and genetics, which boosted productivity to levels unimagined in 1925. The next 80 years could be dominated by the economic forces of trade and globalization. Food, fiber, and every other commodity will be produced where the cost to the consumer is the least. This has led to outsourcing of everything imaginable – development of computer software, audit of tax returns, conduct of surgical procedures, accomplishment of secretarial duties, and manufacturing of almost every product used by the human family, to mention only a few where the product or service is mobile. The trend will almost certainly continue – because consumers love a deal.

But agriculture promises to be different. Soils and climate are not mobile – so crops will continue to be produced heavily where the cost (including transportation cost) is the least, concentrated in areas with a combination of favorable climate and productive soils. Thus, crops are unlikely to be "outsourced" so long as U.S. production is not undercut, price-wise, by areas outside the country. Livestock is mobile, and could move offshore, but livestock production tends to be tethered rather tightly to low-cost feed grains. Moreover, globalization is leading to and will continue to lead to better incomes in the low income countries. Those are the countries where the percentage of additional income going for food is extra-ordinarily high. So as incomes rise in countries devoting, say, 75 percent of additional income for food (the figure in the United States is down around 20 percent), it means a dramatic increase in food demand. That is good news for U.S. farmers, and it addresses one of the great problems of the ages – eliminating hunger and malnutrition. The three most important barriers to solving the world food problem are income, income, and income.

From a policy perspective, the task for the agricultural sector is, bluntly, to shape the economic forces without losing the benefits of efficiency. First, agriculture must reduce cost externalities (odors, stream pollution, ground water pollution, and ocean pollution, as well as pollen drift from GMOs, especially for biopharmaceutical products) to acceptable levels. Society will not long tolerate anything less. Second, the benefits of federal farm programs (to the extent such programs continue) much be shaped to eliminate the advantage of the largest operations in using their economies of scale to bid up cash rents and land values, to the detriment of midsize and smaller operators. Third, society should reaffirm whether it prefers an agricultural sector of independent entrepreneurs or a sector of serfs. If it is the former, and I believe the former is more consistent with a healthy rural America, then increased attention must be given to mergers, consolidations, contract practices, and other factors that reduce the management role of the producer. Finally, a further word on supporting Third World economic development: that move would clearly be in the long-term best interests of the human family. Even if one’s interests go no further than national security, in a world of disharmony, eliminating world hunger is a worthy goal on a priority basis. That is why we need to be peering ahead from a platform of a global food and agriculture policy in the twenty-first century.

Farm Competitiveness: Lessons from Diversity

Mary Bohman - Director, Resource and Rural Economics Division, Economic Research Service, U.S. Department of Agriculture

Over the last several decades, total U.S. agricultural output has continually increased while the total input level has been relatively constant. The increase in output has been driven by productivity growth. Farmers have responded to long-term trends by increasing farm size and specialization and becoming more integrated with the non-farm economy. Farm size has continually increased over the last several decades while the number of farms has declined, and the amount of land farmed has been relatively unchanged. Meanwhile, farms have become more specialized. The average farm produced 5.1 products in 1900, 2.7 in 1970, and just 1.3 in 2000-2002. Farm households over the last few decades have also been relying on an increasing level of non-farm income.

Large farms continue to expand and grow. The share of the total value of production for farms with sales of $500 thousand or more increased from 31.6 percent in 1989 to 44.7 percent in

2003. Farm size is increasing broadly among commodities. From 1989 to 2002, the percentage of farms with at least 1 thousand acres of a commodity increased from 5 to 20 percent for corn producers, from 18 to 41 percent for wheat producers, from 8 to 21 percent for barley producers, from 8 to 30 percent for rice producers, from 9 to 22 percent of soybean producers, from 8 to 20 percent for sorghum producers, and from 19 to 48 percent for cotton producers.

The data show that profits increase with size. The operating profit margin by sales class continually increases as the level of sales increases. Although large farms are generally more profitable, farms of all sizes earn profits and losses. There are successful small farms for all products and all regions of the country.

There is no single strategy in terms of method of operation. Sources of farm income vary. Farms of all types earn off-farm income, but larger farms tend to earn a higher percentage of household income from the farm while smaller farms tend to rely more on off-farm income. Access to land varies. Most farms own land, but a larger percentage of large farms also rent land. Input procurement, whether it be through hired and contract labor, custom work, or machinery lease, also varies.

One thing we do know is that experience matters. The probability of exiting farming decreases for both large and small farms as farming experience increases. Work is ongoing at the Economic Research Service to understand the overall determinants of success.

Concentration in the Food and Agricultural Sector

William Heffernan - Professor Emeritus of Sociology, University of Missouri-Colombia

The food and agricultural sector has changed significantly in recent years. It is becoming more like other sectors of the economy. These changes are occurring through increased concentration, greater vertical and horizontal integration, and the development of more strategic alliances and joint ventures. Concentration in the protein industries (beef, pork, and chicken) and the grain and milling industries has been increasing. Three companies - ADM, Cargill, and Bunge - control virtually all grain movements between countries. There has also been increased concentration in the genes and seed industry, where five firms dominate. The only industry going in the opposite direction has been ethanol, which has become less concentrated since the time when ADM was the dominant player. The United States has been slow in concentrating its retail sector, but this has accelerated in recent years. The change is complete now from the gene to the retail sector. Horizontal integration through consolidation has occurred very rapidly, and vertical integration has connected the retail sector back to the production and processing sector.

These structural changes are occurring not just in the United States, but globally. In Europe, the retail sector has been concentrated for a longer period. Australia and Brazil are largely dependent on firms from other countries, mostly U.S. and European firms, and the industries in these countries are also highly concentrated. The retail sector in Brazil has begun to change rapidly. Africa is also starting to experience an increase in concentration. Four South African firms have expanded into neighboring countries. We do not know as much about the food and agricultural sector in Asia, but we do know that there are large firms that exist throughout the region.

What does this mean for rural development? When a large firm comes into the local community, they see labor as something to be bought as cheaply as possible, and returns to management and capital immediately leave that community. Many people in rural development are starting to realize that this is important and they are putting entrepreneurship as a top priority.

There are a number of compelling social justice issues regarding this changing food and agricultural system. Among these issues is the mission of corporations versus feeding the hungry. Structural change in the food industry could be contributing to an increase in hunger and poverty. Corporations are in business to make money. Their mission is to increase the wealth of their stockholders. A manager of one of these major companies would not worry about meeting the needs of poor people (almost half of the world's population has an income of $2 per day or less) but would spend money developing products for the wealthy to buy. Because of how the system is set up, these firms are not worried about feeding the poor people of the world. Other issues include the problems from western diets (overeating, diabetes, etc), importing food from the poor countries to feed the rich while their own people have a poor diet, non-wage labor, extracting profit from human and natural resources, and the prospects for cooperatives.

PROSPECTS FOR A NEW FARM BILL

Policy Issues Meriting Discussion in Connection with the 2007 Farm Bill

Neil Harl - Professor Emeritus, Iowa State University

Although the last two farm bills have been popular among producers participating in the program, the legislation has been less popular among U.S. taxpayers, Third World producers, and
the World Trade Organization. While it is unrealistic to expect any law to be universally popular, the shortcomings of the 1996 and 2002 farm bills appear likely to lead to significant changes in the 2007 legislation.

The cost of federal farm programs would be notable in any era, but it is especially jarring at a time of record-setting federal budget deficits from tax cuts, fighting a war in Iraq and Afghanistan, repairing the damage caused by 9/11, and rebuilding the Gulf Region after the hurricanes this year. The current and projected deficits are not sustainable economically or politically. Agriculture is expected to make a significant contribution to closing the deficit. Moreover, the agricultural sector has a substantial stake in rational fiscal (and monetary) policies which are at risk if current deficit levels continue. The consequences for interest rates and access to capital could be significant if this problem is not dealt with. In light of those budgetary pressures, the WTO, and the usual divisions in the farm bloc, the next farm bill could be the most difficult politically in history, although that has been predicted before.

Any attempt to stabilize the farm sector runs the risk of distorting resource allocation. Farm commodity legislation has been criticized for decades for causing distortions, but no farm bills have managed to achieve the level of economic distortion reached in the 1996 and 2002 legislation. Production of program crops in the United States, boosted by a robust stream of technology, has driven down prices for program commodities worldwide. In the United States, part of the lost income is made up by generous subsidies from the U.S. Treasury. But in countries that cannot or will not make up lost producer income in those countries, low commodity prices pressure land values and drive down returns to producer labor and management. Workers then leave the land, exacerbating social problems in large cities, and often stunting economic development which frequently begins with improved agricultural productivity. We are at a point in our history where we need to look closely at our responsibilities and the opportunities we have in front of us to start viewing our problems of resource allocation and income distribution a little bit more on a global basis.

The evidence is convincing that a significant portion of the subsidies is being bid into cash rents and capitalized into land values. Land values in the United States are influenced by (1) expected crop profitability, (2) the anticipated level of government payments, and (3) other factors including development pressure. If investors were to expect less federal funding - or none at all - land values would likely decline, perhaps by as much as 25 percent. The drop would be severe if withdrawal of subsidies were abrupt. Some have argued for a deliberate withdrawal of all subsidies, with land values falling to a new lower level, in the interest of competitiveness with other countries. While that might be appealing to some, the ride down would be rough. The presence of higher land values in the United States than in Brazil should not be viewed as a problem. What will drive down land values is a decline in expected profitability or a decline in government payments or both.

The time is here to look at strict limitations in payments. Philosophically, the issue comes down to whether federal farm program payments should be viewed as welfare (in which case the payments would be capped) or as an entitlement program (in which case payments would be made regardless of size or scale of the producer or the eligible "person”). Federal farm program payments have been limited since 1973 but the Congress (statutorily) and the U.S. Department of Agriculture (administratively) have tacitly or otherwise specifically provided for or condoned "escape hatches" for those impacted by payment limitations. Reform should be done to eliminate the opportunity to create persons, strengthen the criteria for determining eligibility of persons, and attribute all payments to an individual and an individual social security number.

Stability is very helpful for producers. We have some alternatives for farm policy to maintain some stability. We can maintain the current policy and hope we have funding. The American people view their agriculture highly enough that we will have funding for a responsible set of programs. We may begin to lose this support, however, if there are payments going in large amounts to a few large operators. We may reduce funding with no change in policy, or we may go back to a previous policy of supply management. The architecture of farm policy from 1933 through 1996 featured authority granted to the Secretary of Agriculture to attempt to balance demand and supply. In the years when the Secretary of Agriculture had surrogate CEO authority, price swings were moderated through the use of storage programs and land idling. The shift back to the 1938-1996 pattern of stabilization for the agricultural sector would be much less costly and less distortive. However, I do not think there is support now for this type of policy. A better option is to give maximum latitude for producers and hope there is funding for times of low prices and overproduction.

A great deal of attention is being given to shifting from commodity-based programs to conservation-based programs. While such a move would have considerable appeal by reducing the impacts on trade, a shift of this nature would have profound economic consequences. To illustrate the shift, assume two sections of land. One we'll assume is a non-erodible, highly productive, flat tract with a high level of commodity payments. The other section is characterized by rough terrain, steep slopes, and thinner soils. The first tract is receiving $40 per year of payments; the second tract has been averaging $15 per year in payments. If an abrupt shift were to occur in payments, away from being commodity-based and to a conservation-based approach, it would be expected that the value of the most productive section would decline and the value of the least productive section would rise. Nationally, the outlays could well be the same, but the micro effects would be substantial. Any shift toward a conservation-based policy should, if possible, be phased in over a period of years.

Food is clearly the most basic need for survival and social stability. Assuring an opportunity for access to an adequate diet is in everyone's interest and should be a win-win for food producers as well as those who would benefit through better diets. Moreover, it is a critically important security issue. Peace and stability rarely coexist in areas of chronic food shortage. The level of disharmony now seen in the world is unlikely to be reduced so long as significant numbers of individuals are suffering malnutrition and starvation.

The surest way to succeed in addressing food availability, food safety, and stability in the world is a global food and agriculture policy. A global policy should include Third World economic development. It generally has been believed that a country that is well fed, prosperous and populated with individuals who see a brighter future in the decades ahead is far less likely to be a mischief-maker in the world. The challenge of this generation, perhaps the first generation to have the means and the inclination in terms of political support to implement such a global food and agriculture policy, is to begin now by laying a foundation for international support for a global food and agriculture policy.

POLICY ALTERNATIVES - SHOULD WE LOOK OUTSIDE THE BOX?

The box we're in...

D. Demcey Johnson - Market and Trade Economics Division, Economic Research Service, U.S. Department of Agriculture

The fact that we rely on commodity based programs imposes a lot of constraints and also has implications. We can divide our payments into two broad categories: those that are fixed and those that are market-contingent. Much of the variation in total spending is due to market-contingent payments, which are still a major feature of the U.S. program despite some movement to decoupling. The fixed payments are green box and are the closest to being truly decoupled, that is, not linked to current market prices or planting decisions. Counter-cyclical payments are partially decoupled. They have not yet been notified to the WTO and would probably be amber box or blue box under a new definition, but that remains to be determined. Marketing loan benefits are fully coupled and are classified as amber box as they have the highest potential for trade distortion.

Limits on the Aggregate Measure of Support (AMS) have motivated a move to decoupled or green box payments in recent years. The Brazil cotton case has cast doubts on U.S. claims that our fixed direct payments are in fact decoupled. The Doha Round will likely leave some of these definitions unclear.

There are some unintended effects from farm programs. Subsidies get capitalized into land values. Government payments may stimulate structural change, resulting in a more rapid move toward larger farms. Farm programs may affect our competitiveness. The effects on land values are not as important as the unmet needs of agriculture and how our spending addresses or does not address issues related to productivity, which is crucial to competitiveness. The rate of productivity growth for U.S. agriculture has slowed in the last 10 years. This should be part of the discussion. We should be thinking about types of public expenditures that can enhance productivity of the entire sector. Many forms of this type of public investment would be considered green box under WTO rules.

Policy reforms have been implemented in other countries. Canada has a new version of income stabilization called the Canadian Agricultural Income Stabilization (CAIS) Act. CAIS combines income stabilization and disaster assistance. It is a fully-subsidized whole farm insurance. This program is a different approach to supporting farm income. The farmer selects a level of protection and makes a fully refundable deposit. The deposit entitles the farmer to government assistance in case of income loss. When net income falls below a certain margin, the government provides assistance. The proportion of government assistance changes depending on the severity of the income loss. For the first 15 percent in income loss, the government provides 50 percent of the loss. When income loss drops between 15 and 30 percent, the government will provide 70 percent of the loss, and for income loss greater than 30 percent, the government will provide 80 percent. The program does not depend on accumulation of account balances. This program has some interesting features that should be looked at more carefully.

EU Common Agricultural Policy (CAP) reforms were motivated by the same things motivating change in the United States: the WTO, budgetary costs, and consumer and environmental concern. Major features of EU reform include single farm payments, cross-compliance, rural development programs, and control of market-support budget expenditures. The single farm payment is a direct income payment based on historical entitlement, it replaces most arable crop payments, extends decoupling, and reduces the role of commodity support. Producers receiving the single farm payment comply with mandatory set aside, food safety and food quality assurances, animal health and welfare standards, and environmental standards.

New Zealand underwent a drastic liberalization in the mid-1980s, reducing support substantially. As a result, there were sizable adjustments. Farmland values dropped, and there were changes in output mix, farm structure, and employment. The adjustments were far from painless. Reforms harmed youngest farmers, who had lower equities, the most. Their agricultural sector, however, showed the ability to adapt, and they came out stronger in the end. Productivity in New Zealand increased after these reforms.

There are two different directions for U.S. farm policy. The first is to make marginal changes. Under this scenario we would preserve the current instruments but implement cost containment through lower loan rates and payment limitations. The second option is comprehensive reform. This could include full decoupling or buyouts. It would include more green, or environmental, payments and a new safety net program. There are also a few other less likely policy options such as a return to supply management or a devolution of policy to the states. When evaluating alternatives for farm policy we need to consider budget implications, WTO compliance, distribution of payments, market orientation, competitiveness, and wealth effects.

Feasibility of Farm Program Buyouts

David Orden - Professor of Agricultural Economics, Virginia Polytechnic Institute and State University, and Senior Research Fellow, International Food Policy Research Institute

A farm program buyout is an explicit agreement to end the farm support program by making a significant but temporary compensation payment. A buyout is a policy option that the United States might utilize to reduce the long-run fiscal cost of subsidies and facilitate agricultural trade liberalization, while providing substantial transition support to farmers. The focus is on whether reforms that decouple support programs, which are designed to reduce potential production- and trade-distorting effects, can be made more convincing through a long-term buyout that would end farm subsidies. Buyouts have not been feasible in the past but recent reforms for peanuts and tobacco provide evidence of what might be done and the conditions under which it occurs. Estimates are provided of the potential cost of a buyout of the main U.S. subsidies of fixed and counter-cyclical direct payments and marketing loan benefits. The present value of a full buyout indicates the economic values at stake. The estimated discounted value (at a 5 percent discount rate) of annual payments for 25 years at levels such as the 2002 bill has provided is nearly $175 billion. The annual cost of a buyout of these 25 years of payments over just 10 years in exchange for ending the support programs is nearly $21.5 billion. This is high, but not unprecedented compared to past annual farm support payments. The value of this buyout as an infinite annuity is nearly $8.3 billion. If enacted, it is equivalent to securing payments at this level forever, but without the need for subsequent political battles to secure the future payments. Other buyout parameters yield different results. A buyout of fewer years of payments reduces the cost to taxpayers and benefits to farmers.

There are some challenges faced by a buyout. A more complete a buyout is more convincing but also more costly. Asking Congress to increase expenditure in the short run to achieve savings in the longer term is a challenge, as would enforcing the buyout when the long term arrives. If these obstacles can be overcome, a buyout might be a good deal for farmers, taxpayers, and an improved world agricultural system.

A New Approach to Providing an Agricultural Safety Net

Bruce Babcock - Professor and Director, Center for Agricultural and Rural Development, Iowa State University

The U.S. WTO proposal would require spending cuts. We have two kinds of choices with regards to what we do with the agriculture safety net. First, we could basically take the status quo but reduce the amount of amber and blue box payments by cutting loan rates, effective target prices, and the proportion of production eligible for support, and maybe replace this with increased direct payments. The concern is what kind of safety net we are left with. The second option is to redesign the U.S. safety net, thinking about insurance principles, and attempt to meet WTO and budget objectives and improve the effectiveness of the farm program.

Producers face risk through variability in yields and prices. A yield safety net does not always work. For example, if yield is high and price is low, the producer receives no payment, but cash receipts are likely to be down due to the low price. On the other hand, if yield is low and price is high, payments will be received, but it could be excessive because of the high market price. If yield is low and price is low, payments will be received, but there is no compensation for low price. Similarly, a price safety net also leads to significant holes. If price is high but yields are low, there will be no payments with a price safety net, yet cash receipts will likely be down for some farmers, and if both price and yield are low, payments are received but there is no compensation for low yields. Instead of providing a yield safety net or a price safety net, providing a revenue safety net makes the most sense. With a revenue safety net, payments are received if revenue is below a target, whether it be due to low yields or low prices. A revenue target would also save some money by avoiding overcompensation.

The WTO agreement allows an income insurance program to be classified as green box, and the green box payments are not restricted. The WTO allows a 5-year Olympic average of income insurance. This would be the basis for the program. In order for the program to be green box, the farmer would get 70 percent of this 5-year Olympic average guaranteed. The value of a 70 percent guarantee is much greater at the farm level than at the county level. An individual guarantee at the 70 percent level provides about the equivalent loan collateral to what producers are obtaining now with crop insurance. The average payment to Steele County wheat producers under a green box income insurance program would be $4 per acre, and it is counter-cyclical aid as farmers would receive this support the most when they need it. This program serves as the base level of a redesigned safety net.

New amber box and blue box programs could be designed to supplement this green box insurance program. Under the new amber box program, we define county target revenue as the product of expected county yield and a target price, and we define actual county revenue as the product of county average yield and national season-average price. Payments flow when actual county revenue is less than the amber coverage level times the target county revenue guarantee. Maximum payments are reached when actual county revenue falls below 70 percent of target county revenue, and payments are made on actual farmer-planted acreage.

In the blue box program, payments flow when actual county revenue is less than the blue coverage level times the target county revenue. Maximum payments are reached when actual county revenue falls below the target county revenue times the amber coverage level, and payments are made on fixed base acreage.

On top of the 70 percent coverage from the green box program would be some level of the amber box and blue box programs. When revenue falls, blue box payments are made first, then amber box payments, and then finally the individual coverage in the green box program. How much safety would this program provide? The objective is to maximize the sum of amber and blue box payments subject to spending limits on these payments under the U.S. WTO proposal. Under the WTO constraints, the amber box in this program would provide a maximum safety level of 85 percent for all crops and counties and the blue box would provide a maximum safety level of 95 percent. This safety net provides greater coverage than the current program which targets only price.

The impacts of this proposed program are that it provides an effective safety net within WTO limits as proposed by the United States; consolidates crop insurance, commodity programs, and disaster aid; adopts the target (revenue) that farmers would prefer; and would be a departure from 70 years of supporting price.

Farm Legislation: Why Does it Exist?

Daryll Ray - Professor and Director, Agricultural Policy Analysis Center, University of Tennessee

The United States has lost its way with respect to agricultural policy. We do not seem to have a clear idea about much of anything, including what the problem is or what objectives are to be achieved, so we are willing to believe anything. We seem willing to believe that staple crops are not sufficiently important to have emergency reserves (unlike oil), that less than full use of farm productive capacity is inefficient, that the reason we have farm programs is because farmers have the political ability to extract billions of dollars from Congress, and that these commodity programs are a waste. We need to understand why we had agriculture programs instituted in the first place.

The supply and demand characteristics of aggregate agriculture cause chronic price and income problems. On average, supply grows faster than demand, so prices decline. Technology expands output faster than population and exports expand demand. Much of this technology has been paid for by U.S. taxpayers. The growth in supply is now being fueled by increased acreage in Brazil and technological advances worldwide. Unlike in other industries, lower prices do not solve the problem of supply outpacing demand. Agriculture cannot right itself when capsized by low prices. In agriculture, there is little self-correction on the demand side because people will pay almost anything when food is short, and low prices do not induce people to eat more. There is also little self-correction on the supply side because farmers tend to produce on all their acreage and there are few alternative uses for most cropland. Since the 1996 "Freedom to Farm" Act, aggregate U.S. corn, wheat, soybean, and cotton acreage changed little despite a large fluctuation in price.

U.S. farm policy needs to be created on the premises that U.S. and world output will continue to outpace demand in the short to medium term, aggregate crop agriculture does not self-correct, our export competitors are as committed to producing for international markets as we are, and our import customers view food as a national security issue and abhor increased dependence.

Many of the current policies do not address the problems of agriculture. Exports have not delivered as a policy option. U.S. crop exports have been flat over the last 20 years. Meanwhile, exports from developing competitors have increased substantially. A problem with the conservation, environmental, and rural development policies is that they do not address the long-standing market characteristics of aggregate crop agriculture. These are important programs, but money should not be shifted away from commodity programs to fund them. Insurance or farm savings accounts also have problems because income protection would ratchet down during extended periods of low market returns.

The farm bill needs to address the following issues: the unique characteristics of crop agriculture that result in chronic price and income problems; variation in production due to weather and disease; trade, environmental, and conservation issues; and rural development beyond agriculture. From my perspective, the 2007 farm bill needs to include provisions for buffer stocks, supply management, a stocks program, and bioenergy production. Buffer stocks provide a reserve supply of grains and seeds in the case of a severe production shortfall. Supply management is needed to manage acreage utilization in the same way that other industries manage their capacity, and a stocks program would ensure an orderly marketing process. These policies would provide a means of dealing with supply and demand inelasticity. A bioenergy policy would keep the land in production so that we do not pay farmers not to farm, and it would provide a needed energy source not unlike the horsepower of times past.

Long-term solutions to chronic price and income problems need to include international supply management to manage supply on a global scale. At the present, U.S. supply management can benefit farmers everywhere in the world. As countries like Brazil and other developing export competitors continue to increase their capacity, they will need to be a part of an effective supply management program.

Collin Peterson - U.S. Representative (MN)

As the ranking member on the House Agriculture Committee, I have had the opportunity to travel around the country. The universal message I get every place I go is that the farm bill is working. This has been a popular farm bill, and most people do not want it changed. However, there is concern among some wheat producers that with the way the program is structured right now, they do not see how they can plant wheat given the target prices. That may be one valid area of concern, but the bill has mostly been successful. This bill put the safety net back in place, and that was what farmers were looking for.

The one thing we are missing is a permanent disaster component in the farm bill. We are kidding ourselves if we think we are not going to have disaster programs. We have been passing ad hoc disaster aid every year over the last several years. It would be better to make this a permanent component of the farm bill. A permanent program would likely cost less money because every time we pass a disaster bill, things get added into it that should not be, and the bill ends up costing more money than it should. The bill I introduced says that you would not qualify for this disaster aid unless you buy crop insurance coverage of at least 60 percent. With a permanent program, we could set up a type of account and the Secretary of Agriculture would have the authority to make disaster payments to producers in disaster counties, and farmers would not have to wonder if Congress is going to pass disaster aid.

We should extend the current farm bill until we see the final WTO deal. The multinational companies are likely to benefit from this deal while producers will get harmed. Congress is starting to pay more attention to these trade agreements, which they were not doing previously. Both Democrats and Republicans in Congress were opposed to U.S. trade negotiators offering cuts to domestic subsidies unless Europeans made a substantial offer to eliminate the disparity between U.S. and EU subsidies. I think that we can compete with anyone in the world if we are on a level playing field, but we are not, and I am skeptical that we will get there.

What happens with budget reconciliation and the WTO will have a lot to do with what we will be able to do in the 2007 farm bill. If trade negotiators give away our subsidies in the WTO or if our baseline is reduced in the budget reconciliation, our hands will really be tied when we write the next farm bill. We are willing to make some changes, but we have to be smart about it.

One thing we need to consider as we write the new farm bill is doing even more to promote the energy component of agriculture. I think that the idea of exports being a solution for agriculture should really be questioned. Historically, this has not played out. We should not give up on exports, but given all the trouble from the WTO and the budget, we should shift our thinking from exporting our crops to producing fuel from our crops. Energy is a major national security problem, and agriculture can be a big part of the solution. There is a huge demand for biofuels coming. We could end up importing biodiesel from Europe because we are not producing enough in the United States. One thing we could look at in the next farm bill is subsidies following energy more than commodities. We need to be careful so that the big multinational companies do not control the ethanol and biodiesel industries like they control the export side.

WILL THE PUBLIC CONTINUE TO SUPPORT AGRICULTURE?

Public Support and Agriculture: The European Experience

Jean-Marc Trarieux - Agriculture Attache, Delegation of the European Commission

The European Union (EU) currently consists of 25 member states and is home to around 11 million farmers, out of a total population of about 455 million. The Common Agricultural Policy (CAP) is the EU's version of the farm bill. A survey found that the top three expectations for farm policy among Europeans are that it ensures that agricultural products are healthy and safe, promotes the respect of the environment, and ensures that the well-being of farm animals is respected. Other key expectations for agricultural policy are that it protects medium- and small-size farms, favors and improves life in the countryside, and protects the specificity and taste of EU products.

Consumer concern is a driving force for policy reform in the EU. Europeans want food safety, quality, and choice. Health and food safety have long been on the top of European consumer concerns, while the environment and animal welfare are more recent concerns. Food safety crises in the 1990s undermined public confidence in the food industry and authorities. It is necessary to establish and keep consumer trust by emphasizing safety and providing information.

Since 1992, CAP reforms have concentrated on reducing the trade-distorting elements of the policy, increasing the significance of rural development, and meeting the growing range of consumer demands. The key objectives for reforming the CAP in 2003 were a competitive EU agricultural sector, environmentally friendly production methods, quality products, enhanced landscapes, and a dynamic and sustainable rural economy. CAP reform consisted of the decoupling of direct payments, cross-compliance, modulation, and strengthening rural development. Cross-compliance means that to receive payments, farmers are required to meet new standards regarding the environment, food safety, plant and animal health, and animal welfare.

The EU's agricultural budget has shrunk from 0.63 percent of EU gross national income in 1990/92 to 0.49 percent in 2000/02, and it is expected to drop to 0.33 percent in 2013. Export subsidies have also been cut by more than half since 1992. Meanwhile, EU net export shares for wheat, beef, and poultry have been dropping.

There is a strong overall support among Europeans for the CAP's new directions. Sixty-six percent of EU citizens see the adjustment of the CAP from a subsidizing system to a system which funds the protection and development of the overall rural economy as well as direct support to farmers as a good thing. Fifty-seven percent believe that the CAP is doing a good job in ensuring that agricultural products are healthy and safe, and 55 percent think that the CAP plays its role fairly well in promoting the environment.

Farm policy should be designed as a contract between farmers and society to translate citizens' demands beyond food production. The key word is sustainability. It is key for farm policy to be economically, environmentally, and politically sustainable.

Will the American Public Continue to Support Spending on Agriculture?

Joseph Molnar - Professor of Agricultural Economics and Rural Sociology, Auburn University

The drivers of changing public views on farm policy are demographic, economic, political, social, and cultural. With respect to demographics, only one percent of Americans live on farms. The farm sector is diminishing, while everything else is expanding. Farming is the occupation with the highest projected job loss. As a result, there is a diminishing fraction of Americans with personal experience with farming. Economically, agriculture remains a central part of the economy, but jobs and activity have moved upstream. Fewer farms produce more, while there is growing employment in marketing, manufacturing, and distribution. Politically, farm votes have become less important. Farm interests do not vote as a bloc but are splintered among many groups. Farm programs follow the political contributions (for example, sugar, cotton, and corn). Meanwhile, other issues overshadow agriculture in getting the public's attention. There is a growing disconnect between farmers and policymakers. This disconnect has resulted from redistricting and rural legislative strength moving to the suburbs, suburban and city friends continually feeling more removed from agriculture, and a lack of a united voice for agriculture. Divisiveness among agricultural groups has prevented an effective case for legislative support.

Despite these changes, results from various national surveys on public attitudes show that Americans do, in fact, support farm subsidies by wide margins. They are particularly likely to support subsidies for small farms, for farms that have been damaged by the weather, and for farms willing to incorporate environmental practices. There is near universal support for providing payments to help farmers stay in business. However, a majority of survey respondents oppose giving subsidies to large-scale farms. Americans believe that farm policy currently favors large farming businesses, but they want subsidies to favor small businesses. Similarly, a majority oppose giving subsidies to businesses that provide farmers with equipment and services.

The public consistently favors subsidizing farms. Reasons for supporting subsidies include controlling food cost, protecting family farms from economic competition, the benefits of locally grown foods, food safety and food supply, and environmental concerns. People value farms and ranches for environmental reasons. They believe land owners have a responsibility to be good stewards of the land, and they value habitats for wildlife and scenic qualities. The public supports subsidies to encourage environmental practices. Farming is not viewed as an environmental problem, but the public believes farmers can be enlisted in environmental solutions. The public is likely to continue supporting spending on agriculture, and support for WTO-acceptable green payments is likely to be high.

A Plausible Alternative Structure for Agricultural Support

Ralph Grossi - President, American Farmland Trust

Change in the farm program is inevitable. The major forces changing the political arena are globalization, budget pressures, and transparency. Increased transparency has resulted in an increased awareness by the public of who is getting what. Farmers are anticipating change, and they want to be a part of the change, but they have a high level of anxiety driven by concerns of economic disruption. There is some embarrassment among farmers about being dependent on the federal government, but they need a safety net. They also have concerns about the opportunities for young people to get involved in agriculture.

A plausible alternative structure for agricultural support consists of three components: risk management, land stewardship, and new market opportunities. New market opportunities include energy, pharmaceuticals, niche markets, and others. There should also be a renewed commitment to research, extension, and technical assistance, and there needs to be a transition mechanism to help farmers move from the current farm program structure to a new one.

We should accept the inevitability of change. Now is the time to start redesigning the farm program in a way that the public will support.

DO THE CUSTOMERS GET WHAT THEY WANT?

Patricia Jensen - Consultant on Food Safety and Public Policy Issues

In a survey of North Dakota consumers in October of 2000, Dakota Heritage Beef learned that food safety is the number one factor influencing beef purchasing decisions. This mirrors a national survey conducted by Michigan State which found consumers to be increasingly concerned about food safety.

Since both of these studies have been conducted, there has been a significant downward trend in foodborne illness, The baseline used most frequently is the CDC estimates which have shown 76 million cases of foodborne illness a year, with 325,000 hospitalized and approximately 5000 deaths.

Research conducted at NDSU by Mounir Siaplay, William Nganje and Simeon Kaitibie[1] on Risk and Food Safety Loss estimates that the turkey industry from 1994-2003, suffered losses as high as $1.35 billion.

So, this is an issue that can severely impact both health and economics.

There has been significant progress recently reported on the trends in food safety. The FDA now reports a dramatic decline of e-coli 0157-H7 infections from undercooked ground beef. There has been a drop of 42% in the last eight years. In Yersinia from raw or undercooked pork, there has been a 49% decline. Camplylobacter has decreased 31% and Cryptosporidium and Listeria have decreased 40%. Salmonella continues to be a challenge with a strong increase in javiana as linked to a Roma tomato incidence in 2004.

These latest numbers are certainly a cause for optimism in the effort to produce safer food. In fact, the USDA reports that its goal of Healthy People 2010 has been achieved for e-coli 0157:H7 --1 case per 100,000 people. The goals for listeria and camplyobacter are nearly achieved as well.

This is good news for food customers, both domestic and international. The message is clear. American agriculture has taken the customer's needs seriously and continues to work on improvements.

Funding in Congress has been prioritized for food safety and biosurveillance. The ND delegation has supported research and education in this topic at ND institutions. State governments and legislatures have also recognized the significance of these issues. Strategies

[1]Former Graduate Research Assistant, Professor, and Research Assistant Professor, respectively, in the Department of Agribusiness and Applied Economics, North Dakota State University, Fargo. This research was published as Agribusiness & Applied Economics Report No. 557 in March 2005, and is available on the Ag Econ Search website: http://agecon.lib.umn.edu/cgi-bin/detailview.pl?paperid=15945.

are being sought to continue the positive trends. Traceback methodologies are rapidly being developed. Pathogen reduction strategies in live cattle are being employed and the Hazard Analysis, Critical Control Points (HACCP) is now fully operational in food plants. And, sensors are being developed to assure safe food pathways from the farm to table.

I believe that it is important that those working in the food chain be rewarded for their efforts and would suggest that USDA implement a stronger voluntary certification program which would allow producers who employ extra effort and management practices resulting in even safer food to be certified for those efforts.

The use of specific humane slaughter techniques is now being required in some contracts. McDonald's and others have refused, for example to accept beef where downers have been used. Special contract requirements are used as marketing tools in reaching customers who respond positively to such measures. This is a trend which is likely to continue.

In conclusion, American agriculture continues to prioritize safe food and customer preferences and priorities. By finding ways to enhance communication with the consumer by marketing techniques and contracting, the successful efforts being pursued in agriculture should result in a stronger economy in the ag sector.

ALTERNATIVE POLICIES OR THE STATUS QUO?

Farm Policy: Why a New Direction is Needed

Robert Carlson - President, North Dakota Farmers Union

There are a number of issues to address: 1) Is real net farm income at a high, near-record level? 2) Do farm program payments, especially the direct payments, get capitalized into land values? 3) Do liberalized trade agreements improve or harm U.S. producer income? 4) How important are farm programs to producer income? and 5) Do U.S. farm programs hurt farmers in developing countries?

Statements from the USDA indicate that net farm income has been at or near record levels the last two years and that farm household income is well above the national average. However, this depends on how you compile the numbers. The USDA numbers are misleading due to the way in which they are calculated. The farm household income number includes off-farm income, which represents a substantial share of household income.

Are commodity payments doing what we want? While the counties most dependent on farm payments likely would be suffering a lot more without payments, the concern is that the government payments are just being capitalized into land rather than bridging an income gap in production. These areas would be susceptible to large decreases in land values if government payments stopped.

Are liberalized trade agreements beneficial to producer incomes? The data show that exports have not delivered. The agricultural trade balance has shrunk over the last decade.

Farm programs are essential to net farm income. Without government payments or insurance, net farm income in North Dakota would have been negative or close to zero in most years since 1997.

We are being told that U.S. farm policies are decimating agricultural production in developing countries. However, the end of agricultural support in the United States and in other countries would likely not reduce production. Data show that there is little acreage response to price in the United States. When Canada reduced subsidies in the 1990s, the crop mix changed, but total acreage remained flat. Mexico eliminated or reduced supports in the 1990s, but total crop acreage increased. When Australia dramatically reduced wool subsidies in 1991, acreage simply shifted from pasture to crops, and total farmland planted increased.

If the United States discontinued all agricultural support, land values would decrease (especially in the Great Plains states), putting producers, their lenders, rural communities, and infrastructure all at risk. The experience in other countries shows that virtually all the land would continue to be farmed, possibly by different owners, but supplies of commodities likely would not change and may even increase as producers try to maximize volume to offset lower revenues.

Here is our vision for future agricultural policy. The measure of success for any farm bill has to be the level of net income for producers. Farm policy should not be developed for multi-national corporations, processors, exporters, integrated livestock producers, and all similar firms who profit from low commodity prices. The Farmers Union is committed to working toward innovative farm policies that improve net farm income. We expect better targeting of farm program payments to family farms, defined as a unit using land and other capital investments operated by a family who provide stewardship and management, take economic risk, and provide the majority of the supervision and work on the farm or ranch. A vertically integrated or multinational grain and food conglomerate is not a family farm. The decline in the number of family-sized commercial farms must be reversed.

A Renewable Energy Reserve should be established for crops that can be dedicated to fuel production. The Conservation Security Program (CSP) should be fully funded, and CRP should be continued only on the most environmentally sensitive lands. We encourage innovative conservation practices. We believe that an analysis of current trade agreements is needed to determine if they are accomplishing their stated goals before our government negotiates any new ones.

A counter-cyclical mechanism and loan rates should be maximized to legal limits under WTO rules, but almost as important is some sort of indexing of loan rates or payment rates to account for increasing costs of production. Risk management will continue to be vital to producers, and we envision some sort of permanent disaster protection.

Farm policy and global trading agreements have the potential to permanently transform agriculture as we know it today. The owner-operated family farm is the keystone of a free, progressive, democratic, national society, as well as a strong America. Above all, farm policy needs to recognize and build on the strength of our nation's agriculture, not throw it on the altar of globalization and the failed economic policies of the past. Change is inevitable, but how we anticipate and adapt to change is up to us.

The Budget Problem and Structural Change in Agriculture

Robert Young - Chief Economist, American Farm Bureau Federation

Most Farm Bureau members probably want to keep the current farm program structure. Producers like the safety net and the current level of support. However, there are a number of pressures moving this structure. The major pressures are the budget, international trade agreements, and the structure of agriculture today.

Five major expenses - defense, social security, medicare, medicaid, and interest on the debt - consume \$1.6 trillion of the \$1.9 trillion federal budget. Spending for health care, social security, and interest is projected to increase \$93 billion per year. The total federal debt is projected to continue increasing significantly, even before rebuilding the hurricane-damaged Gulf Coast, making tax relief permanent, fixing the alternative minimum tax, and increasing defense are considered. Agriculture is but one of many forces competing for federal dollars. When choosing between social security, medicare, and loan deficiency payments (LDPs), most would chose to cut LDPs. Agriculture tends to be high on everyone's list for cuts. Even though farmers like the current level of support, the budget deficit is a very significant problem that needs to be dealt with.

The structure of agriculture has changed significantly in recent years. The total value of U.S. agricultural output is \$200 billion. Ten percent of this production is accounted for by just 389 farms, while 34 thousand farms produce 50 percent of the output, and 145 thousand farms produce 75 percent. The remainder is supplied by close to 2 million farms. Most of those 145 thousand farms would consider themselves family farms, not mega-size operations. Are we writing farm programs for the 145 thousand farms or for the other 2 million? This is an issue we need to think about. A minimum number of farms produce between 25 percent and 75 percent of the value of agricultural output. The number of middle-size operations has been declining. The total number of farms has dropped significantly over the last two decades. As a result, the counties that have lost population since 1980 have been those that are dependent on farming. We need to think about the issue of population decline and what we need to do to keep people in those rural communities.

Some farmers want to hear that trade is a bad thing and that they cannot compete globally. However, U.S. farmers are competitive, and trade agreements are needed to settle trade disputes.

The New Climate

Dale Thorenson - Gordley Associates

The 2002 farm bill is one that most farmers, commodity organizations, etc. would, for the most part, say they are happy with. I say most, because last week, I did hear for the first time the president of a major commodity group express their unhappiness with the bill to a member of Congress during a meeting. But the groups that we work for – and my peers that I talk to – would more than likely be happy to take a do-over with some minor tinkering if they had the chance, warts and all… rather than risk what we all acknowledge will be a very unfavorable climate in 2007/08 when we are scheduled to write a new farm bill.

That climate has been described by many as a Perfect Storm. And it's a storm that is in many ways intensifying. As others have discussed, we had a large projected federal budget surplus in 2002, but today we face massive record deficits for the foreseeable future. Last time, the Administration, having just been elected, was, at best, missing in action, and as Mr. Combest has the lumps to prove, was, at worst, opposed to going forward. Today, it's quite clear – as indicated by the FY2006 budget the Administration offered, the recent speech to the Commodity Club by Secretary Johanns, and the recent WTO trade proposal tabled by the U.S. Trade Representative – the Administration plans to be involved and will recommend major changes to current farm policy. The make-up of Congress has changed as well. Chairman Combest and Ranking Member Stenholm have a new adjective in front of their titles – former – as does Majority/Minority Leader Daschle. Those three Members were major players in 2002. Please don't misread this as criticism regarding their replacements… I'm just stating an obvious fact – the players have changed, and they will have differing priorities. Another item that has not been discussed much is that fruits and vegetables want in. I'm not sure in what fashion they want in, but this is a major change in that collective group's thinking. And remember… there will be less money available this time around.

I do believe there is universal belief in the Ag Community that no matter what outcome takes place with regards to the WTO negotiations, a viable income safety net needs to be retained in the next farm bill for U.S. farmers. We have heard from our members – real farmers with dirt under their fingernails – that although they want free and fair trade, they also believe that the ideology of free markets – even the nirvana of 100% market access everywhere – will not be able to prevent or mitigate prolonged periods of low prices. That's just a simple reality. Market access will not create markets if they become non-existent due to over production, monetary policy manipulation, phytosanitary restrictions, economic depressions, etc. Think back to the 1999-2001 time-frame, and consider what would have happened without the combined help of the 1996 farm bill and market loss assistance payments. The result would have been complete economic chaos in the rural economy.

For that reason, we will all be fighting tooth and nail to keep the ransacking of farm bill baseline spending to a bare minimum. At least $3 billion is being whacked off this year. Those cuts will continue in the years to come. And don't kid yourself, there are people at the Office of Management & Budget as well as the USDA who intend to take the cuts proposed at the WTO talks and put them towards the deficit rather than a green box support program. Those intentions are why you are seeing such strong statements coming out of Congress warning them about such intentions. We all have to tell our Members of Congress to hold that baseline, because without it… well… it's all about money, or the lack of it these days.

Conservation and Environmental Policy Issues

Lynn Tjeerdsma - Initiatives Manager, Theodore Roosevelt Conservation Partnership

Can we support traditional farm policy under the WTO? The quick answer with regard to the Commodity Title is not likely. The Brazilian cotton case has forced policy change. Both the U.S. Senate and House propose to eliminate the Step 2 Cotton Program through budget reconciliation. There are also possible additional cases. Conservation programs authorized under the 2002 farm bill, so far, have not been subject to any negative WTO action.

The most effective conservation programs are the ones that are conceived and carried out at the local level by the people who live and work on the land. Conservation programs are tools provided under the 2002 farm bill to assist you in practicing good stewardship on the land you farm.

We need to better educate the non-farm community regarding the public benefits of all farm bill programs. These benefits include a cheap and safe food supply, clean air and water, and recreational opportunities (hunting, fishing, outdoor activities).

Producers should be as educated regarding availability and applicability of conservation programs to their farms as they are of programs offered under the Commodity Title. Through increased utilization of farm bill conservation programs, expensive inputs can be focused on the farm's most productive soils. Better yields would translate into enhanced crop insurance benefits and reduced premiums. Additional income options would be available in the form of higher wildlife numbers. There would also be benefits to society through increased use of conservation programs, such as cleaner water and air.

Changes may need to be made to create WTO-compliant programs with features that provide a valuable safety net for production agriculture, and yet promote sound land stewardship practices. The closest program we have now authorized under the 2002 farm bill is the Conservation Security Program (CSP). There is a unique opportunity in less populous states such as North Dakota to provide valuable input to your members of Congress. The next farm bill is critical. You need to make sure it works for you.

International Policy Considerations

William Gillon - National Cotton Council

The preferred option seems to be to keep the status quo. Hurdles to the status quo are the WTO, countervailing duty actions, and public opinion. Hurdles within the WTO are meeting the agriculture targets and winning litigation.

To maintain a relative status quo under the U.S. WTO proposal would require a 10-15 percent cut in loan rates, similar AMS cuts in sugar and dairy, target price reduction, and potential offsetting increases in direct payments, insurance, and other programs. Moving away from the status quo could entail programs for government services, public stockholding, domestic food aid, income insurance and safety net, natural disasters, producer or resource retirement, and conservation and the environment.

The keys are to ensure that there is a green box, reduce commodity specific aspects and references, do not have any export subsidy components, and do not get too carried away with conservation, environment, and revenue insurance. There are two things we are uncertain of: will Congress write the farm bill with WTO rules firmly in mind? and can we merge WTO with budget issues and still make policy? Make no mistake, policy changes of this magnitude will have an impact.