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The Farm Bill, Doha, the Budget (and Ethanol!)

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The Farm Bill debate is currently underway in the U.S. Congress. This brief discusses the domestic and international forces influencing the debate, the final outcome of which is hard to predict.

As the first in a series of five briefs on possible 2007 Farm Bill scenarios and their impact on developing countries, this brief sketches the main features of the farm bill debate, outlines linkages between domestic policies and international negotiations, and discusses budgetary and other forces for policy change. The uncertainties in each of these areas make predictions difficult. This roadmap provides the reader with an overview of the processes and forces that will determine the content of the 2007 Farm Bill. While the Farm Bill will have many titles ranging from domestic food assistance programs to R&D and rural development, here we focus on the commodity title that sets the headline farm subsidy programs, which garner the bulk of international attention. The implications of alternative outcomes for world prices and for developing countries will be addressed specifically in the second of this Farm Bill series of briefs.

The 2007 Farm Bill is being written under vastly different circumstances than the 2002 legislation. The US ethanol boom, which has led to high commodity prices, the federal budget deficit, and the possibility of liberalized trade through a conclusion to the Doha Round negotiations in the WTO, all serve to set this farm bill debate apart from its predecessor. Add to this scenario the usual pandering for rural votes by both the Democratic and Republican parties (enhanced by the run-up to the 2008 presidential election) and the increased interest and influence of

non-commodity lobbying groups in the Farm Bill, and you have a unique and highly energetic environment for the crafting of future U.S. farm policy.

The Calendar

The Farm Bill debate is just beginning in Congress, after more than a year of formal and informal meetings held around the country by USDA, private groups, and Congressional committees, and after proposals from numerous stakeholders. The new Bill does not have to be passed until September 2007, and could even be further delayed. Once the budget parameters have been agreed, Congress must consider draft bills in committee. This entails hearings and compromise legislation from the agriculture committees of each legislative body. Legislation could emerge as early as July, but more likely it will be produced in the fall. Given the broad interest in the 2007 Farm Bill, it is not obvious that the full Senate or the full House of Representatives will accept the Bills proposed by the committees, in which case a "floor fight" may erupt. Moreover, the House and Senate versions would still need to be "conferenced" into one proposal. Under those circumstances, the final Bill could be quite different from that put forward by the agriculture committees.

The Players

Typically a powerful force in shaping farm policy, the groups representing program crops (corn, wheat, rice, cotton, and soybeans) have found themselves playing defense for much of the Farm Bill debate in the aftermath of the Brazilian WTO challenge against U.S. cotton programs. Since the WTO dispute settlement body ruled some U.S. subsidies to the cotton industry illegal, all program crops are under the shadow of further cases. Indeed, Canada has already initiated action against U.S. corn subsidies, and it is possible that a case will come against the rice support programs.

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Although the Administration does not have a formal role in the legislative process, it has clearly signaled its desire for U.S. farm policy reforms.¹ USDA's proposals call for reductions of support most closely tied to production incentives. They call for increased direct payments, optional enhanced direct payments in recompense for environmental

stewardship, a reduction in loan rates and a new formula for setting them, a new revenue basis for calculating counter-cyclical payments, and payment caps for individual farmers.

Compared to the last farm bill, a broader list of interest groups are fully engaged on the commodity title of the Bill, and the debates in the Committees as well as on the Floor of the two Houses could be protracted. International development groups, as well as civil society groups representing a range of interests from environment to rural development,

have seized on the results of the cotton case to put domestic pressure on the U.S. to reform its subsidies programs. They argue that the funds devoted to farmers are inequitably and inefficiently distributed and do not meet their stated objectives of supporting family farms and promoting rural development.

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The commodity programs also have to defend themselves against other U.S. agricultural interests. The rise in profitability of Specialty Crops, which are not supported by direct subsidies, along with the growing calls for conservation and bioenergy programs, are placing the current commodity programs under greater scrutiny. Why a few crops should be supported differently from the rest of U.S. agriculture is becoming more difficult to justify.

Furthermore, the five commodity crops are not as closely aligned in their desired outcomes for the Farm Bill as they typically are, which could decrease their lobbying force. Until recently, several farm groups and members of Congress favored a simple extension of the 2002 Bill, albeit with some necessary adjustments. However, because of ethanol's impact on commodity prices, only rice and cotton groups now see an extension of the 2002 Bill as the best that could be achieved. Wheat and soybean growers claim that the 2002 Bill was biased against their interests, while corn growers have argued that a new, revenue-based approach to subsidies would serve their industry better.

High Commodity Prices...

The huge shift in the demand for corn driven by the use of ethanol has provided the biggest "shock" to the economics and politics of U.S. agriculture in many years.

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A broad list of interest groups are fully engaged in the Farm Bill debate, including international development groups, and environmental and rural development interests. They have seized on the results of the cotton case to put domestic pressure on the U.S. for subsidy reform, arguing that the funds devoted to farmers are inequitable and inefficient, and do not effectively support family farms or promote rural development.

The price of corn has doubled in the past year, and other grain and oilseeds prices have also risen.² Output of ethanol was 4.9 billion gallons in 2006, up 25 percent from the previous year. Ethanol capacity has expanded so rapidly that ethanol output is expected to jump by at least another 25 percent in 2007 and, unless the price of oil collapses, additional ethanol plants in the building stage will ramp up demand for corn even more in the next few years. USDA estimates that 10 million more acres will be needed in corn production in the next three years. Neither the Democratic nor the Re-

publican parties are calling for a reduction of government support for ethanol. USDA and other baseline projections assume the price of corn will remain high for years to come, and the Corn Belt is gearing up for a prolonged boom.³

...and their Impact on the Budget Baseline

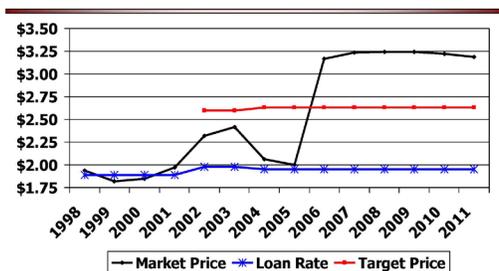
The budget baseline for projected commodity program spending for the new Farm Bill depends on what the current programs would be expected to cost

over the life of the new legislation. Higher projected prices for program crops and therefore lower projected budget costs under the old programs mean a lower “baseline” of funds available for the new Farm Bill.⁴ In recent weeks, it has become evident that an extension would essentially freeze the (lower) budget number given high corn prices. (See Figures 1 and 2)

The Congressional Budget Office (CBO) makes the official cost projections for the new Farm Bill. Additional funds must be allocated by the budget committees, and although agriculture has often managed to secure extra funds, with the size of the U.S. budget deficit, it is unlikely that the 2007 Farm Bill will have the funds allocated that were available in 2002.⁵ The high price of corn has meant that the current farm programs, if continued, would be projected to “only” cost \$75 billion over the next ten years. This is well below the expected costs for the decade projected at the time of adoption of the 2002 Farm Bill. Supporters of the current farm legislation have argued that the policy has been cost-effective, as well as popular with farm groups, and some have even argued that the reward for such budgetary parsimony should be more funding (such as by adjusting support prices upwards).

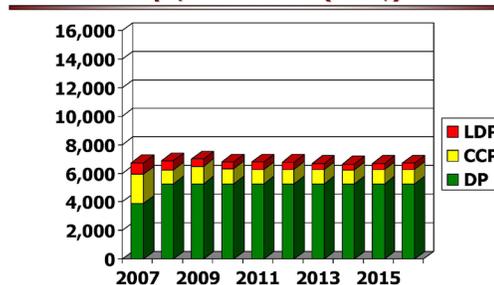
The Administration has taken advantage of these budget “savings” to argue that its own proposal will incur lower costs than what would be projected from a continuation of the 2002 Farm Bill and thus help to cut budget deficits. Conveniently, it can also argue that it is in a position to provide greater government

Figure 1
FAPRI January 2007 Baseline Market Price, Loan Rate, and Target Price for Corn, 1998-2011



Source: Food and Agricultural Policy Research Institute, 2007.

Figure 2
AFPC Projection of CBO March 2007 Baseline for Payments to All Program Crops, 2007-2016 (Mil. \$)



Source: Richardson, Agriculture and Food Policy Center, Texas A&M, 2007.

outlays than it would if the current Farm Bill were extended, given the high prices of key commodities (thus allowing an expansion of certain programs, particularly for conservation). The CBO has calculated that the Administration's proposals would in fact cost about \$10 billion more over the decade than an extension of current programs.⁶

Higher commodity prices make it difficult for farm groups to call for more funds for commodity programs in the 2007 Bill, but may make it easier to

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argue against major changes in the commodity program. It is therefore possible that the 2007 Farm Bill's commodity title will not be substantially changed, and only be modestly modified to become less vulnerable to WTO challenges. Such a scenario would leave little scope

for switching funds to other programs and commodities, or for conservation programs, and may not give the Administration much room to undertake cuts in U.S. domestic support above those it proposed to the WTO in October 2005.⁷

The alternative argument is that since current programs are projected to provide little support for program crop farmers, now is the ideal time to make major changes in the form and substance of the programs. Farm groups have argued in the past that farm programs cannot be changed in times of low prices. It remains to be seen how convincingly they can make the argument that they cannot be changed in times of high prices either.

International Factors

U.S. farm policy is not immune to international influence, and WTO trade disputes and the Doha Round are both factors in the 2007 Farm Bill. It is therefore useful to consider these external farm bill drivers.

WTO trade disputes, especially the cotton ruling under which the U.S. upland cotton programs were found to be inconsistent with WTO obligations, have featured prominently in the Farm Bill debate. Members of Congress, the Secretary of Agriculture, and outside groups have argued that one reason for modifying current programs is to bring them in line with existing WTO com-

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mitments and ensure that the United States is not forced to adjust its programs in response to WTO challenges. The main focus of these concerns are the magnitude of trade distorting support under the marketing loan and counter-cyclical programs and the incentive to modify the direct payment program so that it falls securely into the WTO "green box" of non- or minimally trade distorting subsidies. The USDA cited these issues as a major motivation for some of its farm program proposals, including cuts in marketing loan rates and counter-cyclical payments (especially for cotton) and the plan to remove the restrictions that limit which crops can be planted on land eligible for direct payments.

The Doha Round is again showing signs of life, with gradual convergence on key aspects of the agricultural modalities. Negotiators are examining the "bottom line" of the major countries and trying to formulate modalities that would accommodate these constraints. The United States is showing a willingness to improve on its offer of October 2005 and reduce domestic support limits to match movements by the other major players. It appears likely that the United States could agree to a limit on Overall Trade Distorting Support of around \$15-17 billion, down from the \$22 billion in its current offer. The EU would have to match this by cutting tariffs about 54 percent, and India and Brazil would have to provide significantly greater market access to their economies.

Concerns remain over whether exemptions for “sensitive” products and “special and differential treatment” for developing countries might undo the effect of any market access gains that would come from formula tariff cuts. WTO members are also struggling to address the possible concentration of reduced domestic support on specific commodities, which could negate progress made in trade-distorting support limits. Members of the WTO have been especially critical of the USDA’s Farm Bill proposal on this point, as it does not specifically cap the amount of subsidies that can be devoted to any one program crop within the proposed overall trade-distorting support limit.

Even if all agricultural issues can be resolved, non-agricultural parts of the Doha Round still need to provide balance in the final package. Once a modalities package is agreed, presumably in the next three months, it will have to be translated into binding schedule offers. The process of “verifying” such offers could take six months, and a final detailed Doha package should not be expected much before the end of 2007. But a deal on modalities could still emerge before the Farm Bill debate ends, and could thus be taken into account. Should the Farm Bill be agreed before the Doha Round has ended, changes might then be introduced in the implementing legislation for the Round.

Trade Promotion Authority (TPA) is an agreement between Congress and the Administration that limits the ability of Congress to amend the terms of a trade agreement once notified by the President, and

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submits the agreement to an “up or down” vote.⁸ The current authority expires on July 1, 2007. Congress may renew the authority, but would likely insist on conditions that may make future negotiations more difficult. Congress could also simply let

TPA lapse, at least until after the next President was in place in 2009. Without TPA, or similar legislation, the Administration could negotiate trade agreements, but with the threat of such agreements being subject to amendments in Congress, it is doubtful whether other countries would be willing to complete such talks.⁹ As trade votes in the U.S. Congress are becoming ever more controversial, the scenario of the agricultural lobby groups insisting on a status quo for existing U.S. farm programs in exchange for support of TPA should not be ruled out.

Conclusion

Given the number of factors influencing U.S. farm policy this year, the ultimate outcome remains highly uncertain. Given the difficulties in building a coalition for any particular change, some seasoned observers believe that the new Farm Bill’s commodity title will not differ much from the 2002 Bill, but others believe that the 2007 Farm Bill presents an encouraging opportunity for reform of U.S. agricultural policies to the benefit of both domestic and international constituencies.

Endnotes

1 USDA Farm Bill proposals, January 31, 2007. Other groups with relatively comprehensive proposals includes the American Farmland Trust, an environmental group, and the Chicago Council for Global Affairs, an influential foreign policy group. The Cato Institute, a libertarian think tank, has a relative short proposal; they favor eliminating all farm subsidy programs immediately.

2 In September 2006 the corn price was \$2.60 per bushel, and in March 2007 was \$4.20 per bushel. Over the same period, the price of soybeans rose from \$5.63 per bushel to \$7.28 per bushel.

3 Brief No. 3 will focus on the ethanol issue and the link with the Farm Bill.

4 This discussion is in terms of projected budgets because the main farm subsidy programs constitute “mandatory” spending in the sense that once program parameters are set, the government is obligated to spend whatever amount results from the market outcomes for that period. Outlays for these vary from year to year. The costs of the 1996 Farm Bill exceeded projections and, because prices have been above 2002 projections for several of the past 5 years, the 2002 Farm Bill has come in well under budget.

5 The total federal budget for any fiscal year is set by negotiation between the Administration and Congress at the beginning of a session. Congressional budget committees decide on the allocation of this budget. USDA’s total appropriation for 2006 was \$98.4 billion, of which 60 percent went to nutrition programs and 25 percent to commodity support, trade assistance and foreign aid.

6 The USDA budget cost estimates are “scored” by the Office of Management and Budget (OMB), and differ somewhat from those of the CBO. Given the magnitude of the outlays a difference of about \$1 billion per year between OMB and CBO is quite small and well within any margin of error of either estimate.

7 The current limit on the most trade-distorting policies (AMS) is \$19.1 billion. The U.S. proposal would reduce

that to \$7.8 billion. This is precisely the level that independent experts have estimated for the year 2006 for the United States. So any drop in prices would necessitate adjustments. The USDA proposal would shift a portion of this support into the “green box” and give some flexibility for marketing loans and countercyclical payments to rise.

8 There are five steps to conform with TPA. (a) The President must consult with the responsible Congressional committees before signing a trade agreement; (b) the President must give Congress 90 days notice of his intention to enter into such an agreement; (c) the President must submit the final legal text together with a draft of the implementation bill and a notice of any necessary administrative action; (d) the implementing legislation must be introduced into both House of Congress as soon as submitted by the President; and (e) each House must vote (up or down) on the legislation within 15 days.

9 The bilateral free trade agreement with Jordan was negotiated and implemented without the benefit of any Fast Track authority.

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The International Food & Agricultural Trade Policy Council (IPC) promotes a more open and equitable global food system by pursuing pragmatic trade and development policies in food and agriculture to meet the world’s growing needs. IPC convenes influential policymakers, agribusiness executives, farm leaders, and academics from developed and developing countries to clarify complex issues, build consensus, and advocate policies to decision-makers.
