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U.S. FARM POLICY - AT A CROSSROADS? THE 2007 FARM BILL AND THE DOHA ROUND

by

Clayton Yeutter

Center for International Food and Agricultural Policy
University of Minnesota
Department of Applied Economics
1994 Buford Avenue
St. Paul, MN 55108-6040
U.S.A.

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² Of Counsel, Hogan & Hartson. Former Secretary of Agriculture and Former U.S. Trade Representative.

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By Clayton Yeutter

I. INTRODUCTION

It is a special honor for me to present the inaugural Willard W. Cochrane Lecture in Public Policy. As a graduate student when Dr. Cochrane was in his prime, I was a great admirer not only of his intellect but of the skill with which he articulated policy positions appropriate to that era. He, most deservedly, is high on the list of giants of our profession.

When presentations of this nature are made the speaker usually begins: “This is a critical time for American agriculture.” We have all listened to many such presentations, some of which were on target, others much less so. Through it all American agriculture has survived, and often thrived notwithstanding a lot of handwringing.

It has also changed – tremendously. Dr. Cochrane would be the first to agree that policy prescriptions of the 1930s, or even the 1950s or 1980s, would be of dubious applicability today. We truly were a small farm agriculture when farm programs began; we are not a small farm agriculture today. U.S. farmers planned against a domestic demand curve in those early years. Since the 1970s they have planned against a global demand curve – or at least should have done so. Notwithstanding those and other changes, we have continued to tweak many of the old AAA programs over the past 75 years, rather than overhaul them in any major way. And we still use the same arguments to defend them to the U.S. Congress and the American public even though

today's agriculture barely resembles that of those early program years. One wonders whether we should not update our thinking, our policy positions, and our justifications.

II. IS IT A CRITICAL TIME?

We just might be correct in now asserting that this is “a critical time for American agriculture.” A lot of action lies just ahead, some of which may be unprecedented. It all centers around the 2007 Farm Bill and the Doha Round of trade negotiations, two happenings that are inextricably linked.

The forthcoming Farm Bill debate follows on the heels of 1996 legislation that moved dramatically away from “traditional” farm programs, and 2002 legislation that tilted back toward them. Secretary Johanns is now conducting listening sessions to help in determining the Administration's position going into 2007, and all major farm organizations are doing their own listening or their own member surveys.

Most farmers seem quite comfortable with the 2002 Farm Bill, particularly the major commodity groups who have been its primary beneficiaries. But it has generated considerable criticism domestically because of its cost at a time of huge federal budget deficits. And it is extremely unpopular globally, especially in developing countries. Farmers in the developing world understandably feel they are in an impossible position competing against the treasuries of the U.S. and other developed countries.

Hence, the rest of the world is watching carefully as the U.S. enunciates its negotiating position in the Doha Round while simultaneously preparing for new farm legislation. Are U.S. negotiators, the Congress, and farm groups on the same page? If not, does it appear that a policy consensus will soon emerge, thereafter to be incorporated (if all goes well) in both a Doha Round agreement and the 2007 Farm Bill?

Is the probable U.S. position compatible with the “bottom line” for the rest of the world, especially developing countries? If not, what then happens? These are profound questions, the answers of which will have a huge impact on U.S. agriculture, and global agriculture, for many years to come.

III. THE DOMESTIC POLICY SCENE

Let’s step back for a moment and look at American farm policy somewhat in isolation. Irrespective of what happens elsewhere in the world, we should ask ourselves a few policy related questions. The first is: “Do we still need a safety net for American agriculture?” One could easily make a case for this in the early years of farm programs. Farms were small, relatively unsophisticated, not well capitalized, vulnerable to predatory practices of others, and family incomes were far below those of urban areas. None of that is descriptive of U.S. agriculture today. Nevertheless, there is still widespread support for a safety net, evidenced most recently in passage of the 2002 Farm Bill.

A. Our Present Safety Net

My assumption is that we will incorporate a safety net in the 2007 legislation, so we ought to focus on its underlying rationale (updated by 75 years!), its design, and on whether over time the private sector can supply that safety net, thereby eliminating the need for government participation.

The safety net we have today is incredibly complicated and very expensive to administer. It encompasses a multitude of programs, many of which are difficult to understand even for today’s well educated, sophisticated farm operators. And those

programs are administered by thousands of county offices scattered throughout the United States, convenient perhaps but costly indeed.

Beyond that ours is a safety net designed primarily for producers of a select group of commodities – rice, cotton, corn, wheat and soybeans. Ironically producers of specialty crops, beef, pork, and poultry – all of which are essentially outside the safety net – seem often to be more profitable than those producers who are “helped” most by the government.

Even within that select group of five commodities we have had difficulty achieving what most of us would consider “fairness and equity.” Per capita and per farm benefits in some crops are much higher than in others, and far more subsidy dollars go to larger operators (some in six and even seven figures) than to smaller ones. This is not a “support our small farms” program, no matter how one defines “small.”

Perhaps the biggest disadvantage of U.S. farm policy, as presently designed, is that its benefits are readily capitalized into land values. In the early years that was an “all win, no lose” proposition because there were few absentee landlords. Most farmers owned their own land, and higher land values made them wealthier, made lenders happier, and provided borrowing capacity for their crops and livestock enterprises. And there were no “unforeseen consequences” internationally because we weren’t concerned with global competition. Today, whether we like it or not (and we ought to like it) we are in a global business, and will forever be such. All U.S. farm policies must now be evaluated in that context, and higher land values clearly reduce our international competitiveness (particularly vis-à-vis countries that have few, if any, farm subsidies). Beyond that higher U.S. land values make it increasingly difficult for young farmers to

get started today. Rents are higher than ever before, and many of those rental returns go to non-farmer absentee landlords.

Finally, some of our present-day farm policies are more trade distortive than they should be, or need to be. They may in fact be vulnerable to challenge under World Trade Organization (WTO) rules. We lost a recent case brought by Brazil against our cotton program, and it appears that our rice and corn programs may soon be challenged by other nations. As we approach the 2007 Farm Bill we may discover that all of our traditional commodity programs are in jeopardy because of their inherent trade distortions.

If we are to have a safety net for American agriculture can we not design a better one – from the standpoint of all U.S. farmers, not just a few, from the standpoint of American taxpayers, and in the context of our WTO obligations? If so, what should it encompass?

B. A Future Safety Net – Oriented Toward Managing Risk

The fundamental purpose of a farm policy safety net should be to help producers manage risk. It should not be designed as a welfare program, though at times it has shifted in that direction. The major risks faced by farmers are (1) weather, and (2) price. Or, if combined, the two together constitute most of the revenue or gross income risk faced by all farm operations. One of the elementary economic equations we have all learned is $\text{Price} \times \text{Quantity} = \text{Income}$, weather being most of the quantity component from a risk management perspective. During my years farming in central Nebraska, weather was the risk that worried me most because it was totally outside my control. And in that part of the country it can be horrendously unpredictable, which means

private sector insurers are not enthusiastic about doing business there. So one can certainly make a case for at least some government participation in helping American farmers – large or small – to manage their weather risk. Until now we have done that awkwardly at best – with a combination of government-subsidized public and private sector crop insurance, emergency disaster programs, and certain commodity program benefits that are not production related. This three-tiered approach to managing weather and some additional quantity risks will never win any efficiency awards.

On the price side we do a bit better, though we seem to throw everything but the kitchen sink into that mix. Our farm programs do reduce this risk, though at a cost far beyond what could be achieved. This is a risk management arena that is in no way unique to agriculture. All businesses in a capitalistic, market-based society must manage price risk. Some obviously do it better than others, and some simply absorb the risk whatever it may be. Innumerable techniques exist for doing this, though not all of them will fit agriculture. And it is true that agriculture often experiences a higher level of price volatility than many other industries.

Large numbers of American farmers already use private sector mechanisms to manage price risk – futures, options, and forward contracts being the most prevalent examples. These mechanisms are not yet available on all farm products, so they are not the complete answer today. But they could be, at some point in the future.

Many of the price and quantity risk management policies, programs and techniques provided by the U.S. government over the past 75 years are anachronistic and inordinately inefficient. They need to be modernized and designed so that both provider (the taxpayer) and user (farmers) get more bang for the buck.

C. The Revenue Insurance Option

There are a variety of ways to bring agricultural risk management into the 21st century. Fortunately a lot of good academic research has been done in this area recently by U.S. and other agricultural economists. Some of these concepts have already been enacted into law and implemented in other countries. They are beginning to establish a track record, to be evaluated by our own farm organizations, the Administration and relevant Congressional committees. Among the more interesting are revenue (or gross income) insurance concepts. By definition those programs cover both price and quantity risks. If properly designed they could replace the myriad of commodity programs we have today, our present crop insurance complex, and “emergency” disaster programs which are becoming ever more prevalent.

Revenue insurance (Some might prefer to use gross income, which could be slightly different, depending on legislative definitions.) is not a panacea; it will have its own set of problems, issues and trade-offs. But it certainly deserves careful consideration. It, or similar concepts, could (1) simplify our farm policy structure, dramatically reducing the bureaucracy which all farmers tolerate, but dislike enormously; (2) reduce the level of subsidies now being used, with questionable effectiveness, to manage price and quantity risk; (3) reduce administrative costs in a major way; (4) spread the benefits of risk management to all farmers, not just a select minority; and (5) reduce the trade distortive impact of our policies to the point where they may not be subject to WTO challenge. Were all this possible, and hopefully it will be, U.S. agriculture would be well-positioned for the challenges and opportunities of the coming years.

IV. The Global Scene

There is, however, one more very important piece to this farm policy puzzle and that is the Doha Round of multilateral trade negotiations. Our over-riding policy objective should be a healthy, viable, profitable agricultural industry. (For that matter it should also be a healthy, viable, profitable food industry, from producer to consumer, but that's too much for one lecture!). Achieving that objective depends heavily on boosting demand – somewhere, somehow – for American farm products. Some have suggested that U.S. policymakers have focused too much on export demand (the Uruguay and Doha Rounds) and too little on domestic demand and domestic taxpayer support (the 2002 Farm Bill). That suggests a strategy of battling vigorously in the Congress to sustain and extend the 2002 Farm Bill, defending its merits and the subsidy levels it implies - even if that means “taking a pass” in the Doha Round.

In my view such a strategy would be self-destructive and doomed to fail. It is simply too high risk on the demand side. As Dr. Robert Thompson of the University of Illinois has so aptly pointed out in many of his papers and speeches, once nations reach a per capita income of more than \$10 per day they no longer consume additional quantities of raw agricultural products (including those such as corn, wheat, rice, sugar and soybeans, the major beneficiaries of our present policies). Per capita income in the U.S. is far beyond that trigger point, which means our added expenditures in the food industry go to “value added” products such as beef, pork, poultry, and oilseed products, and to enhanced quality, branding, marketing, packaging, etc. That means the increase in domestic demand for our raw farm commodities will be a function primarily of population growth. And if productivity in U.S. agriculture continues to outrun population

growth (as expected), we will regularly generate surpluses in those commodities.

Therefore, without new export markets we will have no choice but to return to Congress for more and more financial support as the future unfolds. We will become less market oriented and more dependent on the generosity of U.S. taxpayers. That is not the healthy, vibrant, independent agricultural sector that all of us would like to see.

In the long run we must all compete! Globally. So let's follow a farm policy, a risk management policy if you will, that will position us to do just that. Within "quantity" in our basic equation, we can take care of weather risk domestically. We can even expand domestic demand somewhat, in ways that I will outline a little later. But we need to sell globally if quantity is to expand significantly over time. Stating it another way, working with a global demand curve, rather than only a domestic one, should make it a lot easier to nurture not only "quantity" in our equation, but in many cases "price" as well, and assuredly the most important statistic of all, "income."

As Dr. Thompson points out, the demand growth for food products in this world occurs as per capita incomes move from \$2 per day or lower (Half the world's population is so categorized today.) to the \$10 per day trigger I mentioned earlier. There is no "effective demand" for the unfortunate millions who earn \$2 per day or less. They simply cannot afford to buy more food at world market prices. But those in the \$2 to \$10 per day category can and will. These are people in developing countries whose lot in life is improving. They want to improve their diets and they will enthusiastically import food from us or anyone else in order to do so. Not surprisingly a large proportion of those families live in Asia. That is where our growth potential for American farm commodities (and even value added products) lies. There is a lot more "low lying fruit"

in those markets, with populations far greater than ours coupled with growing purchasing power, than there is in our own domestic market.

Parenthetically, we ought to stop spending so much time and energy on market access in our fellow developed countries. They offer little demand potential for raw products, and with often stagnant economies and stabilizing or even declining populations, not a whole lot of potential even for value added items.

Ambassador Portman, our U.S. Trade Representative, and Secretary of Agriculture Johanns have made market access our highest priority in the Doha Round agricultural negotiations. They are correct in that general objective, but within that objective they need to focus on countries that are now in that \$2-10 per capita per day “growth group,” or those likely to join that group during the coming years.

The practical effect of expanding potential demand for U.S. agricultural products globally is to enhance the safety net, fostering the worldwide generation of U.S. farm income in contrast to squeezing a bit more out of U.S. consumers and a lot more from U.S. taxpayers. A successful Doha Round would ease the political stress on farm organizations, Congressional committees, and the Administration, thereby making the 2007 Farm Bill experience much more pleasant than would otherwise be the case. There would be more income generated from the market; less provided by the government. Risk would be spread more widely, managed more readily, and the insurance cost for “income risk” would be less than anticipated, meaning that taxpayers would also be pleased.

If U.S. policymakers were to do no more than what I have outlined thus far, they would have an impressive record of accomplishment. I have suggested modernizing

our farm safety net, irrespective of what is happening elsewhere in the world, but then complementing and supporting this risk-oriented safety net with an enhanced international component based on improved market access (particularly in certain developing countries). With private sector risk management mechanisms become more prevalent and more effective every year we should be able gradually to reduce the taxpayer cost of government risk management programs. And if we avoid policies that diminish our international competitiveness we will offer American farmers the benefits of a global demand curve that is increasingly favorable to them.

V. A Rural Development Component

But let's embellish this policy dissertation a bit more. Would it not be desirable to place this discussion in the context of policies for rural America rather than just "American agriculture?" Should not our objective be to have a viable, vibrant, prosperous rural sector, rather than just a viable, vibrant, prosperous farm sector with trickle down benefits to others living in rural America? If so, what should the role of the Federal government be? Can we do this in a way that makes our agricultural safety net more defensible from a policy standpoint? And in a way that makes that safety net even less trade distortive than the one I outlined earlier?

We do not have time today to explore these possibilities in detail, but permit me to offer a few thoughts for your contemplation.

First, as you well know, our traditional commodity programs provide much of the Federal funding which flows to rural America today. If those should be modernized, as I have already suggested, or altered if necessary to comply with WTO rules, would it not be wise to find alternative ways to funnel appropriate taxpayer resources to rural areas?

If thereby one can simultaneously meet other legitimate public policy objectives, this becomes a “dual winner.” And if this shifting of expenditures will provide an assured “green box” categorization in the WTO, then this is a “triple winner.”

In my view there are several possibilities for doing precisely this, all of which are worthy of further exploration.

The first lies with environmental programs, many of which are already authorized in existing farm legislation, but have traditionally been underfunded. Without doubt most, if not all, of our producers of the major commodities – cotton, rice, corn, soybeans, and wheat – would willingly incorporate additional environmental benefits in their farm operations. The governmental financial support provided to them for doing so would at least partially substitute for any diminution that might result from restructuring traditional commodity programs. Environmental prospects would include programs fostering water conservation, soil conservation, water pollution management/control, air pollution prevention and mitigation, wetlands preservation, tree planting/carbon fixation, and others. Farmers and other residents of rural America already have a strong commitment to the environment, but there is much more that could be done. The 2007 Farm Bill provides that opportunity.

A second major area of interest is energy generation and conservation. Energy legislation recently passed by the Congress moves aggressively in this direction, with significant encouragement to ethanol production being the principal example. That alone will alter the domestic demand curve for some farm products, primarily corn at present. Biodiesel production is also coming to the fore, doing the same for soybean producers. We may even figure out better ways to harness wind.

As a nation we have just begun to confront the challenge of finding ways to expand our own sources of energy, thereby reducing our dependence on foreign sources that have proven terribly unstable. It may be difficult to justify some of these programs in economic terms, presently at least, but it is not difficult to justify them in national security terms. These programs deserve to move ahead, and we should make a major effort to increase production efficiencies in each of them. That in itself offers potential for rural areas as we search for the best mix of biomass materials from which to produce energy. I am persuaded this is an investment we Americans should make, with a healthy portion of it being in rural areas. We will know soon whether that too is a commitment the U.S. Congress will make in the 2007 Farm Bill, supplementing what is now in the Energy Bill.

We should not forget the potential for industrial, including pharmaceutical, uses of farm products either. All of us have hoped longingly for major breakthroughs in this area; they have not yet materialized. But advancements in chemistry are breathtaking, and some of these will inevitably affect the face of rural America. The number of opportunities to develop, in rural areas, commercial applications of plastics, pharmaceuticals, nutritional products, and biotechnology research generally is impossible to predict. But the potential is far beyond anything we have seen in the past.

Finally, as a nation we need to be investing in our rural infrastructure. That has always constituted the “absolute advantage” we have had over our global agricultural competitors. We have had the rural roads, elevators, railroads, barge facilities, and ports to get our farm products to market in excellent condition and at low cost. But that competitive margin is narrowing as Brazil and other developing countries commit the

financial resources necessary to catch us. We need to leapfrog them once again! If we can do so, farm gate prices in locations far from our major domestic and export markets will increase, and that will be infinitely more rewarding than fighting over farm subsidies.

This suggests not only updating our present physical infrastructure, but investing in “softer infrastructure” as well. The latter could include advances in information technology, telecommunications, and even selective educational endeavors.

VI. Conclusion

In summary, what I have outlined here is a three-pronged effort to update U.S. farm policy for the 21st century.

The first involves getting our domestic house in order by re-designing our farm safety net. If we can combine our coverage of weather and price risks into a safety net focused on revenue we will be able to eliminate many of the shortcomings of our present, increasingly anachronistic, policy structure – and do so at a lot less taxpayer cost.

We need simultaneously to work on the second prong, which involves opening up market opportunities elsewhere in the world. If we are prepared to make the changes suggested in the first prong, they will provide leverage for achieving the objectives of the second. Reducing or restructuring our farm subsidies is a high priority negotiating objective for the rest of the world. And if we obtain additional export market opportunities, our own domestic reforms will put us in a better position to take advantage of those opportunities. That in turn will give U.S. producers greater confidence in a redesigned, updated safety net. Obviously these first two prongs

complement each other in many ways, so much so that it is unlikely one will be a success without the other.

The first prong hopefully will improve the farm safety net, even if not much else changes. It will likely reduce somewhat the flow of taxpayer resources to U.S. producers, an appealing proposition to those concerned about our Federal deficit, and an appealing proposition to developing country farmers adversely affected by our farm subsidies. The prospect of a reduced Federal revenue flow will, however, worry many of our farmers.

The second prong is intended to mitigate or eliminate that worry. Expanded export opportunities should move the gross income line for American farmers in the right direction, so long as they meet the challenges of competition!

The third prong will add further comfort to the farm safety net by expanding domestic demand (via energy generation in particular), and by boosting our competitiveness via infrastructure improvements. It will also contribute to gross revenue by directing additional taxpayer resources to farmers and other rural residents in non-traditional ways (environmental in particular) – while also helping to achieve related policy objectives (e.g., broader rural development).

It is impossible to discern how the policy issues subsumed in these three prongs will evolve, over the next couple of years (the Farm Bill and the Doha Round), or beyond. Simultaneity is required in the first two; the third could come later, and some parts of it obviously will. But the more of the third that can be combined in a complementary way with the other two, the more attractive our farm safety net will be and the more political support it will generate.

Much of this is transitional. Hopefully one day, in the not too distant future, U.S. farmers will manage their own risk via private sector institutions, with no need for subsidies – even those that are green box in character. If and when that occurs, I am confident they will be able to compete with their counterparts elsewhere in the world. Australian and New Zealand farmers do that today. They concluded that government help was the problem, not the solution. That is why we need a transition from, not a continuation of, outdated policies and programs. I believe we can do that and have a viable, vibrant, competitive and profitable agricultural economy, and that we can do the same for rural America as a whole.