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The 2002 Farm Bill

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On May 14, 2002 President Bush signed the 2002 Farm Bill into law. As with previous farm bills, this most recent bill will significantly affect North Carolina agriculture in terms of the profitability of farming, the mix of crops grown by the state's producers, and the amount of farmland devoted to agricultural production.

This issue of the *NC State Economist* reviews key provisions of the 2002 Farm Bill. Important changes in commodity programs are summarized, with particular emphasis on changes in the peanut and cotton programs, along with a discussion of the process in which agricultural policy-making is undertaken.

Changes in the Commodity Programs

Counter-Cyclical Payments

The 1996 Farm Bill represented a sea change in how federal support for agricultural producers was structured. Prior to 1996, all commodity program payments were tied to the crops grown on the farm. For the first time, the 1996 Farm Bill provided for "direct" payments to farmers that were completely separate from their planting decisions. These direct, or "production flexibility," payments were initiated under the aegis of making farm level decisions more responsive to market forces. Although the commodity loan programs remained in place and were tied to production decisions, these direct payments were a move toward a free-market agricultural economy.

That was all well and good until several excellent growing seasons around the world drove commodity prices down to the lowest levels seen in decades. In response, Congress passed a series of ad hoc disaster programs that compensated farmers for the low prices. In the past, the disaster programs were intended to help when some sort of natural disaster caused low yields, not low prices. There was a fear that this type of ad hoc support would mushroom and become the sole basis for commodity program support. It is hard for Congress to resist these types of politically beneficial, grand gestures.

In an attempt to move away from the ad hoc disaster support when prices are low, the new farm bill provides for counter-cyclical payments – payments that are made only if a commodity price falls below a pre-set level known as the target price. This payment scheme is not new, but it was not part of the 1996 Farm Bill at all. The 2002 crop year has been disastrous because pervasive, severe drought and spring flooding in the Upper Midwest have resulted in low yields, driving the prices of corn, soybeans, and wheat up to historic levels. As a result, counter-cyclical payments are unlikely for these crops this year. So, farmers are faced with a smaller crop to sell and no counter-cyclical price support. Not surprisingly, ad hoc disaster payments have already been announced.

Acreage Base and Yield Updating

The counter-cyclical payment program provides an opportunity for farmers to update their base acreage in the program crops and to update their program yields. The current base acreage – the amount of cropped area that forms the basis for how much a given farmer is paid by the government – was assigned to farms under the 1985 Farm Bill. Farmers, if they are land owners, can choose to keep that set of base acres or they can update their base using the acreage planted to program crops in the 1998 through 2001 crop years. If the farmer is not the landowner, then the landowner must make the acreage base updating decision. If a farmer chooses to update the farm's base acreage, then he/she can update yields, as well, or choose to use the farm's currently assigned yields (which were average yields calculated from the 1981 to 1984 crop years).

This decision is very complicated, given the parameters in the new law, and it is not obvious which of the many options available to farmers is best. Moreover, the rules are still changing. Fortunately, extension economists around the country have developed web-based software that is updated immediately upon a rule change to help farmers make this decision. Hopefully, the dust will settle by the time farmers have to make it.

Payment Levels

In addition to the new counter-cyclical payments, the direct payments were retained from the 1996 Farm Bill, along with the commodity loan programs. With the combination of the new loan rates and higher direct payments, plus the counter-cyclical payments, total potential support for agricultural producers is higher for commodity producers under the 2002 Farm Bill than it was in the 1996 Farm Bill. Time will tell if actual support levels, including any future ad hoc payments, will be higher or lower under the 2002 Farm Bill.

Changes in the U.S. Peanut Program

The 2002 Farm Bill brought sweeping changes to the peanut program. Prior to 2002, a quota program had restricted the quantity of peanuts that could be sold by U.S. farmers for U.S. consumption and had set a minimum price of $610 per ton for peanuts sold for consumption in the U.S. Farmers either owned or rented marketing quotas that allowed them to sell peanuts into the domestic market at $610 per ton. They could grow and sell peanuts in addition to their quota, but they had to either export the peanuts or put them under government loan, usually at a much lower net price.

The 2002 Farm Bill did away with the quota system. Quota owners receive $0.55 for each pound of quota owned. They can take the compensation over five years at $0.11 per pound per year or take it all up front.

Under the new farm bill there are no supply restrictions on the amount of peanuts farmers can grow, and the national average support price on all peanuts sold is $355 per ton. Active peanut growers can establish base acres and yields based on their 1999 – 2001 total peanut production. Unlike other commodity programs, the base established for peanuts is not linked to the farm on which the peanuts were grown. Instead, the base goes to the peanut producer who has until March 31, 2003 to assign the base to a farm of his choice. Farmers who were active peanut producers in 2001 are eligible to receive counter-cyclical and direct payments on their base acres.

The market price of runner peanuts (used in peanut butter and the predominate type grown in the U.S.) is expected to settle near or below the loan rate of $355 per ton. Virginia-type peanuts (the type grown in North Carolina, most of which are sold in the shell as "ball park" peanuts) may fetch a premium over runners. The price of both types of peanuts will be well below the domestic price received under the previous quota system, but may be above the prices received for peanuts sold into the export market under the old program.

Large shifts in price will cause much structural change in the peanut producing areas. In the Virginia-type growing area of Virginia and North Carolina, many producers in traditional peanut counties will choose to exit peanut production – especially since they can still receive their counter-cyclical and direct payments. Other North Carolina producers with high yielding soils, such as those located in Gates or Chowan counties, could increase production. Overall, North Carolina likely will grow fewer peanuts.

Changes in the U.S. Cotton Program

In general, the cotton program ended up operating very similarly to other commodity programs, such as wheat, feed grains, and soybeans. Producers are eligible to update bases and receive counter-cyclical and direct payments. They are also subject to the same payment limitations as under the programs for wheat, feed grains, and soybeans.

As was the case under the 1996 Farm Bill, the "Three Step Competitiveness Plan" is retained. Because of this, cotton remains unique among commodities in the way loan repayment rates and Loan Deficiency Payments (LDPs) are calculated (known as "Step 1"). The loan repayment rate for cotton is the Northern European price for cotton (the "A index") minus an adjustment for transportation costs calculated by USDA. For most other commodities, the loan repayment rate is an observed average domestic market price. The LDP is the difference between the loan rate (that is, the floor price) and the loan repayment rate. The significance of this difference is that cotton producers often receive an LDP greater than the difference between the loan rate and the domestic price of cotton. Also retained are the programs which provide subsidies to domestic textile mills when the U.S. cotton price is above the world cotton price and govern imports of foreign cotton – Steps 2 and 3 of the Three Step Competitiveness Plan.

The ability to update bases (historical acreage on which counter-cyclical and direct payments are based) is very important to North Carolina cotton farmers. NC producers have increased acreage from an average of 512,000 acres for the base building period for the 1996 Farm Bill to 855,000 acres for the base building period for the current farm bill. As with other commodities, base yields may be updated for use in calculation of counter-cyclical payments. This provision is also important to NC producers since average yields increased from 607 pounds per acre in the previous base building period to 687 pounds per acre in the current base building period.

What Drives Farm Bill Decision-Making?

The 1996 Farm Bill was widely touted as marking the beginning of the end of government involvement in farm commodity markets. By 2002, federal support to commodity producers in the form of direct payments (not including payments made through the loan-deficiency program) had been scheduled to fall to under $4.0 billion. Instead, direct payments to farmers this year are likely to be almost $17 billion (USDA, Agricultural Outlook, October, 2002).

In addition to sharply higher levels of overall support to the farm sector, the recent farm bill also ensures that support will be available to a wider range of agricultural producers than ever before. For the first time, producers of small chickpeas, lentils, and dry peas will be eligible to receive marketing loans under the farm bill's commodity program. Moreover, support to the producers of wool and mohair and honey, which had been discontinued under previous legislation, has been re-introduced into farm policy. A major new source of support arises from the inclusion of soybeans as a crop eligible for both direct payments and counter-cyclical payments under the new farm bill (soybeans had been eligible only for loan-deficiency payments under the 1996 legislation).

To paraphrase Mark Twain, the reports of the demise of farm subsidies were greatly exaggerated. What explains the sharp increase in spending under the 2002 Farm Bill, and the expansion of benefits? It is well known that there are fewer full-time farmers today than ever before. Wouldn't a decline in the number of farmers suggest that overall support to farm producers would fall, as there are fewer and fewer producers to support?

A large part of the story lies in the effective ability of farm producer organizations to lobby Congress on behalf of particular commodities. In fact, this lobbying may actually be facilitated by the decline in the number of producers. One of the strange facts about producer organizations is that as the number of producers declines, their ability to organize and coordinate their activities increases. In part, this reflects the fact that each remaining producer has an even greater incentive to lobby for stronger support. So the fact that there are fewer than 2000 commercial beekeepers in the U.S. may actually make it easier for them to resurrect the federal honey program. The small number of producers who grow dry edible beans (lentils, chickpeas, dry peas) actually makes it easier for them to garner support, particularly if they happen to be concentrated in one geographic area.

What does this suggest about the future of farm programs? The 2002 Farm Bill indicates that farm subsidies are not likely to fade away any time soon. The effectiveness of farm organizations in lobbying for additional support is likely to grow as the number of producers continues to decline and agricultural production becomes more concentrated.

For more information about the 2002 Farm Bill, check out the USDA Farm Service Agency's 2002 Farm Bill website: http://www.fsa.usda.gov/pas/farmbill/default.asp.

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