

## Economic Analysis of the 2002 Farm Bill

The 2002 Farm Bill costs taxpayers about \$20 billion a year with “normal” crop yields and exports. Crop prices that are pushed well below the cost of production is one of the results of the policies contained in this legislation. As a result, integrated livestock producers and other grain demanders become the real beneficiaries of farm program payments due to lower feed procurement costs. One of the other results is that farmers worldwide experience low crop prices prompting accusations of dumping and trade-dispute lawsuits.

Analysis with the POLYSYS model at the Agricultural Policy Analysis Center shows that the typical \$20 billion cost of the current bill could be cut in half by applying policy tools from earlier farm bills. Prices would be buoyed and more of farmers’ income would come from the marketplace as compared to current legislation. Livestock integrators would have to pay closer to the cost of producing grains and other feed. Farmers worldwide would see higher prices and international criticism would be reduced.

The commodity portion of the 2002 Farm Bill is essentially an extension of the 1996 Farm Bill. The major difference is the addition of counter-cyclical payments in the 2002 version, which, in essence, replaced the “ad hoc emergency payments” that were paid during the last few years of the 1996 Farm Bill’s tenure. The 1996 Farm Bill, or as it became known—Freedom to Farm, replaced the price enhancing tools of previous legislation with “transition” payments. The transition was understood to mean to a freer, if not totally free, market for agriculture over a multiyear period. But, as a result of the policies contained in that legislation, crop farmers have become more, not less, dependent on the government.

As we contemplate replacement farm legislation in 2007, it is important consider why the 1996 mindset didn’t provide the expected results. From my perspective there are two reasons the expected results were not forthcoming. One was an overly optimistic expectation for crop exports and the other was a belief that the agricultural sector could better adjust to changing price and economic conditions now than it could decades ago.

The export and price optimism was fueled by favorable exports and prices during the time the 1996 Farm Bill was debated. But rather than increase sharply over time, major-crop exports barely held their own over the next decade. This flat trend is not new. Total crop exports, although variable, have had a flat trend for the last 25 years. Without the expected export growth, prices collapsed. In addition, it turned out that the agricultural sector was no better at adjusting output downward as prices declined than it was years ago. These conditions, along with other factors, caused prices and incomes to fall lower and quicker than many had thought possible. Remedial action was taken via emergency direct payments to farmers and the reinstatement of counter-cyclical payments in the 2002 Farm Bill.

Agriculture and food are different from most other commodities. The self-correction that we take for granted in other sectors does not happen in a timely fashion in the agriculture/food sector. Total food intake per person varies little with price and farmers tend to use all their acreage to produce something that impacts the total agriculture/food market. This uniqueness is perhaps the most important thing to understand when considering policy for agriculture. If a policy direction does not address

the unique characteristics of agriculture, it is likely to be ineffective as a stabilizer of agricultural prices and market incomes.

The current policy benefits those that supply inputs to farmers and those that buy output from farmers. More seed, fertilizer and pesticides are sold than are optimal if agriculture is to produce at output levels that will fetch a price that covers all or most of the cost of production. Similarly, those that market, handle, or process agricultural production work with that larger volume of output. The degree of concentration on both sides of the farm gate also reduces pricing and marketing opportunities for production agriculture. It is not uncommon for four agribusiness firms to have over 80 percent of their industry's market share.

Current farm programs are likely not sustainable. They cost too much. Long-term deficit and current-budget considerations almost ensure reductions in budget commitments for the next farm bill. Looking down the road there are a number of possible policy directions that could be pursued.

From my perspective, I would like to see agriculture become a significant player in energy production as well as food production. Ethanol and biodiesel are an important part of that picture but agriculture can also play a larger role in providing fuel for co-firing with coal with a grass crop such as switchgrass. By using a significant amount of acreage for a crop like switchgrass, major crop prices would improve as well as providing farmers with a non-food and non-tradable crop alternative. Government payments would decline as well as having positive impacts on the environment and becoming less dependent on fossil fuel and energy imports.

Other possibilities in addition to staying the course with a 2002-like farm bill or making minor changes in the legislation are to intensify the free market prescription, switch to green payments, bring back some traditional farm policy instruments, and further down the road perhaps enlist multinational cooperation.

Given what we have seen the last decade or so, farm legislation that does not address aggregate agriculture's inability to right itself when capsized by low prices may not achieve the positive agricultural impacts that are expected.