III. Special Articles

Farm Bill Update

Ed Jesse, Bruce Jones, and Paul Mitchell

Status of New Legislation

This special article was supposed to be a condensed description of the 2007 farm bill — omnibus legislation to replace the Farm Security and Rural Investment Act of 2002. Most of the provisions of current law expired in 2007. However, at this writing, it is apparent that new farm legislation will not be enacted in 2007.

The House of Representatives wrapped up its farm bill (The Food, Nutrition, and Bioenergy Act of 2007) on July 27, when the full House voted passage 231-191. The Senate Agricultural Committee approved the Senate version (The Food and Energy Security Act of 2007) on October 25, and debate before the full Senate began in early November. Progress toward a vote was stymied by numerous amendments, most of them unrelated to the Bill. A cloture vote held on November 16, before Congress recessed for its 2-week Thanksgiving break, failed to yield the 60 votes necessary to limit debate and amendments.

Following some behind-the-scenes negotiations, the Senate informally agreed to limit amendments to 20 each from each party. Amendments were debated during the week of December 10, and on December 13, the Senate voted 79-14 to adopt the Committee bill almost intact.

The next step in the enactment process is House-Senate conference committee action to work out differences between the two bills. This will occur sometime after Congress returns from recess on January 21.[4] The compromise bill will then be submitted for President Bush's signature. But administration advisors have threatened a presidential veto of any compromise bill that contains certain provisions of the current House and Senate bills, citing a number of hidden tax increases to create budget offsets and "gimmicks" to hide the true cost of the legislation. The administration has also expressed dismay that both the House and Senate bills propose increased payments to U.S. farmers at a time when net farm income was record high.

Delays in passage of farm legislation are not uncommon, though the current bills are being held up for different reasons than in the past. In fact, the last two farm bills were enacted after their predecessors expired. The 1996 Farm bill expired at the end of 2001, and what was initially the 2001 farm bill became the 2002 farm bill when it was passed by Congress and signed by the president in May. The 1995 farm bill was transformed into the 1996 farm bill, enacted in April.

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[4] In late December 2007, Congress extended the Farm Security and Rural Investment Act of 2002 until March 15, 2008 to accommodate the delay in passage of new legislation.

There will be a new farm bill, and it will not likely deviate much from what the House and Senate have proposed. Though differing in specifics, the House and Senate bills are similar in content. Both bills:

- Retain fixed direct payments, countercyclical payments and loan deficiency payments for eligible crops.
- Provide farmers the option of receiving revenue-based payments as an alternative to price-based payments (countercyclical and loan deficiency payments).
- Tighten payment limitations by reducing the adjusted gross income eligibility cap.
- Substantially increase research and market-enhancement support for producers of horticultural crops.
- Require implementation of Country of Origin Labeling (COOL) for red meats in 2008.
- Strengthen the conservation title, mainly by increasing funding for existing conservation programs.
- Rename the Food Stamp Program and expand benefits and eligibility.
- Expand funding for Rural Development.
- Significantly increase funding for research and commercial development of crop-based biofuels.

Noteworthy differences between the two bills that will need to be worked out in conference include:

- Both bills contain a new Title X, increasing the number of titles from 10 to 11. The Senate's Title X is, "Livestock Marketing, Regulation, and Related Programs." The House's Title X is, "Horticulture and Organic Agriculture."
- The Senate creates a Special Counsel for Agricultural Competition within its Title X that, among other things, limits packer ownership of livestock. This controversial provision is not included in the House bill.
- The Senate bill includes a provision for permanent disaster payments to cover losses from droughts and other natural disasters and authorizes $5 billion in funding; the House bill does not have a disaster payment provision.

- There are significant differences between the two bills in funding of the Environmental Quality Incentives Program (EQIP) and the Conservation Security Program (CSP). The House proposes adding $1.9 billion to EQIP; the Senate keeps EQIP funding even and adds $2 billion to CSP.

The House-Senate conference committee will probably also have to make changes in the compromise bill to meet White House objections regarding budget impact — the close vote in the House suggests there are insufficient votes in that body to override a veto. This could reduce authorized funding for some programs, and these cuts could prolong the House-Senate conferencing process.

Since the details of new farm legislation are unknown at this time, we will use this article to discuss some changes in policy direction suggested by the House and Senate bills. We first examine implications of changes (or lack thereof) in existing policy instruments: commodity price and income supports (including payment limitations), conservation, and energy. Then we look at a new element of the farm bill proposals that suggest a shift from supporting farm *prices* though price supports and deficiency payments to supporting farmer *incomes* through some form of subsidized gross revenue insurance.

Current Policy Mix

Income Supports and Subsidies

The farm bills developed by the House and the Senate both call for the continuation of three income support programs from the 2002 Farm Bill: (1) loan deficiency payments; (2) counter cyclical payments; and (3) direct payments. The administration's farm bill proposal released early in 2007 also supported these programs.

The only changes in the loan deficiency payments program proposed by the House and Senate would be to increase the loan rates for wheat, barley, oats, minor oilseeds and decrease the loan rates for dry peas and lentils.

Counter cyclical payments (CCPs) were introduced in the 2002 Farm Bill. They are designed to counteract declines in crop prices to keep farm incomes from falling below targeted levels. CCPs are a modified version of deficiency payment programs used from the late 1970s through the mid-1990s to support incomes for crop farmers. CCPs differ from traditional deficiency payments in that farmers receive payments based on *historic* versus *current* production. Thus, farmers who historically grew corn and thus have a corn acreage and yield base receive CCPs as if they were growing corn even though they may actually be growing hay or soybeans on their land. Because there is no link between CCPs and current production, the program complies with WTO rules pertaining to the trade-distorting effects of domestic agricultural support programs.

Both the House and Senate versions of the farm bill continue CCPs in much their current form, but they make some adjustments in the target prices. Target prices for wheat, barley, oats, soybeans, and other oil seeds are all increased while the target price for cotton is lowered. These adjustments are intended to eliminate any real or perceived disparities that existed among program crops under the 2002 Farm Bill's CCP program.

The Bush Administration's farm bill proposal called for farmers to continue to receive direct payments and for these payments to grow over time. The House and Senate versions of the farm bill also continue direct payments, but they hold these payments at the levels specified under the 2002 Farm Bill.

Direct payments are fixed and paid to farmers regardless of commodity prices. Both the House and Senate farm bills retain the same direct payment levels authorized in current legislation.

The practice of paying farmers subsidies that are unrelated to their income position got its start in the 1996 Farm Bill, often referred to as the "Freedom to Farm Act." The idea was to wean farmers from payments tied to acreage bases. A key component of the Act was guaranteed "transition payments," paid to farmers on the basis of historic program crop acreage bases and yields but freeing them from actually producing the program crops. For example, corn farmers received transition payments on corn acreage bases applied to historical yields even if they quit growing any corn and started growing hay.

These payments were to be made only through 2001. However this did not happen. In the 2002 Farm Bill, the funds that had previous been paid out as transition payments were transformed and paid to farmers as direct payments.

The inclusion of direct payments in the House, Senate, and Administration Farm Bill proposals dramatizes their popularity with farmers. This is not surprising. Direct payments reward farmers without requiring them to do anything in return. Politicians are apparently unwilling to shut down this system because they are afraid they will face the ire of disgruntled farm voters. But with current farm incomes at record high levels, it is difficult to come up with any economic justification for a farm program that pays out large sums of taxpayer dollars to add to farmers' large market-based profits.

Payment Limitations

Both the House and Senate versions of the Farm Bill limit the amount of farm income supports and subsidies given to individuals whose principal occupation is something other than farming.

The House proposes that an adjusted gross income (AGI) in excess of $1 million would disqualify persons from receiving program payments. The income eligibility requirement, as reflected by AGI, is reduced to $500,000 in those cases where less than 67 percent of AGI is from farming.

The Senate version of the farm bill phases in income eligibility requirements over time, continuing the current limit of $2.5 million AGI through 2008 and then scaling it back to $1 million in 2009 — except in those cases where more than 67 percent of AGI is from farming. The Senate bill further reduces the income threshold to $750,000 in 2010-2012 except for those who earn more than 67 percent of AGI from farming.

The key thing to note is that the Senate does not limit payments to persons who earn 67 percent or more of their AGI from farming. This means that larger farmers are generally not at risk under the Senate bill.

Both the House and Senate farm bills eliminate the limits on the benefits farmers can collect from loan deficiency payments. But both bills put new limits on the benefits farmers can receive as direct payments and counter cyclical payments. The House allows a farm couple (a wife and husband) to collect up to $250,000 in direct payments and counter cyclical payments with no more than $60,000 being direct payments. The Senate version of the farm bill further limits the total payments that can be received by farm couples: They can receive no more than a total of $200,000 of counter cyclical payments and direct payments annually, and no more than $60,000 can be counter cyclical payments.

The 2002 Farm Bill allowed persons to collect full benefits for one farm operation and half benefits for up to two additional farming operations in which they had ownership interests. This provision, known as the three-entity rule, gave some persons more opportunities to collect farm income supports and subsidies. Both the House and Senate versions of the new 2008 bill close this special doorway to additional program benefits.

Conservation

The House and Senate versions of the farm bill both continue the conservation programs that were in place in the past farm program and they generally maintain or increase funding for the various programs that are intended to promote and enhance the preservation of natural resources. The key components of the total conservation plan are:

- Working Lands Program
- Land Retirement Program
- Farm Land Protection
- Watershed Protection
- Conservation Innovative Grants

The Working Land Program and the Land Retirement Programs are probably the most important to farmers because they provide the financial resources that farmers can use to adopt conservation practices or idle or preserve fragile cropland, wetlands or grasslands.

The longstanding Conservation Reserve Program (CRP) is continued as one of the key components of the new farm bill. So are the the Wetlands Reserve Program and the Grasslands Reserve Program.

Another important objective of the farm bill's conservation title is to preserve and enhance environmental quality. Both the House and Senate propose to continue the

Environmental Quality Incentives Program (EQIP) as well as the Conservation Security Program (CSP) and the Wildlife Habitat Incentive Program (WHIP).

Energy

The new Farm Bill will provide even greater financial support for the development of biofuels and other renewable energy sources. Both the House and Senate versions continue nearly every energy program in the 2002 Farm Bill, and increase funding for most of them.

The House's version of the Energy Title calls for federal agencies to continue to purchase bio-based energy products. The Senate's bill also calls for federal agencies to give preferences to bio-based products and requires USDA to develop a voluntary labeling program for bio-based products.

The new Farm Bill will most likely continue the grants program started in 2002 to finance the cost of developing and constructing biorefineries and biofuels production plants. The House mandates spending $800 million on this initiative over FY 2008-12. The Senate is less generous in mandating only $300 million.

One major difference between the energy titles of the House and Senate bills is the level of mandatory funding authorized for the Bioenergy Program. The Senate plan sets funding at $245 million, which is well above the $150 million appropriated in the 2002 farm bill, but is far below the $1.4 billion of mandatory spending called for by the House. It is a good bet that biofuel producers will get considerably more financial support from new farm legislation. But it is doubtful that the Senate will agree to spend $1.4 billion on this initiative. The final spending authority on this program will likely be closer to the $250 million proposed by the Senate.

Income versus Price Safety Nets

Both the House and Senate versions of the farm bill take an important new direction regarding the "safety net" that the federal government provides for commodity producers. Neither of these versions would replace existing counter-cyclical programs. Rather, each offers farmers an alternative choice. We describe and compare these new proposed programs below and demonstrate their potential benefit to Wisconsin farmers using an historical analysis.

The House's Revenue-Based Counter-Cyclical Payments

The House version of the farm bill offers *Revenue-Based Counter-Cyclical Payments* as an alternative to the current counter-cyclical commodity program. The proposal specifies national target revenue for each program crop. If the *actual* national revenue for the crop is less than the *target* revenue, participating producers receive per-acre support payments equal to the difference. Thus, the program attempts to create a revenue floor.

The table below lists the national target revenues for corn and soybeans from the House farm bill. The bill doesn't specify how target revenues will be determined. Actual national revenue for a crop is calculated by multiplying the national average yield by the higher of (a) the national average market price received by producers during the 12-month marketing year or (b) the loan rate. The House farm bill does not indicate how the national average yield and national average market price are determined. For our analysis, we used USDA-NASS national yield per harvested acre and price data to compute the implied revenues and revenue-based counter-cyclical payments for corn and soybeans for 2002 to 2006 shown in the table.

These results suggest that the House proposal could have substantial value to corn farmers and some benefit to soybean farmers. The large average revenue-based counter-cyclical payments for corn are due to low corn prices, especially in 2002 and 2005. Using current futures prices as a guide, we expect that marketing year average prices for corn and soybeans will be much higher in the next few years than they were from 2002 to 2006. Consequently, only if national *yields* are very low could farmers expect to receive revenue-based counter-cyclical payments. But then, neither are current price support programs likely to trigger payments for corn and soybeans over the next few years.

The House bill does provide a process to update the national target revenues. Such a process is important since the national yield potential for most program crops has been increasing over the years. The implication is that, without such a procedure, both the chances of receiving revenue-based counter-cyclical payments and the size of those payments would decrease over time.

Yields, Prices, and Revenue for Corn and Soybeans and Implied Revenue-Based Counter-Cyclical Support Payments under the House Program.

Corn					
Year	***Yield (bu/ac)***	***Price ($/bu)***	***Actual Revenue ($/ac)***	***National Target Revenue ($/ac)***	***Support Payment ($/ac)***
2002	129.3	2.32	299.98	344.12	44.14
2003	142.2	2.42	344.12	344.12	0.00
2004	160.4	2.06	330.42	344.12	13.70
2005	148.0	2.00	296.00	344.12	48.12
2006	149.1	3.04	453.26	344.12	0.00
Soybeans					
Year	***Yield (bu/ac)***	***Price ($/bu)***	***Actual Revenue ($/ac)***	***National Target Revenue ($/ac)***	***Support Payment ($/ac)***
2002	38.0	5.53	210.14	231.87	21.73
2003	33.9	7.34	248.83	231.87	0.00
2004	42.2	5.74	242.23	231.87	0.00
2005	43.0	5.66	243.38	231.87	0.00
2006	42.7	6.43	274.56	231.87	0.00

The Senate's Average Crop Revenue Payments

The farm bill approved by the Senate includes *Average Crop Revenue Payments* as an alternative to the current counter-cyclical commodity program. The Senate version structures its revenue program somewhat like the Group Risk Income Plan (GRIP), a revenue insurance policy based on county revenue.

Average Crop Revenue Payments for a crop would be triggered when *actual* state revenue is less than the state crop revenue *guarantee*. This guarantee is 90 percent of expected state yield per planted acre times the pre-planting crop price. Expected state yield is based on a linear regression trend of yield per planted acre using USDA-NASS yield data for 1980 to 2006. The pre-planting crop price is the average of the pre-planting crop prices used for crop revenue insurance policies for the current and the two previous years. For corn and soybeans, these prices are based on the average Chicago Board of Trade (CBOT) settle prices in the month of February for December corn and November soybean futures.

The table below reports the expected yield, price and revenue guarantee for Wisconsin corn and soybeans for the Average Crop Revenue program for 2002 to 2007.

Yields, Prices, and Revenues for Corn and Soybeans in Wisconsin and Implied Revenue Guarantees and Average Crop Revenue Support Payments under the Senate Program.

				Corn			
Year	*Expected Yield (bu/ac)*	*Pre-Plant Price ($/bu)*	*Revenue Guarantee ($/ac)*	*Actual Yield (bu/ac)*	*Harvest Price ($/bu)*	*Actual Revenue ($/ac)*	*Support Payment ($/ac)*
2002	103.6	2.43	226.59	107.3	2.52	270.30	0.00
2003	104.9	2.40	226.56	98.0	2.26	221.57	4.99
2004	106.2	2.52	240.80	98.2	2.05	201.36	39.44
2005	107.5	2.52	243.71	112.9	2.02	228.15	15.56
2006	108.7	2.58	252.49	109.7	3.03	332.39	0.00
2007	110.0	2.99	296.07	144.1	3.58	408.39	0.00
				Soybeans			
	Expected	*Pre-Plant*	*Revenue*	*Actual*	*Harvest*	*Actual*	*Support*
2002	39.7	4.83	172.56	43.4	5.45	236.69	0.00
2003	40.1	4.81	173.58	27.2	7.32	199.00	0.00
2004	40.5	5.49	200.11	33.4	5.26	175.80	24.31
2005	40.9	5.84	214.97	43.2	5.75	248.29	0.00
2006	41.3	6.14	228.23	43.7	5.93	259.34	0.00
2007	41.7	6.60	247.71	38.7	9.75	275.24	0.00

Actual state revenue is the USDA-NASS Wisconsin yield per planted acre times the harvest price used for crop revenue insurance policies — the average of CBOT settle prices for the month previous to the harvest month futures contract. Actual state revenues and implied Average Crop Revenue Payments for 2002 to 2007 are calculated using NASS-reported state yields.

This historical analysis seems to indicate that the Senate program could have value to farmers, but payments are lower than the House proposal. Interestingly, the two proposals benefit farmers in different years, a point discussed below in comparing the two programs.

In the Senate version, expected corn yields for Wisconsin are much lower than the national yields used in the House version because the House version uses yield per *harvested* acre, while the House uses yield per *planted* acre. In most states, the difference between planted and harvested acres is primarily due to crop loss, but in Wisconsin, about 20-25 percent of planted corn acres are used for silage. These acres do not contribute bushels to the state production, but are included when dividing by total planted acres, and so make yield per planted acre substantially lower in Wisconsin. This "silage effect" of the Senate's Average Crop Revenue program substantially reduces revenue guarantees and program payments for Wisconsin corn farmers.

GRIP, the crop insurance policy that the Senate program uses as a model, requires growers to choose whether they want their indemnities to depend on the NASS yield per planted acre or yield per harvested acre. Wisconsin is the only state for which GRIP (and the closely related GRP policy) makes this option available. Indeed, the value of these insurance policies can be quite different depending on which option is chosen. It is important for Wisconsin that if the final version of the farm bill includes a revenue support program based on state or county yields, Wisconsin farmers have the option to base their payments on yield per harvested acre or yield per planted acre, the same option they have for the GRIP revenue insurance policy.[5]

Comparing the Programs

In general, farmer revenue will track state revenue more closely than national revenue. Thus, farmers face more "basis risk" for their support payments under the House program than under the Senate program. This difference between the programs is important. When farmers incur low yields because of local weather conditions, they are generally more likely to receive income support payments under the Senate program, since its payments are more closely tied to local conditions. However, other factors also influence payments.

Because the Senate proposal uses the three-year average pre-plant price, not the current year's pre-plant price, it has "momentum" built into its revenue guarantees. If pre-plant futures prices are high for two or three years and then drop sharply, the revenue guarantee for the Senate proposal will tend to remain high, even though farmers' expected revenue

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[5] See "Is GRP a Good Deal for My Corn?" available at http://www.aae.wisc.edu/mitchell/Crop%20Insurance/Corn%20GRP.pdf).

at planting is low. Then, because payments are based on the realized harvest price for only the current year, farmers in this situation are more likely to receive support payments. However, the reverse is also true. If pre-plant futures prices are low for two or three years and then rise sharply, the revenue guarantee under the Senate's proposal will tend to remain low, even though farmers' expected revenue at planting is high.

This momentum effect highlights another significant difference between the two programs. The House's target revenue is not affected by market history or current conditions — it is a constant revenue floor. The Senate's revenue guarantee moves with market conditions. Specifically, the House program makes support payments whenever national revenue falls below the target revenue, regardless of price and yield expectations at planting time. In contrast, the Senate proposal makes payments whenever state revenue falls below 90 percent of the revenue the market expected at planting. In other words, the House program aims to provide a constant revenue floor as a safety net while the Senate program tries to provide a safety net for larger than expected revenue declines. Thus, if expected prices and revenues are low, the House program is more likely to give support payments, but if expected prices and revenues are high, the Senate program is more likely to give support payments.

The differences in the support payments in our historical calculations are largely due to these three factors: (1) using state yields and CBOT prices versus national yields and marketing year average prices, (2) the momentum effect built into the prices used by the Senate program, and (3) the different nature of the safety nets provided by each program.

It will be interesting to see how the conference committee goes about reconciling the House and Senate versions of these new revenue based counter-cyclical programs. Once the specifics of the final such program are settled, we will provide additional information to help Wisconsin farmers choose the best option among those available. However, given the nature of the political process, this may not happen until after 2008 crops are planted.