PolicyPennings by Dr. Daryll E. Ray

Eliminating commodity programs reduces net farm income by 25%

The structure of the 2007 Farm Bill has engendered a lot of discussion at most of the meetings we have attended this summer. Of particular interest has been the impact that trade negotiations will have on the shape of the new farm legislation. The impact of trade negotiations has generated significant attention since the recent cotton ruling went against the U.S. While not dealing with other U.S. crops, some of the language in the decision makes it clear that government support for other crops might be in danger as well.

One of the provisions of current commodity support programs restricts those participating in these programs from taking the direct payments and then switching to the production of vegetables and fruits. Because this provision influences production decisions, it could be held to be trade distorting, possibly throwing U.S. direct payments out of the green box (non-trade distorting) and into the amber box (trade distorting).

Some would like to solve the issue of subsidies and boxes by eliminating all subsidy programs in the U.S. and allowing agriculture to respond to market forces. Those who advocate this solution argue that trade subsidies in countries of the global north, like the U.S. and the E.U., are responsible for overproduction and low prices.

Proponents of this view hold that if agricultural markets are allowed to work freely, the agricultural sector will prosper. So that farmers, agribusinesses, and consumers can make efficient decisions, it is necessary to eliminate any government actions that may interfere with market signals. The expectation is that all market forces – supply, demand, price, and structure – will respond to free market signals and adjust in a timely and efficient manner.

To estimate the potential impact of a policy that involved the elimination of the three major sources of U.S. farm program payments (direct payments, marketing loan payments, and counter-cyclical payments), our office (the Agricultural Policy Analysis Center at the University of Tennessee) conducted a study to see what would happen if subsidies were eliminated. This study is available online at http://www.agpolicy.org/blueprint.html .

Counter to the expectation of the advocates of the elimination of U.S. crop subsidies, in response to the elimination of the three subsidies, total U.S. planted acreage for five crops (corn, wheat, soybeans, cotton and rice) fell only slightly from what would have been expected under a continuation of present policies. By 2011, the five crop acreage decreased by one million acres out of 234 million acres, all of which can be attributed to cotton and rice. This was not unexpected due to the tendency of farmers to plant all of their acres under a wide range of prices and conditions. Cotton was down slightly less than 900,000 acres from what would have been expected under a continuation of current policies.

Prices for the various crops increased over the 2003-2011 period, but not enough to stop a drop in U.S. net farm income from around $50 billion a year to $33-$36 billion a year, a decline of 25 percent or more. Government payments dropped by $14 billion a year, an amount almost identical to the drop in net farm income. For major crop producers, net farm income declines by well over 50 percent.

The prices for corn, soybeans, and wheat do not increase while the prices of cotton and rice increase by less than 10 percent in 2011. The general expectation for crop agriculture was that U.S. production would decline appreciably and prices would increase significantly. This was not evident from the simulation. Developing countries were no better off as the result of the elimination of U.S. subsidies than they were under current policies. This study suggests that the expectations of trade negotiators that developing countries will benefit from the elimination of subsidies may not be realized in the real world.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.

Originally published in *MidAmerica Farmer Grower*, Vol. 22, No. 33 August 19, 2005

Reproduction Permission Granted with 1) full attribution to Daryll E. Ray and the Agricultural Policy Analysis Center, University of Tennessee, Knoxville, TN; 2) Copy of reproduction sent to Information Specialist, Agricultural Policy Analysis Center, 310 Morgan Hall, Knoxville, TN 37996-001