

FARM
BILL 02
CHOICES

Hit or Miss?

Congress approved emergency supplemental payments to farmers in 1998, 1999, and 2000.

Were they prudent responses to unusually tough times, or do they signal a fundamental flaw in current farm policy?

BY CRAIG JAGGER

Government payments have long been important contributors to net farm income in the United States (Figure 1). In fact, over the last 20 years they have accounted for about 25 percent of the total. While their share of net farm income for calendar 1999 and 2000 is unusually high, what makes payments for these years unique is that they include "one-shot" supplemental income support payments.



How Many Shots?

When farm prices declined to unexpectedly low levels two years after passage of the 1996 farm act (Figure 2), the act's fixed contract payments did not automatically increase.

Hoping that the decline was temporary, Congress enacted emergency assistance to provide one-year supplemental income support payments for 1998 crops.

Further price declines led Congress to pass new legislation providing a second shot of supplemental income support payments for 1999 crops.

And continued low prices led to legislation providing a third shot of income support payments for 2000 crops.

Together, these one-shot payments total \$15.9 billion paid out for income support for crops (excluding crop disaster, livestock, and conservation payments) during fiscal years 1999 through 2001 (Figure 3). They supplement the \$16.2 billion in fixed contract payments paid out for 1998 through 2000 crops and the \$18.6 billion in counter-cyclical loan deficiency payments and marketing loan payments already made for 1998 through 2000 crops. Most observers expect that if low prices continue, the Congress will provide a fourth one-shot payment for 2001 crops and a fifth shot for 2002 crops — unless a new farm bill is passed before the 1996 act expires in 2002.

Traditionally, farm income support has been legislated in multi-year farm bills, not in single-year emergency bills. In a multi-year farm bill, Congress sets the terms of farm income support by specifying formulas, levels, limits, and the like, for the life of the bill. In the past, changes in support during a farm bill's life have occurred for two reasons, neither related to farm-sector economic disasters caused by low prices. First, Congress has used one-shot payments to address income problems caused by natural disasters such as the droughts of 1988 and 1989 or the floods of 1993 (Figure 3). Second, Congress periodically has reduced farm program benefits in "budget reconciliation" bills that required government-wide reductions to help reduce the deficit.

A series of one-shot payments was not part of the plan when the 1996 farm act was passed. The act provided over \$35 billion in income support over seven years through fixed contract payments that declined over the life of the law, independent of market conditions. This was a major shift from previous farm bills whose deficiency payments were designed to be counter-cyclical—increasing when prices fell and decreasing when prices rose.

The 1996 farm bill also limited counter-cyclical benefits provided by loan deficiency payments and marketing loan gains by capping commodity loan rates generally at 1995 levels.



Congress imposes budget rules on itself when negotiating and passing legislation. The Budget Committees of the House and Senate manage the Congressional budget process and determine compliance with the rules. The Congressional Budget Office (CBO) acts as a key advisor to the Budget Committees. The budget rules and the process are complex. The following is a simplified explanation of two key concepts: the baseline and budget scoring.

The CBO baseline is CBO's estimate of all federal budget spending and receipts for the next ten years assuming that current laws and policies continue into the future. It incorporates current and projected market conditions and economic trends. Congress generally uses the CBO baseline as the basis for its budget resolution, the annual budget plan that reflects its budget and policy goals. The resolution's allocations set limits on spending for current and new programs for each committee. CBO's baseline estimates and budget scores (see below) are advisory to the Budget Committees, but they follow CBO's numbers almost all of the time.

The CBO baseline also serves as the benchmark from which CBO develops a score for the costs or savings associated with new laws. A budget score is CBO's estimate of the difference between (1) the estimated spending or receipts for a new program, and (2) estimated spending or receipts for the program under the current-law baseline (In other words, will the new program cost more or less than the current program?).

Budget scoring is important to the legislative process. When a bill with a positive score (meaning it will cost more) is brought to the floor for a vote, it may be subject to a parliamentary hurdle known as a budget point of order. This can raise the barriers to passage of a bill. For example, in the Senate, passing a budget point of order bill requires 60 votes rather than a simple majority.

To avoid a potential budget point of order, members and staff may, during the bill's development phase and in response to an informal CBO cost estimate, change a proposed program. Possible changes include reducing its costs, offsetting new costs by reducing costs of current programs, or increasing revenues through fees or other sources. Since Congress makes its own budget rules, it can change or override them at any time.

This should help illustrate some of the complexities that can impact the legislative process, especially regarding agricultural transfer payments. Budget constraints and political considerations can be every bit as important as "the merits of the case"—and sometimes more so.



The Role of One-Shot Payments

No one knows when Congress will pass a new farm bill, nor what its final provisions will be. However, the views policy makers hold of the successes and failures of current policy will have a strong influence on the new bill. Some might view one-shot payments as a sign that the 1996 farm bill's fixed contract payments have failed. Others might view one-shot payments as extraordinary measures for extraordinary times. Several observations can be made about the role of recent one-shot payments.

One-shot payments are counter-cyclical. One-shot income support payments have provided counter-cyclical farm income support for recent low-price years. Prices fell and Congress increased payments. However, one-shot payments are not automatic counter-cyclical payments like prior deficiency

payments, current loan deficiency payments or marketing loan gains.

But not fully counter-cyclical. One-shot payments are not fully counter-cyclical. Price declines likely will need to be significant, and to reach levels well below long-run average prices, before Congress will

Some might view one-shot payments as a sign that the 1996 farm bill's fixed contract payments have failed. Others might view one-shot payments as extraordinary measures for extraordinary times.

pass new legislation to provide these payments. Small price declines or levels a bit below average prices likely won't bring forth one-shot payments. Further, one-shot payments are likely to be asymmetrical: in other words, they will only provide counter-cyclical support for low prices. Congress has supplemented fixed contract payments when prices are low, but is unlikely to reduce fixed contract payments when prices are high.

One-shot payments have elements of uncertainty. Will payments be provided and, if so, when, for whom, and how much? The uncertainty of one-shot payments can alter planting incentives more than programs that automatically guarantee higher-than-market returns. However, this point is untested with current one-shot payments whose benefits are paid on historical — not current — production.

Significant policy changes are unlikely. One-shot payments are biased toward existing income support mechanisms. Using existing mechanisms allows payments to go out more quickly. Doing so also reduces the administrative burden on USDA's local and national offices by reducing training and programming needs and administrative errors.

Passing a one-shot bill requires agreement on (1) the need for the bill, (2) the level of payments, (3) how payments will be funded, and (4) who will receive the benefits. Getting agreement on need and funding may be sufficiently difficult that getting agreement on targeting and distribution may not be possible — especially for a one-year program. The practice generally has been to work hard on the full-fledged policy debate during farm bill years.

Some observers have noted that the 1996 farm act had substantially fewer Congressional hearings than previous farm bills and have suggested that the depth of support for its final provisions was less than for most farm bills. In 2000, the House Committee on Agriculture held ten field hearings around the country and, as of mid-April, 2001, had heard from nine general farm or commodity groups (with more to come) on preferred programs and policies for the next farm bill.

A seven-year farm bill may be too long. Until the 1996 farm act, recent farm bills ran for three years (1970), four years (1965, 1973, 1977, 1981), or five years (1985, 1990). A longer term provides more time for unintended consequences to arise and extends the interval for scheduled fixes. If the 1996 farm bill had been a four-year bill authorizing programs for 1996 through 1999, last year's farm legislation would have been a new, multi-year farm bill rather than a one-shot farm income support bill. The number of years covered by a bill may be less important, however, than whether its policies are consistent with political and policy needs under a variety of possible market conditions.

The Next Farm Bill: Back on Automatic?

Given the experiences of the last several years, most observers believe that the next farm bill will provide more of its farm income support through automatic counter-cyclical payments. All nine general farm and commodity groups testifying on income support policy before the House Committee on Agriculture as of early April, 2001, proposed increased funding for automatic counter-cyclical payments. (All but one wanted to continue fixed contract payments, too.) If this early effort proves successful, a continuation of one-shot payments in 2001 or 2002 can be viewed as a stopgap measure until a new farm bill is debated and passed.

"Show me the money." Some proponents of automatic counter-cyclical payments have expressed concerns about how the agriculture committees will fund new farm income support programs given the confines of Congressional budget rules (see "Of Baselines and Budget Scores" for a discussion of budget rules, baselines, and budget scoring).

These rules provide for additional barriers to passage for bills that increase spending without offsetting the costs. A traditional means of funding new programs within the budget confines is to offset the costs of new programs using savings earned by eliminating or modifying current programs. This works only as long as the costs of the new programs are no more than the costs of the programs they replace.

How much money? Eliminating contract payments beginning with 2002 crops would save about \$4 billion per year. (Budget rules require that the baseline assumes that contract payments continue into the future even though the payments are authorized only through 2002.) These savings are much less than the \$11.5 billion in contract payments plus one-shot payments provided for 2000 crops. And only contract payments with their multi-year

Figure 1. Only Big Increases in Government Payments Have Maintained Net Farm Income

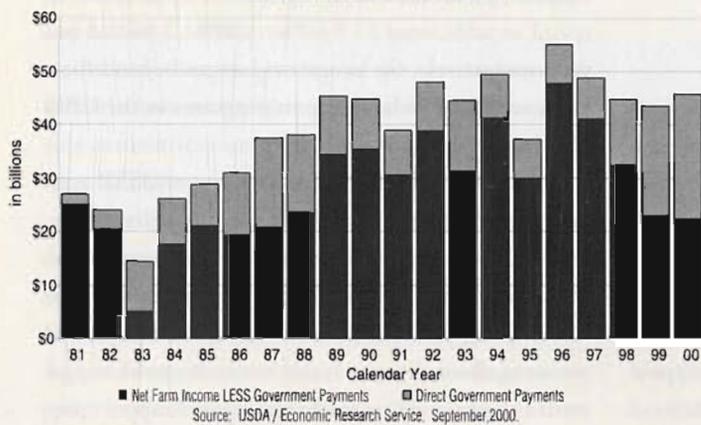
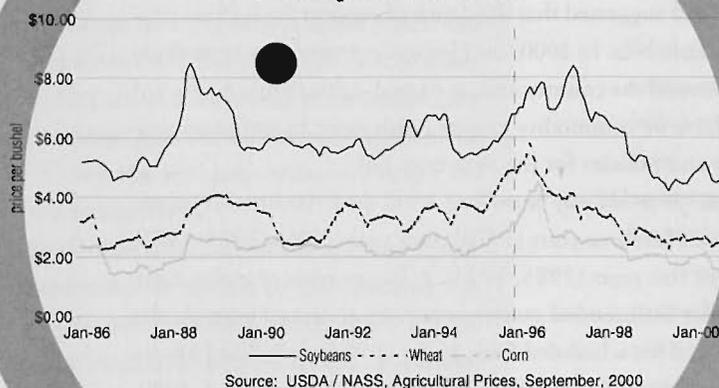


Figure 2. Crop Prices Have Declined to Below-Average Levels Since 1996



authorization — but not one-shot payments — are in the budget baseline from which costs or savings are “scored” in Congress. If the agriculture committees want to provide automatic counter-cyclical support in the next farm bill at levels greater than provided by current commodity loan programs and comparable to the support for 2000 crops, they must find additional funds beyond the estimated spending in the current budget baseline for contract payments.

Analysts at the Congressional Budget Office (CBO) are responsible for estimating the federal government costs of funding a given level of price or income support (see “Of Baselines and Budget Scores”). Estimating future costs of fixed payments is straightforward — the costs are the amounts provided in legislation adjusted for payment limitations and other factors. Estimating the costs of automatic counter-cyclical payments is more complex. Costs of counter-cyclical payments are large in years with low market returns and zero in years with high market returns. Because prices and other market components in future years are impossible to forecast accurately, CBO analysts use “probability” or stochastic scoring to calculate the expected costs of counter-cyclical programs. Probability scoring gives an expected program cost for a future year that accounts for a range of possible market returns, the programs costs associated with each of those possible market returns, and the probability

that each of those market returns will occur (Jagger and Hull, 1997).

Find the votes. There are numerous routes for satisfying Congress’s budget rules, given sufficient support. The route used to fund one-shot payments — designating them “emergency spending,” which does not count as increased spending for budget enforcement purposes (see sidebar) — would be harder to justify for a multi-year farm bill than for a one-shot bill responding to a current need.

A more likely route for providing additional advance funding is that used for the 1994 and 2000 crop insurance reform efforts. Congress, in its annual budget resolutions, authorized the agriculture committees to spend an additional \$1.0 billion and \$1.6 billion per year, respectively, for program changes beyond forecast spending for then-current programs in the CBO baseline.

How difficult is it? Sufficient Congressional support for additional income support appears secure. Three years of one-shot payments can certainly be viewed as an indication of broad support for agriculture in Congress. While some members have expressed concerns about the continuing series of one-shot payments, their remedy is to change income support programs in the next farm bill so that one-shot payments are not needed. Indeed, preliminary Congressional budget resolutions passed separately by the House and Senate in Spring 2001 provide for additional income support for 2001 and future crops. Projected federal budget surpluses also make obtaining Congressional support easier. But many interests other than agriculture are competing for projected surpluses: tax cuts, increased benefits for other government programs, higher defense spending, paying down the national debt, or some combination of the above.

If the farm bill debate is delayed until 2002, projected budget surpluses may be lower if Congress passes other laws drawing on the surplus, or if general economic conditions weaken (some believe they already have). But if current agricultural market conditions improve enough to change baseline projections of agricultural prices, production, and baseline spending, scored costs of proposed counter-cyclical programs would likely change and would likely be lower for many — but not all — types of programs.

Other considerations are important, too. This article focuses on domestic policy considerations for one-shot payments and budget considerations for counter-cyclical income support programs. Obviously, other considerations are important, too. For example, linking counter-cyclical income support to production, as with current commodity loan programs, can encourage production and lead to lower prices and higher program costs. (Harwood and Jagger, 1999; Westcott and Young, 2000) Counter-cyclical programs must be designed carefully if the U.S.'s WTO (World Trade Organization) commitment to limit covered costs of domestic income support program to \$19.1 billion per year is to be met. (Nelson, Young, Liapis, and Schnepf, 1998)

Indeed, the core question of the current farm bill debate is how to maintain production flexibility, provide automatic counter-cyclical income support, and meet WTO commitments. This will not be easy.

Prevailing market conditions obviously influence the debate, too, but to assume that prices will always be as low as recent levels is probably as unreasonable as to assume that prices will always be as high as in 1996. A good farm policy will be robust — providing appropriate levels of support under a variety of market conditions. As for where prices and other market components will be in the future, consider the answer to the question about droughts in Kansas: "A dry year in Kansas is followed by (a) a wet year, (b) another dry year, (c) another year." The correct answer is (c).

Acknowledgements

The author acknowledges with appreciation the comments and insights of Roger Hitchner, Jim Langley, Greg Hitz, David Hull, Sandy Davis, and Pete Fontaine of the Congressional Budget Office, and Joy Harwood of the Economic Research Service.

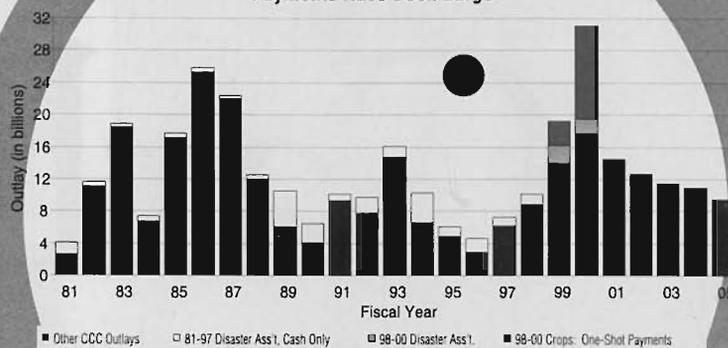
For More Information

Committee on Agriculture, U.S. House of Representatives. Website: <http://agriculture.house.gov>.

Harwood, Joy and Craig Jagger. "Agriculture's Safety Net: Looking Back to Look Ahead." *CHOICES*. Fourth Quarter 1999, 54-60.

Jagger, Craig and David Hull. "Calling the One-Sided Bet." *Review of Agricultural Economics*.

Figure 3. "One-Shot" Income Support Payments Have Been Large



Source: Commodity Credit Corporation Outlays. CBO June, 2000 baseline. Spending is by fiscal year—not crop year. FY 2000 includes one-shot payments for both the 1999 and 2000 crops. Reflects the Agricultural Risk Protection Act of 2000 and prior (but not later) legislation.

19(Spring/Summer 1997) : 178-192.

Nelson, Fred, Edwin Young, Peter Liapis, and Randall Schnepf. "Domestic Support Commitments: A Preliminary Evaluation" in *Agriculture in the WTO Situation and Outlook Series*. WRS-98-4, December 1998.

Orden, David, Robert Paarlberg, and Terry Roe. *Policy Reform in American Agriculture: Analysis and Prognosis*. Chicago: The University of Chicago Press, 1999.

Schertz, Lyle P. and Otto C. Doering III. *The Making of the 1996 Farm Act*. Ames, Iowa: Iowa State University Press, 1999.

Schick, Allen. *The Federal Budget: Politics, Policy, Process*. Washington, DC: Brookings Institution Press, 2000.

Westcott, Paul and C. Edwin Young. "U.S. Farm Program Benefits: Links to Planting Decisions & Agricultural Markets." *Agricultural Outlook*, October 2000.

Craig Jagger is chief economist for the majority staff of the U.S. House Committee on Agriculture. This article was developed while Jagger was a principal analyst at the Congressional Budget Office. The views expressed here are those of the author and should not be interpreted as those of the House Committee on Agriculture or the CBO.

