South Dakota Legislative Research Council

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AN OVERVIEW OF THE 1996 FARM BILL

Introduction

In March of 1996, Congress enacted the Federal Agricultural Improvement and Reform Act (FAIR, Public Law 104-127), originally known as the Freedom to Farm Act. Passage of the new farm bill marks probably the most significant change in federal agricultural policy since the 1930s when the basic elements of federal farm policy were first formulated. The 1996 law will phase out price supports and deficiency payments for major crops using market transition payments over a seven-year period, thus allowing farmers to let the market determine the number of acres and types of crops to be planted. The new act does not completely eliminate existing farm programs, but it represents major change in many areas of farm policy. The new farm bill is controversial and will probably be a focus of dispute on agricultural questions for some time to come, but the fact remains that the bill is a new departure in American farm policy and in the way that American farmers will do business.

U.S. Farm Policy Background*

Modern U.S. farm policy began as a series of emergency New Deal measures to fight effects of the Great Depression of the 1930s. For agriculture, however, hard times had actually begun during the 1920s after commodity prices collapsed at the end of World War I. Although frequently amended, the farm program has evolved into an intricate system of price supports and production controls that has continued to the present day.

The basic concepts were to prevent farm commodity prices from declining beneath a certain level through a system of price supports, to avoid the tendency toward overproduction that results when prices are artificially high by instituting production control measures to limit agricultural production, and to find means of providing income or financing to farmers to counteract unfavorable market or weather conditions. The Commodity Credit Corporation (CCC), which was created in 1933, made low-interest loans to farmers using farm commodities as collateral. If the borrower defaulted on the loan, the commodity passed to the CCC with no further obligation for the borrower. Commodities were held in storage by the CCC until market conditions were favorable for selling. The storage provisions were intended to support higher commodity prices by keeping surplus commodities off the market while allowing producers to obtain at least the loan amount on their products if market prices fell. The CCC also attempted to support prices at certain levels by making direct purchases of commodities to remove them from the market, which would reduce supply and raise or support prices.

While price support mechanisms helped to maintain farm income, problems developed in attempting to get rid of the commodities in storage without depressing the market. Production controls, such as acreage allotments and marketing quotas, were instituted to attempt to restrict production rather than manipulate prices by storing commodities. Acreage allotments restricted the number of acres that farmers could plant of a specific crop. Marketing quotas restricted the quantity of commodities that farmers could place on the market. In order to be effective it was necessary to place restrictions on almost all crops so that producers would not simply switch to crops that had no production controls.

A complex agricultural policy mechanism quickly developed under the basic legal framework provided by the Agricultural Adjustment Act of 1938, which implemented the system of price supports and production controls. The 1938 legislation established price supports between 52 and 75 percent of "parity." Parity was deemed to be the amount of purchasing power that a specific commodity had between 1910 and 1914, the last "normal" period for the farm economy before the disruptions of the First World War, the 1920s farm depression, and the Great Depression of the 1930s. After World War II, fears of a new farm depression similar to the post-World War I farm depression led to the Agricultural Act of 1949, which set price supports between 65 and 90 percent of parity at the discretion of the secretary of agriculture. The 1949 Act also authorized marketing quotas and acreage allotments subject to referendum approval by two-thirds of the producers. If producers rejected the marketing quotas or acreage allotments, price supports could be reduced to 50 percent of parity.

The Agriculture Act of 1949 remains the United States' basic farm policy legislation in that it is the last "permanent" piece of farm legislation that has been enacted. All farm policy legislation since the 1949 Act, including the 1996 Act, have been amendments to the 1949 legislation and have included expiration dates. If Congress had not passed the 1996 law and allowed the previous farm bill to expire, policy would have reverted to the 1949 Act with its price support and parity levels and producer referenda. Because much has changed in farm policy since the 1949 Act, the threat of reverting to the original provisions of the 1949 law has always been a powerful incentive for Congress to come to an agreement on farm policy before the expiration of the current farm bill.

U.S. Postwar Farm Programs*

During the 1950s and 1960s, crop surpluses were a major problem, and efforts to reduce production by reducing price support levels were not successful. While the government was incurring large grain storage costs, prices remained near loan levels, which caused increasing amounts of grain that had been held as collateral in the nonrecourse loan program to be forfeited to the CCC. One attempted solution to the problem was to reintroduce some form of production controls. The Agriculture Act of 1956 created the Soil Bank program, a voluntary program in which farmers were paid to take land out of production. The Soil Bank program remained in effect until the early 1970s and at its peak included 63 million acres of land. Another production control approach was a "set-aside" or acreage reduction program coupled with direct price support payments to producers. The set-aside program, which was instituted in 1970, required farmers to remove a certain percentage of land from production in order to be eligible for farm program benefits.

Lack of success with production controls, along with large Soviet purchases of grain during the early 1970s that eased grain surplus problems, led to a more market-oriented U.S.

farm policy. The 1973 Agriculture and Consumer Protection Act used the "target price" concept in which producers were paid the difference between a commodity's target price and average market price if the market price fell below the target price. The payment for the difference was known as a "deficiency payment." Target prices were established for all major food and feed grains and were intended to support farm income, although the methods used to establish target prices have been the subject of controversy. Another innovation during the late 1970s was the Farmer-Owned Reserve (FOR), which was an extended loan program covering loans for periods of three years. Loan amounts were higher than regular price support loans, and USDA provided payments to cover storage costs. In return, farmers agreed not to market the grain until market prices reached specified levels.

The 1985 farm bill included the "payment-in-kind" or PIK program as well as the Conservation Reserve Program (CRP). Under CRP, farmers were paid to keep approximately 35 million acres of highly erodible land out of production and in wildlife habitat. Like the Soil Bank before it, CRP land produced a significant side benefit for South Dakota; the increased wildlife habitat resulting from CRP acres produced record numbers of pheasants, which further enhanced South Dakota's reputation as a prime pheasant hunting area and contributed significantly to the state's economy.

Other aspects of U.S. postwar farm policy include disaster payments, crop insurance, and emergency loans. Disaster payments were authorized in 1973 and were made to producers of certain commodities who suffered losses to drought, flood, or other natural causes. Critics said that the program amounted to free crop insurance and that it encouraged production on marginal land. The program was canceled in 1981. The Federal Crop Insurance Act of 1938 made insurance coverage available on a limited number of crops in some areas of the United States. The 1938 law was succeeded by the Federal Crop Insurance Act of 1980, which modernized the federal crop insurance program and replaced the disaster payments program. Emergency loans with subsidized interest provisions were made to farmers in areas that experienced natural disasters and were declared to be disaster areas.

The 1996 Federal Agricultural Improvement and Reform Act

The 1996 farm bill represents major changes in U.S. farm policy and, like its predecessors, is the result of a lengthy political process in Congress and is the subject of controversy around the country. Basically, the 1996 Act removes the connection between income support payments and farm prices and eliminates target prices, deficiency payments, and acreage reduction programs. Instead, farmers will receive seven annual, declining "production flexibility contract payments" that do not depend on the level of farm prices. The bill is intended to enhance the role of free markets in agriculture. By replacing price supports with fixed and declining payments, the new bill ends most government efforts to manage the supply of agricultural products, giving farmers the freedom to decide what crops they will plant, based on their response to market forces. The seven payments coincide with the expiration date of the bill, when a new Congress will decide whether the new directions embodied in the 1996 bill are to be continued. The 1996 bill also extended the Conservation Reserve Program at approximately 36 million acres. Because the

1949 Agriculture Act was not repealed by the new legislation, the 1949 law remains as this country's permanent farm legislation.

The major features of the 1996 Federal Agricultural Improvement and Reform Act are as follows:

TITLE I - Agricultural Market Transition. As noted above, producers may enter into seven-year production flexibility contracts. Producers are eligible if they have participated or had certified acres in the wheat, feed grains, cotton, or rice programs in any one of the last five years. Payments will decline over the seven years. Any commodity may be grown on contract acres, and there are no restrictions on haying and grazing or the planting of alfalfa or forage crops. The nonrecourse loan program will continue with loan rates essentially capped at 1995 levels. The bill includes special provisions for peanuts and sugar.

Dairy producers will no longer have the budget assessment deducted from milk checks, and the support prices on butter, powdered milk, and cheese are phased down, with the support program eliminated at the end of 1999 and replaced with a different loan program. Milk marketing orders must be consolidated from 33 to not less than 10 or more than 14 within three years. The bill also allows a Northeast Dairy Compact in the New England region and directs the secretary of agriculture to implement a dairy export incentive program.

The 1996 bill reduces the current payments limitation from $50,000 to $40,000 per person per year for production flexibility contracts and extends current provisions that limit marketing loan gain and loan deficiency payments to $75,000 per person per year. The bill makes certain reforms in CCC programs and eliminates mandatory catastrophic crop insurance, although producers who do not purchase catastrophic insurance must waive all federal disaster assistance. The bill also creates a commission to monitor the agricultural economy during the transition period and to report to Congress in 1998.

TITLE II - Agricultural Trade. The 1996 bill reauthorizes the Food for Progress program and several existing agricultural trade and export programs and directs the secretary of agriculture to monitor compliance with the agricultural provisions of the Uruguay Round of the General Agreement on Tariffs and Trade.

TITLE III - Conservation. The 1996 bill reauthorizes the Conservation Reserve Program at 36.4 million acres. Farmers currently in the program may withdraw acres that are not classified as environmentally sensitive. The bill also retains the Wetlands Reserve Program but places more land under temporary rather than permanent easement. The Swampbuster program, which discourages farmers from converting wetlands into cropland, will also continue, although there are reforms in the Swampbuster provisions to adjust penalties to fit the wetlands violation and to grant exemptions in certain cases. The bill also includes an Environmental Quality Incentive Program, which gives special attention to conservation problems associated with livestock operations, as well as other conservation concerns. Other conservation programs are included in the bill, such as Farms for the Future, which tries to protect farmland from commercial development, the Conservation Farm Option program, and numerous other conservation measures.

TITLE IV - Nutrition. The 1996 legislation extends the Food Stamp program for two more years, along with several other new or existing nutrition assistance programs.

TITLE V - Agricultural Promotion. This title of the Act requires an independent evaluation every five years of the effectiveness of agricultural promotion programs. The title also allows the secretary of agriculture to establish certain research and promotion activities without further authorization, as well as authorizing new promotion programs for popcorn, canola, rapeseed, and kiwifruit.

TITLE VI - Credit. Title VI of the 1996 bill is intended to tighten up and reform certain provisions of USDA's farm lending programs, including redirecting farm lending programs to their original intent rather than making certain loans for nonagricultural purposes, authorizing the use of collection agencies for recovering delinquent loans, prohibition of additional loans to delinquent borrowers, and revising procedures for the sale of inventory property by the government. The bill also contains provisions to provide loan funding for new and beginning farmers.

TITLE VII - Rural Development. The 1996 bill creates the Rural Community Advancement Program (RCAP) to provide rural development assistance for rural community facilities, rural utilities, and rural business and cooperative development. The bill creates the Fund for Rural America and authorizes funding for water and wastewater systems and telemedicine and distance learning programs. The title also repeals or reorganizes unused or duplicative programs.

TITLE VIII - Research, Extension, and Education. The bill lists purposes of agricultural research, extension, and education, and it creates a National Research, Education, and Economics Advisory Board and a Strategic Planning Task Force.

TITLE IX - Miscellaneous. The bill authorizes a variety of miscellaneous programs and activities related to agriculture.

Farm Bill Issues

The 1996 Federal Agricultural Improvement and Reform Act has been greeted with praise, criticism, and skepticism from various points on the political spectrum. While most observers felt that reform in farm policy was necessary, there is disagreement as to how far-reaching the reforms of the 1996 Act will be. The Act expires after seven years, at the same time that the new program flexibility payments are due to expire, and it is not certain that the political system will be able to resist reinstituting farm subsidies at that time. Some programs, such as sugar and peanuts will not be seriously affected by the new legislation. Also, under current market conditions, many farmers by coincidence will actually receive more federal assistance through the declining seven-year transition payments than they would have received under the old system. Others worry that after the seven-year transition period is completed, the safety net for farmers will be removed, leaving them vulnerable to circumstances beyond their control. The decision to cut the link between farm program payments and farmers' decisions on the kinds and amounts of crops to plant will force farmers to base their decisions on market conditions rather than on government programs, and some will be able to adapt to the new system more successfully than others. As always, the crux of the argument lies in finding the proper mix of government assistance and protection to go along with personal risk and responsibility.

Summary

The preceding discussion is a brief overview of an extremely complex federal farm program that has evolved since the 1930s out of a complicated mix of foreign and domestic economic and political forces. Farm policy over the decades has experienced its share of success and failure and has been the subject of intense political debate, but it has also been shaped by dramatic changes in the farm economy as the farm population declines, individual farms become larger, and corporate forces play an increasingly large role in U.S. and foreign agriculture. As the essential problem of attempting to regulate and manipulate agricultural production, prices, and market forces in a global economy becomes more complex, calls for a thorough restructuring of American farm policy with more reliance on market forces and more choice and responsibility for individual farmers have intensified. The 1996 Federal Agricultural Improvement and Reform Act is one result.

The 1996 farm bill represents the most significant change in farm policy since the Great Depression, when the foundation for much of the current farm program was established. The new legislation allows farmers to plant what they want, when they want, based on their perception of market conditions. Whether the new reforms will actually be continued when government payments expire, and, on the other hand, whether the new system will be in farmers' best interests, are questions that will not be answered until the transition period is over.

*Much of the background material on U.S. farm policy comes from *Agricultural and Food Policy* by Ronald D. Knutson, J.B. Penn, and William T. Boehm; Prentice-Hall, Inc., Englewood Cliffs, New Jersey, 1983.

This issue memorandum was written by Tom Magedanz, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.