

The 1996 U.S. Farm Act Increases Market Orientation

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Introduction

The Federal Agriculture Improvement and Reform Act of 1996 (1996 Act) was signed into law in April 1996, providing new farm sector law for 1996-2002. The 1996 Act is a milestone in the evolution of U.S. agricultural policy because it fundamentally redesigns income support programs and discontinues supply management programs for producers of wheat, corn, grain sorghum, barley, oats, rice, and upland cotton. This bulletin provides a general overview of major changes related to production agriculture resulting from the commodity provisions (Title I), the agricultural trade provisions (Title II), and the conservation provisions (Title III) of the 1996 Act. Impacts are based on a comparison of the 1996 Act with a continuation of the previous legislation as reported by USDA (1996a) in its long-term projections.¹ More specific results depend on underlying program implementation decisions, many of which are yet to be made.

The 1996 Act replaces a system of *deficiency payments*, based on the difference between a pre-set

target price and the market price, with a system of fixed *production flexibility contract payments*. Further, these new payments are now largely decoupled, since there is virtually no link between payments and current plantings. The 1996 Act expands planting flexibility and lets authority expire for Acreage Reduction Programs (ARP's) and the 0,50/85-92 provisions.² In so doing, it accelerates the trend toward greater market orientation of the previous two major farm acts, which gradually reduced the Government's influence in the agricultural sector through traditional commodity programs over the past 10 years.

Agricultural and Budget Pressures Led to Fundamental Change in U.S. Agricultural Policy

Developments in the agricultural sector and the general economy combined to support fundamental change in U.S. agricultural policy (see box, "Pressure for farm program reform..."). New farm legislation was expected to continue trends toward increased market orientation. U.S. support for open and freer trade in the Uruguay Round of GATT and later the North American Free Trade Agreements complemented this expectation. Also, central to the

Pressure for farm program reform grew in recent years

- Farm programs originated in the 1930's and many provisions were outdated
- Program rules were restrictive
- Growing movement for less government intervention
- ARP's allowed foreign competitors to expand
- Federal budget costs were high and variable
- Strong markets meant less opposition to reduction in government payments

¹ The terms previous legislation and *previous law* in this report refer to U.S. agricultural laws in effect during 1995. These laws include provisions of the Agricultural Adjustment Act of 1938, the Commodity Credit Corporation Charter Act of 1948, and the Agricultural Act of 1949 (the so-called permanent legislation), as amended by the Food, Agriculture, Conservation, and Trade Act of 1990 and the Omnibus Budget Reconciliation Acts of 1990 and 1993.

² The term 0,50/85-92 provisions refers to the 50/85 and 50/92 provisions for rice and cotton and the 0/85 and 0/92 provisions for wheat and feed grains that were in effect in various forms over the last 10 years. Under these provisions, farmers could idle all or part of their permitted acreage, putting the land in a conserving use, and receive deficiency payments for part of the acreage. A minimum planting requirement of 50 percent of maximum payment acreage applied for rice and cotton.

farm legislation discussions were budgetary issues regarding the level and variability of Federal expenditures for farm programs. These agricultural and budgetary pressures led to farm policy alternatives ranging from minor modifications of the 1990 farm legislation to elimination of agricultural programs.

Setting for Agricultural Commodity Programs Changed

Much of U.S. agricultural commodity policy dates back to programs established in the Agricultural Adjustment Act of 1938, the Commodity Credit Corporation Charter Act of 1948, and the Agricultural Act of 1949 (the so-called permanent legislation). Originally, the programs were designed to stabilize and boost farm income as a means of economic recovery and development in the Depression and post-War eras. Agricultural policies have been amended since then to address additional objectives, such as export promotion and environmental quality.

When the permanent legislation was enacted, one-quarter of the U.S. population lived on farms and agriculture employed almost 40 percent of the labor force. Agriculture's direct contribution to GDP averaged around 7 percent in the 1930's. Farm household incomes averaged about one-third of nonfarm household income. Farms were generally small and owner-operated. Most farms were diversified and produced some of a small number of principal crop and livestock commodities. In the 1930's, about 60 percent of U.S. farms produced corn and 40 percent produced milk. Program benefits were dispersed widely throughout the sector, even though supports were tied to only a few commodities.

Today, agriculture contributes less to the general economy and even to rural America. Only about 2 percent of the U.S. total population lives on farms. Production agriculture's direct contribution to GDP is around 1.5 percent. Farm households, on average, have generally achieved income parity with all U.S. households, primarily through off-farm employment. Farm households depend more on income from off-farm sources than on income from farming. Farms are now larger and more specialized, with 20 percent of farm operations producing 80 percent of total U.S. agricultural output. Today, 26 percent of U.S. farms produce corn, while 7 percent produce milk. Farmers now compete directly with nonfarmers for inputs, such as capital. They also compete directly with farmers in other countries, with over 25 percent of the value of agricultural production

exported and the equivalent of 8 percent of U.S. consumption imported.

Many farmers and policymakers felt that planting restrictions during the 1980's were particularly limiting. Program acreage bases and deficiency payments were based on historical plantings, creating an incentive for farmers to maintain historical production patterns. Some farmers wanted to change the mix and level of crops they produced in order to comply with conservation requirements and to respond to market conditions. Legislation enacted in 1985 began to address this concern. In addition, many argued that the annual acreage reduction programs, which idled U.S. farmland and thereby reduced U.S. crop production, provided an incentive for foreign competitors to expand their production, reducing U.S. agricultural exports.

Reducing the Federal Budget Deficit Strengthened Pressure for Reform

Increased concern over the Federal budget deficit strengthened pressure for agricultural policy reform. Farm program costs were high and benefits were concentrated both geographically and among large-scale producers. Federal commodity program outlays were also highly variable, ranging during the past decade from \$7 billion in fiscal year 1995 to a record \$26 billion in fiscal year 1986. As part of the effort to balance the Federal budget, these agricultural outlays were targeted for a 7-year cut of \$13 billion from an early-1995 Congressional Budget Office (CBO) forecast of 1996-2002 outlays that assumed a continuation of past programs. This legislation was vetoed by the President in December 1995 and did not become law. Nonetheless, many features of the commodity program provisions of the vetoed legislation remained largely intact in the 1996 Act.

The 1995/96 market setting also contributed to the reform effort. High commodity prices weakened the case for continuing price and income support programs. Many called for less government intervention to free producers from government regulations, particularly planting restrictions, and to allow them to respond to market signals.

The 1996 Act Builds on Market-Oriented Trends of Past Legislation

Economic conditions in the U.S. agricultural sector in the early 1980's led to a new direction in agricultural programs (see box, "Market-oriented farm policies...") beginning with the Food Security Act of 1985 (1985 Act). Previous farm legislation had been too rigid to

Market-oriented farm policies started in 1985

Key features of Food Security Act of 1985 and related 1985-90 legislation

- Target prices reduced
- Program payment yields frozen
- Loan rates based on percentage of past market prices
- Secretary given discretion to further reduce wheat and corn loan rates
- 50/92 provisions established, changed to 0/92 for wheat and feed grains starting in 1988
- ARP's based on stocks
- Marketing loans established for cotton and rice
- EEP initiated under CCC charter in early 1985 and included in 1985 Act
- CRP established

Key features of FACT Act of 1990 and related 1990-95 legislation

- 15 percent "normal flex acres" and 10 percent "optional flex acres" introduced
- Marketing loan provisions extended to oilseeds in 1991 and to wheat and feed grains in 1993
- 0/92 for wheat and feed grains changed to 0/85 starting in 1994
- 50/92 for rice and cotton changed to 50/85 starting in 1994
- Oilseeds and alternative crops could be planted on 0/85-92 land without loss of payments
- ARP's based on stocks-to-use ratios
- Secretary given additional authority to reduce wheat and corn loan rates
- Farmer-Owned Reserve revised
- NAFTA and Uruguay Round Trade Agreements negotiated in early 1990's

allow U.S. producers and exporters to adjust to changing world market conditions. Relatively high U.S. loan rates in the early 1980's provided a floor for U.S. and world market prices, which led to mounting grain surpluses in the United States, escalating program costs, increasing foreign production and trade competition, falling exports, and increasing farm financial stress.

The 1985 Act, in response, moved toward a more market-oriented farm policy that would enable farmers to better respond to market signals. The legislation inaugurated marketing loan provisions for upland cotton and rice, lowered loan rates and provided discretionary authority for their adjustment, reversed upward trends in target prices, and generally froze program yields.

The Export Enhancement Program (EEP) was included in the 1985 Act as a means of competing with export subsidies of other countries, particularly those of the European Community. EEP was initiated in early 1985 under existing Commodity Credit Corporation (CCC) authority to promote U.S. agricultural exports, and then was included in the 1985 Act.

The 1985 Act revived long-term land retirement by implementing the Conservation Reserve Program (CRP), with a goal of protecting fragile cropland and improving water quality by retiring 40-45 million acres of highly erodible and environmentally sensitive cropland from production for 10-15 years.

The Food, Agriculture, Conservation, and Trade Act of 1990 (1990 Act), as well as the Omnibus Budget Reconciliation Act of 1990, built on the market-oriented foundation laid by the 1985 Act. By 1990, conditions in the agricultural sector had improved. Broader initiatives were under way to promote freer trade and to move U.S. and world agriculture toward greater market orientation. Pressure to cut the Federal budget deficit also played an important role.

The main goals of 1990 farm legislation were to further market orientation, reduce government spending on agricultural programs, help maintain farm income through expanding exports, and protect the environment. To lower budget expenditures and increase market orientation, the 1990 legislation reduced payment acres and introduced planting flexibility. Producers could respond to market signals in their planting decisions because they could plant alternative crops on the new 15-percent normal flex

acres that were not eligible to receive income support payments. This resulted in a further reduction in the portion of production covered by government payments, continuing the trend started in the 1985 Act (Westcott, 1993). Marketing loan provisions were extended to wheat and feed grains starting in 1993 under GATT trigger provisions of 1990 farm legislation. EEP was retained to help counter the export subsidies of other countries.