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Agricultural policy reform in the United States: an unfinished agenda[†]

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The 1996 Federal Agriculture Improvement and Reform Act (FAIR) contained important breaks with a tradition of crop-by-crop subsidies dating back to the Agricultural Adjustment Act of 1933. Farmers with recorded base acres were given the opportunity (which nearly all accepted) to sign a seven-year 'contract' with the US Department of Agriculture (USDA), under which payments will be continued on the merged base acres on a declining schedule until the year 2002. FAIR is an unfinished agenda. First, the coverage of 'freedom to farm' is only partial, with numerous commodities left out of the decoupling programme. Second, the largest producers will augment their already significant receipts with generous lump sum transfers from USDA. This will further reinforce the concentration of roughly 90 per cent of receipts and payments in the hands of the 100 000 to 200 000 largest producers of field crops. An alternative would be to make payments in times of low marketing receipts which recede when prices are high.

1. Introduction and overview

In the scheme of things, the 1996 Federal Agriculture Improvement and Reform Act (FAIR) contained important breaks with a tradition of crop-by-crop subsidies dating back to the Agricultural Adjustment Act of 1933. It freed many producers of 'program commodities' (maize, grain sorghum, wheat, barley, oats, cotton and rice) from a system of crop-specific base acre accounting, merged these accounts into a single 'whole farm base', and allowed production of any but a few crops on these lands. Through such 'freedom to farm' provisions, payments to farmers were thus decoupled from these crops. Farmers with recorded base acres were given the opportunity (which nearly all accepted) to sign a seven-year 'contract' with the US Department of Agriculture (USDA), under which payments will be continued on the merged base acres on a declining schedule until the year

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2002. By fixing these future obligations on a per-acre basis, the floating obligations implied by the previous system of deficiency payments are largely ended (for now), resulting in agricultural subsidies that are no longer open-ended entitlements to future payments from the Federal Treasury. While signers of the contract with USDA are entitled for seven years to a per-acre payment (whether or not they produce a crop), the total amount of these obligations is fixed at $35.6 billion and therefore predictable from a budgetary point of view. Overall, the freedom to produce in direct response to market forces, rather than on the basis of crop-by-crop subsidies, as well as the budget discipline of predetermined payments, are important steps in the direction of decoupled lump-sum compensation.

Yet from the point of view of advocates of policy reform, FAIR is an unfinished agenda. A number of problems and issues remain. First, the coverage of 'freedom to farm' is only partial, with numerous commodities left out of the decoupling programme. The mechanisms under which producers of these absent commodities (dairy products, sugar, peanuts and tobacco) receive compensation (and they differ) represent relatively low budget exposure, reinforcing their backburner status. Second, those critical of the distributive impacts of the commodity programmes find little to cheer about in the new contracts, and consider the acronym FAIR ironic. As in the past, those who have accumulated the largest eligibility through combined acreage bases will receive the largest payments, effectively limited only to $80 000 per operation. Since these payments will be made *over and above* any marketing receipts, the largest producers will augment their already significant receipts with generous lump sum transfers from USDA. This will further reinforce the concentration of roughly 90 per cent of receipts and payments in the hands of the 100,000–200,000 largest producers of field crops. With 1996 market prices near all-time highs due to short grain stocks world-wide, it is difficult to justify such transfers on grounds other than pure political expediency. A third and related issue is whether the contract payments, once decoupled from specific crops, should necessarily be completely divorced from market receipts. An alternative would be to make them countercyclical, so that payments are made in times of low marketing receipts and recede in high times such as the present (see Cochrane and Runge 1992). Fourth, political realists tend to doubt that the end of the seven-year contract will actually terminate transfers to these producers, as advertised. Careful observers of the Congressional Budget Office 'scoring' of spending have noted that $4 billion remains in the 2002 budget for commodity programmes, despite the alleged end of contract payments in that year.

One of two competing scenarios seems most likely to result. The first scenario is that global demand-side pressures will cause market prices to

remain strong throughout the seven-year cycle of the FAIR legislation. In that case, growing public attention will be focused on large producers who make enormous marketing receipts, only to receive additional transfers from the Federal Treasury. If these transfers coincide, as seems likely, with reductions and income-adjusted 'means-testing' of large entitlements outside agriculture such as Social Security, Medicare and Medicaid, the transparency of the agricultural transfers will become a source of political embarrassment and a target for those critical of 'welfare for the rich'. The second scenario is that supply responses induced by current price levels will lead to substantially lower marketing receipts toward the end of the seven-year contract (when per acre transfers are in principle phased down and out). A call will then arise to resuscitate some form of safety net, such as a return to deficiency payments or an extension and increase in contract payments under the 1996 Act beyond 2002. Neither scenario is especially attractive from the point of view of agricultural policy. In the first case, farmers are further exposed as already rich recipients of unearned and unneeded tax dollars. In the second, they and their representatives emerge as chronic special pleaders, willing to extend indefinitely a system of transfers from the public purse, despite signing a seven-year contract that was supposed to lead to a transition to the market. Avoiding either of these scenarios, we shall argue, will require frank recognition of the need for some form of countercyclicity.

One possibility discussed below would be to allow producers to 'bank' transfers in the next several years of high marketing receipts, which could then be used to trigger pay-outs in years of lower receipts, or eventually be converted to retirement income. The effect would be to combine countercyclicity with an extension of the coverage of the contract, while retaining 'freedom to farm'. We shall also argue that more explicit connections can and should be made between such protections and investments in a variety of environmental and conservation measures, based less on denial of transfers for failure to comply than on the creation of incentives (including higher returns for 'banked' transfers) for those willing to invest in environmental projects at the farm level.

The article to follow will be divided into three sections: a discussion of the major provisions of the FAIR Act of 1996; a review of the political forces leading up to it; and a discussion of reforms that could extend the incipient agenda that it represents.

2. Summary of 1996 Farm Bill: major provisions

President Clinton signed the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) on 4 April 1996, following a protracted, politically

charged legislative process. The 1996 Farm Bill contains nine titles: the Agricultural Market Transition Act, containing the majority of its reforms; as well as titles on agricultural trade; conservation; nutrition assistance; agricultural promotion; credit; rural development; research, extension, and development; and a miscellaneous title.

2.1 Title I: Agricultural Market Transition Act (Freedom to Farm)

Title I, the Agricultural Market Transition Act (AMTA), contains many elements of the vetoed 1995 Freedom to Farm Act (FFA). In shorthand, this title establishes the production contracts for wheat, feed grains, cotton and rice discussed above. In addition, it continues non-recourse loans, amends the dairy programme, extends the peanut and sugar programs with minimal alterations, describes administration of the title, temporarily suspends permanent law regarding price support authority, establishes the Commission on 21st Century Production Agriculture, and includes other commodity provisions.

The AMTA contains most of the reform elements in the 1996 Farm Bill. Through the creation of transition payments contained in seven-year production flexibility contracts, the Act decouples subsidies from the crop grown. It also caps spending on agricultural subsidies at $35.6 billion, over seven years, thus removing them in the aggregate from the entitlement category. In this sense, the AMTA fundamentally changes the way in which farm subsidies for the affected crops operate. The previous system, parts of which dated back to the Great Depression, provided programme crop farmers with income support in the form of 'deficiency payments', calculated on the basis of recorded crop acreage and government-set target prices. When the market prices fell below the target price, farmers received deficiency payments equal to the difference in price to augment their income. In return for this protection, the government sought to control the supply of programme crops through acreage reduction programmes (ARP) (see Young and Shields 1996; Cochrane and Runge 1992). This combination of simultaneous support and control led to serious distortions in farming methods and the agricultural economy.[1]

[1] Evert Van der Sluis and Willis Peterson (1994), at the University of Minnesota, recently completed a detailed evaluation of the impact of crop set-asides on rural employment and outmigration. Using 40 years of data from 100 randomly selected farming-dependent US counties (1950–1990), the study found that the larger the number of diverted acres in a county, the smaller the demand for goods and services supplied by the rural non-farm population. The negative impacts on rural communities appeared to outweigh any price-enhancing effects of acreage diversions.

In contrast, the AMTA establishes seven-year production flexibility contracts with fixed transition payments as the income support mechanism for farmers. Eligible farmers include those who have participated in programmes for wheat, feed grains, cotton and rice during the past five years. The Act eliminates income support deficiency payments, target prices, underplanting provisions, acreage reduction programmes (ARPs), and the Farmer Owned Reserve Program (Hallberg 1996). In doing so, it severs the connection between subsidies and current farm prices.

In addition, increased planting flexibility arises from the separation of eligible programme acres from the crops planted on the acres. Under production flexibility contracts, 85 per cent of 1996 base acreage computed under the 1990 Farm Bill (plus or minus Conservation Reserve Program [CRP] acres) determines payment acres. Under the production flexibility contract guidelines, farmers may plant any commodity they choose with limitations only on fruits and vegetables. For example, a farmer with 100 acres of programme wheat receives 85 payment acres of wheat whether that farmer plants wheat, corn, hay, or soybeans (Salathe and Langley 1996). The new system ends the Farmer Owned Reserve (FOR) and thus removes the government as a stockholder of commodities. Because the government no longer accumulates these commodities through the FOR or loan

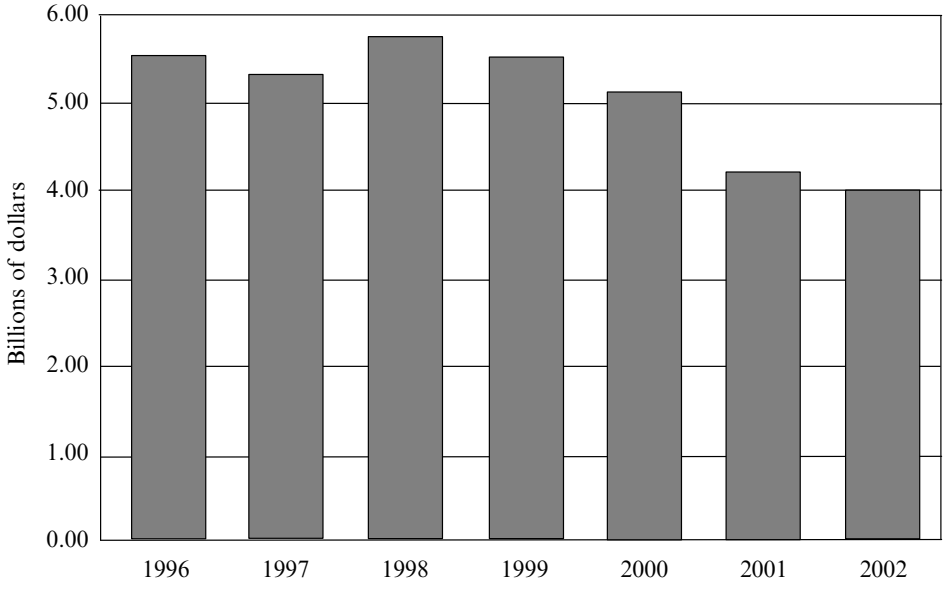

Figure 1 Schedule of contract payments

programmes, a much more limited reserve capacity exists in the event of sudden shortages.

In addition to decoupling farm subsidies from cropping obligations, the AMTA caps total annual payments. The Act limits fiscal year total expenditures to $5.6 billion in 1996, $5.4 billion in 1997, $5.8 billion in 1998, $5.6 billion in 1999, $5.1 billion in 2000, $4.1 billion in 2001, and $4 billion in 2002, thus ending the open-ended entitlement of previous legislation (figure 1). While payments decline after 1998 until 2002, they are generally constant until then. Spending on the basis of previous crop-specific base acreage is prorated, so that 26.26 per cent of total funds will go to acres previously enrolled as wheat base, 46.22 per cent as corn, 5.11 per cent as sorghum, 2.16 per cent as barley, 0.15 per cent as oats, 11.63 per cent as upland cotton, and 8.47 per cent as rice (figure 2). The annual payment rate for each crop depends on the total payment to be allocated, divided by the estimated eligible production. Within the crop allocation, farmers receive 85 per cent of contract acreage multiplied by the farm programme contract yield multiplied by the annual payment rate. Each individual farmer faces a contract limit of $40 000 or $80 000 using the

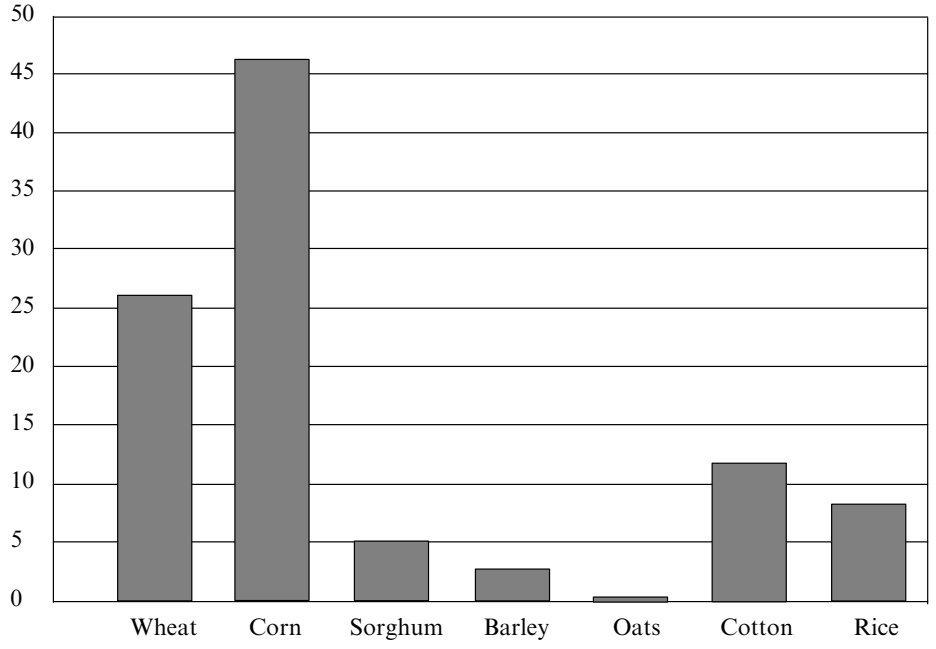

Figure 2 Distribution of contract payments by crop

'three entity rule', which allows a relative to increase eligibility to the higher amount. To see how this would work for an individual farmer holding 100 contract wheat acres, consider the following example:

Example: Suppose a farmer holds 100 contract acres, the following USDA example calculates the farmer's 1996 payment for wheat acres (Salathe and Langley 1996):

Farm contract acres: 100
Contract payment acres: 100 (.85) = 85
Payment production: 2,890
Program yield: 2 890/85 = 34
Estimated payment rate for 1996: .94
Estimated payment: (.94) (85) (34) = $2 717.00

It should be noted that 100 acres of wheat base is a relatively small amount. The average wheat farm in the United States in 1992 had an acreage of 202, but most commercial operations are larger than this average (USDA 1995c). Production flexibility contracts require compliance with conservation, wetland protection, and planting flexibility requirements. In brief, these stipulate that a conservation plan be maintained, that designated wetlands and erosion-prone soils not be disturbed, and that no fruits or vegetables be grown. In addition, compliance requires agricultural use of programme acres, precluding development for non-agricultural uses such as vacation homes. The 1996 Farm Bill adds an early out option for some land in the Conservation Reserve Program (CRP) held by farmers who have signed the 7-year production flexibility contracts.

Contract holders remain eligible for non-recourse loans with marketing loan provisions as under the 1990 Farm Bill (see Vande Kamp and Runge 1994). However, the Act caps the wheat and corn loan rates at relatively low 1995 levels and sets correspondingly low loan rates for sorghum, barley, oats, cotton, rice, oilseeds and soybeans. The programmes for cotton and rice also retain government price guarantees by setting loan rate floor prices. The Act sets the minimum price for cotton at $0.50 per pound and for rice at $6.50 per cwt. Individual producers of these crops face maximum marketing loan gains of $150 000 under the three entity rule. Loan deficiency payments continue on all loan commodities excluding ELS cotton. However, since loan rates are so low and current market prices so high, these payments will generally be small or zero.

The AMTA alters the dairy programme through changes to price supports, milk marketing orders, and dairy export programmes. Dairy price support alterations include the cessation of government assessments

on dairy producers (which had been equal to 11.25 cents per hundredweight under the 1990 Farm Bill), phasing out price supports for butter, cheese, and powdered milk over 4 years, establishment of a recourse loan programme and continuation of the Fluid Milk Promotion Program. The Act provides for the consolidation of the current 33 milk marketing regions into between 10 to 14 regions. It also consents to the Northeast Interstate Dairy Compact, a regional price-fixing scheme demanded in return for his support of the final bill by the leading minority member of the Senate Agriculture Committee from Vermont. Application of the scheme was subject to a finding of 'compelling public interest' on the part of the Secretary of Agriculture, which he dutifully fulfilled in late 1996, opening the provision to court challenges from upper-Midwest producers in Minnesota and Wisconsin. The Act also continues the Dairy Export Incentive Program.

Despite innovations in wheat, feed grains, cotton and rice, the AMTA continues the price supports for tobacco without change and leaves the peanut and sugar programmes largely intact. The minimal changes to the peanut and sugar programmes illustrate the continuation of market-distorting policies, although a small achievement was the elimination of the honey programme, which had a small but well-subsidized constituency.

Modest revisions transform the peanut programme into a 'no net cost' to the government programme, analogous to the sugar programme. While the programme operates as 'no net cost' to the government, it costs American consumers several hundred million dollars a year in terms of higher product prices (Rauch 1996). The sugar programme itself continues as a 'no net cost' program, although it was modestly adjusted by freezing the sugar loan rate, terminating marketing allotments, transforming the non-recourse loan programme to a recourse loan programme when import levels drop, and increasing the assessments on sugar processors by 25 per cent. The principal device supporting domestic prices continues: tariff-rate quotas for sugar imports that keep domestic sugar prices high. Like the peanut programme, 'no net cost' in sugar policy refers to budget expenditures, however, American consumers pay approximately $1 billion a year in higher prices (Rauch 1996).

Other commodity provisions include: the authorization of the Options Pilot Program in which farmers are subsidized to participate in hedging production risks in futures and options markets. More broadly, provisions exist to support risk management education and the establishment of an Office of Risk Management. As part of this complex of risk management approaches, provisions direct the implementation of the Revenue Insurance Pilot Program, which some feel may be a prototype for future income support policies. However, a separate provision drops the require-

ment that farmers enrol in crop insurance programmes, provided they waive their rights to emergency crop loss assistance. In effect, this preserves the political opportunity of the Congress to use 'emergency relief' as a form of transfer to constituents adversely affected by weather, wind and floods.

In summary, Title I changes the mechanism providing farm income support to some key programme crops from deficiency payments to transition payments, caps farm spending, but leaves numerous commodities largely unaffected. In the face of more market orientation, a greater emphasis is also given to risk management tools. However, much of the past law remains in the dairy, sugar and peanut programmes as well as the continuation of non-recourse loans and the retention of permanent law.

2.2 Title II: agricultural trade

Title II amends the Agricultural Trade Development and Assistance Act of 1954 and Related Statutes, amends the Agricultural Trade Act of 1978, and contains additional agricultural trade provisions. Part of the impetus for adjustments in these parts of the Farm Bill was the 1993 Uruguay Round agreement in agriculture, which required a revision of spending and the volume of grain subsidized for export. The new legislation amends the 1978 Trade Act by continuing the Export Credit Guarantee Programs, capping annual spending on the Export Enhancement Program at $3.2 billion over the seven years, limiting spending on the Market Access Program (the renamed Market Promotion Program) to $90 million, providing embargo compensation under specific circumstances and authorizing first-time statutory authority for the Foreign Market Development Program.

Under amendments to the 1954 Trade Act, the FAIR Act also extends authority for the Food for Peace (PL 480) programme, a long-standing foreign assistance programme and vent for US surpluses. It expands PL 480 programme eligibility for low-interest food loans to private entities as well as foreign governments, and increases PL 480 programme funding from $13.5 million to $28 million in order to cover administration costs. Other amendments affecting food aid policy include extension of authority for the Food for Progress Program, replacement of the Food Security Wheat Reserve with the Food Security Commodity Reserve, and increased funding for the Farmer to Farmer Program. Under the Food Security Commodity Reserve, the commodities that compose the four million metric ton reserve are expanded from wheat to include any combination of wheat, rice, corn or sorghum. In addition, the change increased the amount eligible, per fiscal year, for release to assist overseas relief efforts from 300 000 to 500 000 metric tons. Additional agricultural trade provi-

sions include authorization for the Emerging Markets Program and direction for a new USDA trade strategy. The title also repeals several Agricultural Acts concerning trade.

2.3 Title III: conservation

Title III extends and alters existing programmes, creates new initiatives and broadens the conservation agenda with $2.2 billion in additional funding (Hallberg 1996). The Act retains conservation compliance provisions in relation to transition payments and other eligibility for cost-sharing and insurance coverage from WPA (see Title I above). It also clarifies the definitions under the land conservation ('sodbuster') provisions, broadens wetland authority, extends the Conservation Reserve Program (CRP) for seven years, maintains 'swampbuster' provisions, and continues the Wetlands Reserve Program (WRP) for seven years. Among the most significant changes are efforts to better target the Conservation Reserve Program (CRP), which since 1985 has held more than 36 million acres out of active crop production. In a period of low stocks and high prices, there is pressure to bring much of this land back into production. Changes to the CRP include capping the maximum allowed CRP area at 36.4 million acres, strengthening the criteria regarding eligible land, and providing an early out option for land outside of environmentally sensitive areas. The new legislation caps the maximum WRP area at 975 000 acres. Beginning in 1997, it splits the area into three equal categories of permanent easements, 30-year easements, and restoration cost-share agreements.

New programmes funded under Title III include the Environmental Quality Incentives Program (EQIP), Conservation Farm Option (CFO), Grazing Lands Conservation Initiative, Wildlife Habitat Incentive Program, Farmland Protection Program, an initiative for frequently flooded cropland, Everglades Ecosystem Restoration, and the National Natural Resources Conservation Foundation. EQIP combines the Agricultural Conservation Program, Water Quality Incentives Program, Great Plains Conservation Program, and the Colorado River Basin Salinity Control Program in order to coordinate the provision of technical assistance and funding for cost-sharing or financial incentives connected with conservation and environmental practices. The new law provides EQIP with $1.3 billion in funding over the seven-year period.

In addition, the title establishes the Environmental Conservation Acreage Reserve Program (ECARP) to house the Conservation Reserve, Wetland Reserve and Environmental Quality Incentives Programs. Furthermore, by including the Wildlife Habitat Incentives Program, the title widens the conservation focus of the Farm Bill.

2.4 Title IV: nutrition assistance

Title IV reauthorizes the Food Stamp Program (FSP) and other smaller nutrition programmes. The new law extends the Food Stamp Program for only two years due to the inclusion of the programme in current welfare reform efforts. Other programmes continue for seven years including the Commodity Supplemental Food Program (CSFP), Soup Kitchen and Food Bank, Temporary Emergency Food Assistance Program (TEFAP), Commodity Distribution Program, Puerto Rico Nutrition Assistance Program, American Samoa Assistance Program and National Commodity Processing Program. Separate legislation in 1994 extended the school lunch and Women, Infant, and Children (WIC) Programs. These programmes illustrate the substantial transfers to dependent groups in the form of food assistance, especially in American territories such as Puerto Rico and Samoa, but also to as many as 1 in 9 Americans living in the 50 states.

2.5 Title V: agricultural promotion

Title V authorizes the establishment of producer-funded programmes for promotion, research, and education regarding agricultural commodities. The Act appropriates funds for the promotion of canola and rapeseed, kiwi fruit, and popcorn as well as extending the programme for fluid milk. The law provides the Agriculture Department with the authority to establish new producer-funded promotion programmes without prior congressional approval.

2.6 Title VI: credit

Title VI reauthorizes and revises farm loan programmes, clarifies emergency loan assistance and provides for a study of rural credit availability. Among the issues addressed are the types of loan assistance to be made available, eligibility for credit assistance, and treatment of delinquent borrowers. The Act distances credit from direct loans, in favor of guaranteeing loans (Hosansky 1996a). New restrictions on the purpose and length of time for eligibility appear in the 1996 Farm Bill and repeal authority to make loans for most non-agricultural purposes. In addition, the Act targets lending to beginning, rather than established, farmers and ranchers. It authorizes lines-of-credit for up to five years, providing additional loan opportunities for farmers. However, delinquent borrowers face tighter restructuring rules, collection practices and expedited sales of forfeited property. To qualify for emergency loan assistance, the law requires

farmers to have held hazard insurance at the time of the loss. The Act limits emergency assistance loan amounts to $500 000 per farmer.

Finally, Title VI provides for a study to examine the rural demand for credit and the current capacity and future ability of the current infrastructure to meet demands. As part of this examination, the study will investigate the Federal Credit System (FCS), commercial banks, and other federal agencies.

2.7 Title VII: rural development

Title VII consolidates existing rural development programmes and establishes new programmes targeted at rural infrastructure development. The Act provides $100 million annually for telemedicine and distance learning services, in which medical expertise and teaching are routed through new information systems to rural areas. A renamed and reorganized Alternative Agricultural Research and Commercialization Corporation continues to make grants and loans directed towards non-traditional, non-food farm and forest products, expanding industrial uses of agricultural commodities.

A consolidated source of rural development funds was created in the Fund for Rural America, with approved financing of $100 million annually for 1997–1999. This fund provides money in equal proportions for rural development projects, agricultural research, and discretionary spending for rural development or research. In addition, Title VII establishes the Rural Community Advancement Program (RCAP). RCAP reorganizes and expands rural development infrastructure spending in three areas: rural community facilities, rural utilities, and rural business and cooperatives. The legislation also authorizes $590 million for water and waste facility loans and grants, provides $50 million in funding for the Rural Cooperative Development Grant Program, authorizes the National Sheep Industry Improvement Center, and establishes a Rural Venture Capital Demonstration Program.

2.8 Title VIII: research, extension and education

Title VIII provides broad reauthorization for existing programmes, subject to appropriations limits, from 1998–2002 (Young and Shields 1996). It appropriates funds for agricultural research, extension, and education programmes at 1995 levels through to 1997. The new legislation establishes the National Agricultural Research, Extension, Education and Economics Advisory Board. Furthermore, the law directs the Agriculture Secretary to develop a system to monitor research and extension projects. The title expands animal health and disease research, repeals authorization for a

turkey research centre, and authorizes research on human nutrition and citrus fruit pests. In addition, it provides for higher education research grants and amends the process for reviewing proposals for agricultural research facilities.

2.9 Title IX: miscellaneous

Title IX provides guidelines for the humane transportation of horses, amends the Plant Protection Variety Act, amends the Swine Health Protection Act, and provides for the collection and use of agricultural quarantine and inspection fees. It also establishes the Safe Meat and Poultry Inspection Panel and provides for overseas inspections of agricultural imports. Finally, it authorizes operation of the USDA Graduate School as a non-appropriated, non-federal entity and provides for the expenses of the USDA student internship programme.

3. Prices and politics of the 1996 legislation

The final form of the 1996 Bill is attributed to many factors. Prior to passage, analysts singled out budget concerns as the primary force driving change. Yet in the year or more of consideration, federal deficit projections fell significantly. In retrospect, some authors attribute the reform elements not so much to budget concerns but to the Republican control of Congress and the rise of commodity prices during legislative consideration (Orden, Paarlberg and Roe 1996a, 1996b). The final Farm Bill calls for costly additional programmes such as rural development and environmental initiatives. This, combined with the continuation of relatively costly policies such as export subsidies, suggests that budget concerns faded as consideration went on (*The Economist* 1996).

Market conditions, in contrast, played an increasingly central role in the formation of the AMTA contained in the FAIR Act of 1996. Here, we will focus especially on global and domestic markets for corn and wheat, which together accounted for the majority of prior programme spending. During 1995–96 grain prices rose to record highs and world grain ending stocks fell to their lowest levels in 25 years, as global consumption outpaced production. Poor growing conditions and market-distorting agricultural policies created production shortfalls in the exporting countries, as economic development and population growth stimulated demand in the importing counties. China, previously a net exporter, began importing feedgrains in 1995 (Smith 1996). In the United States, 1995 corn production suffered from below trend yields combined with a low number of acres planted and adverse weather factors. As a result, production fell

2.7 billion bushels from 1994. Late or prevented planting, hot weather, and disease problems hindered the ability to predict production levels, increasing price uncertainty (USDA 1995a). Lower production, combined with strong domestic and foreign demand, resulted in depleted reserve stocks, which fell 24 per cent to 6.1 billion bushels, the lowest level in the United States in 50 years (Smith 1996). Wheat production in 1995 suffered from a similar reduction in area planted, area harvested and lower yields. In addition, winter wheat in 1995/96 experienced adverse weather conditions leading to a 6 per cent drop in US production (USDA 1996). Corn prices started 1995 at \$2.19 a bushel and steadily increased to \$3.07 by December. The prices continued to rise during 1996, starting at \$3.09 in January and rising to \$4.49 by August. January 1995 wheat sold for \$3.69 increasing to \$4.88 by year end. Wheat prices rose during much of 1996 from \$4.83 a bushel in January to a high of \$5.73 in May. However, in July wheat prices declined slightly from the high to \$4.87 (USDA 1995/96).

Thus, while the debate surrounding the Farm Bill occurred, commodity prices rose, along with predictions for higher future prices. High prices for corn and wheat, based not only on supply shortfalls but predictions of strong global demand, created opportunities for policy change (Thrane 1996). As the cost of deficiency payments and thus producer benefits under the previous legislation shrank in reaction to rising market prices, farmers were required to repay partial deficiency payments received prior to planting. Short supplies, rising prices, strong global markets and some farmers' repayment situation helped make decoupled transition payments appear a better alternative than continued low levels of deficiency payments.

Future commodity prices and stocks continue to affect the 1996 Farm Bill in terms of producer and public acceptance. Low stocks and continued global demand suggest that prices will remain high for corn and wheat for the next two to three years, at a minimum (USDA 1996). In the public mind, high marketing receipts due to high prices, with transition payments loaded on top, are likely to further the perception of excessive transfers to farmers. Supporters of the Bill argued during passage that the payments were a mechanism of transition from decades of subsidization. However, as Congress seeks to limit welfare benefits to low income non-farm households, and to reduce Social Security and Medicare benefits, seven years of transfer payments to relatively wealthy farmers may offend advocates of both fiscal responsibility and fairness.

The fairness issue, under both new and older legislation, turns on the concentration of payments in the hands of the largest producers. Under previous Farm Bill legislation, 90 per cent of the direct payments accrued to the largest farms, representing just 18 per cent of all farmers. The remaining 10 per cent of the direct payments went to a group of small and

medium farms representing another 18 per cent of the total. The remaining 64 per cent of farmers received no direct payments at all (Runge, Schmittker and Penny 1995). Under the 1996 Farm Bill direct payments will remain based on the number of acres under production, so that the largest farmers will continue to receive the lion's share of the government benefits regardless of their level of need.

4. Party and politics

For four and a half decades during the Democratic control of Congress, coalitions servicing farm interests formed around crop, regional and subcommittee interests rather than political parties, creating a bipartisan basis for maintaining existing subsidy programmes. The election of 1994, in which control passed to Republican hands, called into question this tradition (Paarlberg and Orden 1996). This section considers the political process and the role political parties played in shaping the Farm Bill.

The long and arduous political process that generated the final form of the 1996 Farm Bill began with proposals geared towards reducing the cost of the programmes contained in the 1990 legislation. The proposals consisted of plans to cap the budget, provide revenue assurance, and increase non-payment acres. Proposals to decouple payments from the market and crop grown existed but received little attention (Orden, Paarlberg and Roe 1996a). During this process, priorities differed between both House and Senate and Democrats and Republicans. The Republican House leadership advocated deregulation and a plan to cap entitlement spending, based on a perceived mandate for budget constraint and policy reform arising from 1994 Congressional victories and Speaker Gingrich's 'Contract for America'. The Senate, also newly under Republican control, advocated a more moderate approach that included conservation and nutrition initiatives. The Democratic Clinton administration, meanwhile, endorsed the continuation of a long-term safety net for farmers, additional planting flexibility, increased conservation measures, new rural development initiatives and the extension of nutrition programmes. Democrats in the House and Senate shared these general priorities, and also reflected regional devotion to continuation of cotton, rice, peanut, tobacco and sugar programmes.

The Agricultural Market Transition Act, Title I of the 1996 Farm Bill, began its political life in the House as the 1995 Freedom to Farm Act. Agriculture Committee chair Representative Pat Roberts (R) switched from a supporter of the existing farm programmes to an advocate of decoupled payments as commodity prices rose. While rising commodity prices decreased direct payments to farmers under the 1990 Farm Bill, the

newly supported decoupled payments remained fixed regardless of market conditions. Yet the Freedom to Farm Act initially faced substantial opposition from other members of the House Agriculture Committee and the Clinton administration. Rice and cotton interests in particular feared change, and blocked passage of the Act in committee. In order to keep the Freedom to Farm proposal alive, Roberts convinced Republican leaders to incorporate it into Title I of the larger Balanced Budget Act, effectively circumventing his own committee vote, at least for a time (Orden, Paarlberg and Roe 1996a).

However, President Clinton vetoed the Budget, which threw Freedom to Farm back into Congress, where Roberts began trying to consolidate a coalition among diverse agricultural interests to support a revision. This coalition included representatives tied to field crops, sugar, peanuts, dairy products, cotton, and rice. Each group was granted concessions which appear in the final version of the Farm Bill. Field crops gained by receiving transition payments on top of record high commodity prices. Sugar and peanut programmes escaped all but minor reform. The dairy programme experienced moderate reform acceptable to dairy interests. Finally, cotton and rice interests received special price support in the form of an established price floor in the loan rate provisions. Roberts faced opposition from urban liberals and conservative suburban representatives who targeted farm programmes generally, and the sugar and peanut programme in particular, for elimination (Hosansky 1996b). This increased the importance of enlarging the coalition to account for the non-farm interests. Despite some opposition, the Senate passed a version of the Freedom to Farm Act. What was then necessary was to marshall Democratic support in the House and the Clinton administration. This was ultimately achieved by including conservation programmes, rural development and nutrition initiatives, trade programmes and a provision that allowed 'permanent law' to come back into effect at the end of the seven-year contract period, unless overturned by a future Congress.

Initially, the administration and Senate Democrats resisted the concept of transition payments decoupled from the market. Under previous Farm Bills, deficiency payment subsidies increased when farm prices fell and decreased when farm prices rose, providing a 'countercyclical' policy instrument. Under the new legislation, payments remain fixed whether farm income rises or crashes, providing farmers with a windfall during favourable market conditions and possibly deficient income support if the market turns in two or three years. The only remnants of a true safety net, non-recourse loans and permanent legislation, are too low or too far off to offer any real security in the event of downturn. In any case, retaining permanent law would cause a reversion in the year 2002 to 1950 levels of

subsidized yield allotments, completely out of touch with current prices and budget constraints (Hosansky 1996b).

The Democratic administration conservation programme requirements included continuation of the CRP and WRP, and an increase in mandatory spending for cost-sharing expenditures. Bipartisan support existed for the creation of a programme aimed at restoration and conservation of the Florida everglades. The administration also advocated the inclusion of rural development initiatives for telemedicine, distance learning, rural infrastructure, agricultural research, rural credit and other programmes. In summary, in order to garner support for fixed declining transition payments, Republicans succumbed to sugar, peanut, and dairy interests. Democrats demanded conservation initiatives, rural development funding, food stamp programme funding, and the retention of permanent legislation. The ultimate outcome of this political 'logrolling' was something midway between fundamental reform and convenient retention of other approaches. The 1996 FAIR Act affords farmers the freedom to plant for market and weather conditions, as well as the freedom to fail, unless risk-sharing devices such as futures markets, marketing consultants, forward contracts, and insurance are actively utilized (Thrane 1996). The Act also removes the government from the business of managing price and supply. The new legislation no longer leads the government into sending mixed signals by setting high price support levels that increase production, on the one hand, and by limiting acres under ARPs, on the other. Furthermore, the 1996 Farm Bill prevents cost overruns by capping spending on agricultural programmes for the first time.

However, the Act failed to address many issues including the income disparity generated by the programme, a concrete schedule for ending subsidies, significant budget savings, elimination of EEP, and rationalization of CRP rental rates (Orden, Paarlberg and Roe 1996a). In addition, the reform contained in the new legislation occurs for the most part in Title I. The remainder of the titles experienced modifications but escaped any radical reform. The inclusion of 9 titles in the Farm Bill signals the continuation of logrolling in the formation and passage of the Farm Bill. The question remains whether or not the change to fixed transition payment will result in the final permanent decoupling of farm subsidies from the market and crop planted. Already the Act faces challenges under the appropriations process.

5. Finishing the agenda

An alternative approach to the current dilemma posed by a combination of high market prices and large contract payments would be to allow

farmers to defer receipt of contract payments in high price years, and to receive them later if and when prices fall. The effect of such a deferral would be to retain the sanctity of the contract, but to extend its application to later years. This would reduce budget expenditures in the next several high price years, and convert the contract to a countercyclical policy in which payments function as a hedge against declining prices rather than a lump sum (but declining) windfall.

Some explanation of the second-best nature of this policy prescription is in order. First, the contracts signed by the vast majority of base acreage holders are essentially a fixed constraint, despite their egregious effects on the distributive allocation of government receipts. Second, in a period in which high crop prices are likely to be capitalized rapidly into land values, there is reason to avoid additional ratcheting up of these values through direct transfers to producers. Hence, if farmers are allowed to voluntarily 'bank' contract payments for later use and avoid current taxation, an element of countercyclicity will be combined with the political appeal of less transparent transfers, without direct violation of the contractual obligation established in 1996 law. Of course, the decision to exercise this option would be a function for farmers of the marginal tax savings set against the present value of the future contract payment, in relation to the expected level of future prices.

One interesting question is whether the extenuation of the contract should be a fully voluntarily individual decision, or should be applied by USDA to all contracts under the 1996 legislation. Subsidiary questions are whether individuals should be free to defer all, some, or none of their contract payment, as suited their own needs, and whether the advantages of deferral should be greater if farmers are smaller, or are prepared to engage in environmental or other initiatives. In any case, the payment deferral could be exempted from current taxes, analogous to an Individual Retirement Account (IRA). This may have considerable appeal given the marginal tax liability likely for the largest farmers, receiving high market receipts *and* large contract payments in the next few years. In general, advocates of strict adherence to the contract are more likely to favour the first, voluntary option. But one consequence of the voluntary approach is that by 2002, some farmers will have 'banked' more contract funds than others, creating a divided constituency for new approaches to policy. On the other hand, a general withholding of contract payments by USDA might be interpreted as a breach of contract, and would more likely, at minimum, require new legislation.

Apart from attempts to extend the contract under Title I, and make it countercyclical, an additional part of completing a reform agenda is likely to include efforts to bring the 'excluded' commodities, notably dairy,

sugar, peanuts and tobacco, more fully in line with the decoupled payments scheme now affecting the other programme commodities. This will be complicated, both politically and in terms of programme details, but would represent a real achievement in establishing new, more trade-neutral policy measures for these commodities.

Finally, it is arguable that future agricultural policy will continue to shift towards agro-environmental themes, in which market and non-market mechanisms are combined to promote new environmental initiatives (Runge 1996). These initiatives will require better targeting of incentives: taxes, subsidies, and penalties, to the recognized impacts of agriculture on water quality, chemical residues and biodiversity. While some aspects of the 1996 Farm Bill reflect this recognition, 1994 victories by Republicans in the House and Senate put a temporary chill into environmental policy initiatives. The policy environment for these initiatives now appears to be waning.

In conclusion, the 1996 Farm Bill represents an unfinished reform agenda. Still needed, in the authors' view, are measures to induce greater countercyclicity and equity into lump-sum compensation under Title I, as well as greater coverage of commodities largely uncovered by reform. Finally, we would argue that the survival of direct compensation schemes in the future will hinge in large measure on whether public perceptions improve of agriculture's impact on the natural environment.

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