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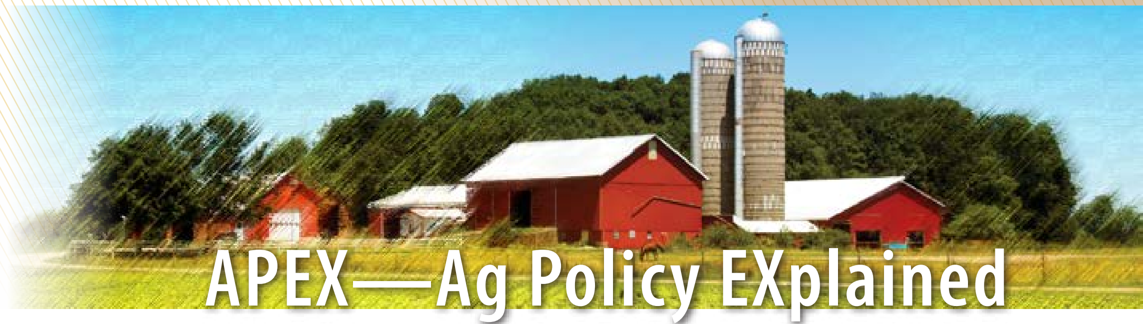

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The End of the Direct Payment Era in U.S. Farm Policy

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APEX—Ag Policy EXplained

Audience: Farm decision makers, tax payers, policy makers, and other consumers of agricultural policy news and information.

Purpose: To provide foundational knowledge to help the audience make decisions and form opinions about developments in agricultural policy.

Outcome: Improvements in learning, decisions, and discourse in matters of agricultural policy.

The process to replace the 2008 Farm Bill with new five-year legislation was begun in the fall of 2011 and has generally served to create higher than normal uncertainty for farm and agribusiness interests. On October 1, 2013, current farm bill program authority lapsed for the second time in as many years, meaning that controlling legislation for commodity support reverts back to various permanent pieces of law from the mid-20th century.

The uncertainty of new farm legislation rests on many questions:

- Will farm support and food assistance continue to be married in omnibus legislation?
- What role will budget and debt ceiling negotiations have on allowable farm bill spending?
- What insurance, disaster assistance, and safety net programs will be available to producers in a final bill?

Amid the increasing uncertainty, only one thing seems sure regarding a new farm bill. It will not feature direct payments to farmers. The direct payment program that provides a fixed payment to farmers regardless of on-farm decisions or market prices is universally agreed to have outlived its usefulness among congressional lawmakers, and barring an extension of the 2008 farm bill that would provide for their continuation, these payments that farmers have received for more than 15 years will end.

Considering the likely case that these payments will be made for the last time in 2013, we consider some questions and our best reasoned answers about the direct payments system's fall from favor. Our hope is that this same kind of scrutiny might be afforded to all programs both in place and imagined when Congress, opinion makers, or average citizens stop to contemplate government and how it chooses to spend money in agriculture or elsewhere. We believe that these and other questions aimed at the logic, purpose, and consequences of the direct payment system provide an appropriate framework for making informed policy decisions in all facets of the farm bill.

What Is the Origin and Logic of Providing Farmers a Direct Payment?

Direct payments were instituted in 1996 to replace a set of farm programs that supported a number of crop commodity prices at above market levels. Direct payments were initially designed as transition payments; farmers would receive a reduced direct payment each year until 2002. The reform of farm programs to a direct transition payment had three goals: 1) reorient agricultural commodity markets to supply and demand price determination, 2) provide farm operators a set of funds to help them adjust to the market reflecting supply and demand conditions without government supports, and 3) bring U.S. farm support policy into compliance with World Trade Organization (WTO) rules for agriculture.

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Why Are Direct Payments Ending with This Farm Bill?

The removal of direct payments from the farm bill is a product of both the political environment and the requirement to deliver deficit reduction in the new Farm Bill. Beginning in 2002, the idea of direct payments as transitional was abandoned, and farmers received a constant annual payment. When agricultural incomes were considerably lower in the 2002-2008 period, the idea of providing $5 billion worth of agricultural income support via fixed annual payments had enough political support to be maintained. Since 2008, while most of the U.S. economy has been strongly affected by recession and a slow recovery, agricultural incomes have soared, setting historical highs in recent years. The prospect of continuing to make direct payments during this period of prosperity no longer has any political champions. Meanwhile, rising farm prices and incomes of the past five years have meant very few payouts have been made to farmers from support programs that respond to low prices or incomes, leaving the $5 billion dollars of direct payments as the primary target for deficit reduction inside the commodity title of a new Farm Bill.

How Much Deficit Reduction Is Generated by Eliminating Direct Payments?

Deficit reduction is calculated against a 10-year projection of spending. Under that rubric, the elimination of direct payments generates about $50 billion in deficit reduction. However, both the House and Senate have elected to use part of the savings from elimination of direct payments to enact new farm subsidies that would add back spending in the commodity title. Projections for the new money spent range from $15 to $30 billion, leaving the deficit reduction from the commodity title at a figure of $20 to $35 billion over the 10-year period. The projections vary widely because the set of programs replacing direct payments will vary depending on what happens with prices, yields, and participation choices that are unknown at the time of enactment. Because of this feature, under sustained declines in farm revenues, new farm subsidy spending could actually increase dramatically over the 10-year period rather than decline.

What Is the Origin and Logic Behind the New Subsidies Replacing Direct Payments?

The new payment system will look very much like the optional ACRE (Average Crop Revenue Election) program that was authorized in 2008. Under that program, farm payments were only provided when farm revenues declined more than 10 percent relative to an average of the previous five years, with years of steeper declines increasing the amount of the payment. The ACRE program was offered as an optional program to farmers who were willing to give up 20 percent of their direct payments and some measure of price support. The ACRE program was not widely adopted by farmers during the past five years for a variety of reasons, not the least of which is that farm revenues were expected to strengthen as food and fuel demand continued to drive prices higher. Under Senate and House versions of new farm legislation, the direct payments program is eliminated and replaced with a program option that allows producers to receive payments tied to five-year benchmarks of either revenue or prices. As with ACRE, these payments (whether a farmer elects price or revenue options) will increase with declines relative to the benchmark and will be tied to current decisions and market outcomes. This last aspect is referred to as the coupling of payments to farm decisions and would thus make payments under any new program subject to U.S. commitments to the WTO.

How Will the End of Direct Payments and Their Replacement with New Subsidies Affect the Farm Economy?

The primary impact of the change is to reverse the paradigm of the 1996 Farm Bill, which sought to divorce government support received by farmers from their production decisions and market outcomes. Farmers will now have to be more attuned to a set of program payment parameters that annually update based on the choices they made and the resulting revenue from the most recent crop year. The most promising aspect of the proposed policies is that farmers can know they have a government safety net in place in the event of downturns in agricultural markets rather than having to wait for the passage of emergency legislation to deliver support to farm and rural communities.

It is more difficult to summarize how farmers are affected by the disappearance of direct payments. Researchers have devoted numerous articles to theory and tests about how direct payments may influence on-farm input decisions, investments, land markets, and a host of other choices. The results are remarkably varied, with the only uniform result being very weak ties between the level of the direct payment and the particular measure of impact. This weak link is to be

expected because direct payments by design intend to provide income support while limiting interference into on-farm decision processes and market functions.

Conclusion

Direct payments are to be eliminated from the new farm bill, an action that has near unanimous support among U.S. lawmakers. The confluence of events that has led to such a uniformly supported action only makes sense as modern political theater when one considers that direct payments have the following virtues relative to the government budget situation and agricultural economy.

1) Direct payments are not subject to overrun spending relative to their baseline allocation in the budget. This is because a farmer cannot change the level of the direct payment through any action or choice in the business.
2) Direct payments have underpinned one of the strongest agricultural economies in history. The past several years have rewritten the record books on national farm income. The contribution of direct payments to this is that farmers have not been hemmed in by crop base allocations or legislated price supports when making planting decisions.
3) ACRE has not been viewed as a reasonable alternative to direct payments by farmers. For the past five years, farmers have not generally been willing to forego 20 percent of their direct payments for the ACRE subsidy program. Under the new farm bill, managers will be required to participate in a revenue or price option that operates similarly to ACRE.

Direct payments have had their negative consequences as well, though it is not clear how proposed alternatives remedy these.

1) The transparency of the direct payment system and its fixed nature makes it easy for landlords to charge tenants the full direct payment amount as part of a lease contract. For landlords who are not engaged in agriculture, this presents a high degree of spillover of farm program benefits out of the farm economy.
2) Higher land rents from direct payments make it more difficult for the next generation to get their start in production agriculture. This consequence runs directly counter to programs aimed at promoting next generation farming.
3) A payment that is identical when a farm profits or loses can hardly be classified as safety net policy. Only in the sense that direct payments may be saved and invested in high-income years to weather low-income years would this be true, but the policy has no mechanisms that direct the funds in this manner.

It seems unlikely that significant attention will be focused on direct payments in debating the new farm bill. Direct payments have become so derided in political public statements that their reauthorization is uncertain even in the event of a one-year extension of 2008 farm bill. The story of direct payments and their end should bring attention to the importance of soundness of policy design going forward. This is particularly important given the likely form of new farm support, which will be less transparent in terms of identifying beneficiaries and less predictable in terms of projecting budget outlays.

In Other Words . . .

Direct payments are no longer politically sustainable as part of the agricultural safety net. In comparison to direct payments, current proposals for new subsidy programs will increase the likelihood that U.S. agriculture will experience significant market distortions, violations of trade agreements, and increased spending on commodity support.

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