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ANNEX A

Main Elements of the 1985, 1990, 1996 and 2002 Farm Acts

A.1. 1985 Farm Act

In the early 1980s, relatively high US loan rates[1] provided a floor for US and world market prices, which led to mounting grain surpluses in the United States, escalating programme costs, increasing foreign production and trade competition, falling exports, and rising farm financial stress.

By that time, price support policies had limited international marketing opportunities, while increasing global supplies had undercut domestic supply control efforts. Government stocks of programme commodities were steadily increasing, and record agricultural spending, coupled with high federal budget deficits, emphasised the need to reform agricultural support policies.

The farm legislation of 1985 and 1990 maintained the traditional combination of price supports, supply controls, and income support payments, but introduced changes that moved farmers towards greater market orientation by reducing price supports, introducing greater planting flexibility and giving more attention to developing export opportunities for US farm products.

In particular, the 1985 Farm Act reduced price support and slowed the accumulation of government stocks. Crop price support levels, known as "loan rates", were lowered by 25%, causing world grain prices to fall. Marketing loans, introduced for rice and cotton, specified that farmers repay loans at low, market-based prices rather than forfeit the crop to the government. That meant that for rice and cotton, payments replaced government stock accumulation. Marketing loans were authorised for grains and oilseeds, but these were not applied until after the 1990 Act came into effect.

In order to transfer income to farmers, the 1985 Farm Act provided "deficiency payments" that were made counter-cyclically so as to offset movements in market prices compared to higher legislated "target" prices. They were equal to the difference between a politically determined "target price" and the market price or the loan rate (price support) – whichever was higher. Deficiency payments were no longer based on a farmer's actual production, but rather on historic output levels (*i.e.* a fixed-base acreage using a fixed average of past crop yields). However, eligibility required continued production of the specific base-acreage crops, subject to announced annual cropland set-asides. Farmers were required to plant all base acreage subject to Acreage Reduction Programme; 0/5092 and 0/5085-92 provisions.

The 1985 Farm Act also introduced conservation compliance and a new, long-term Conservation Reserve Program (CRP) was authorised. It also included the introduction of export subsidies under the Export Enhancement Program (EEP) and Dairy Export Incentive Program (DEIP) to promote US commodity exports, which entailed a move away from market orientation.

A.2. 1990 Farm legislation

The Food, Agriculture, Conservation, and Trade Act of 1990 continued the policy path established in 1985. The main goals of the 1990 farm legislation were to advance market orientation, reduce government spending on agricultural programmes, help maintain farm income through expanding exports and to protect the environment. 15% flex acres and 10% optional flex acres were introduced.

Budget and policy concerns led to lower payments, lower price supports and more planting flexibility. Marketing loans were re-authorised for wheat and feed grains, and mandated for oilseeds. The Export Enhancement Program and the DEIP were retained.

A.3. 1996 Farm Act

The Federal Agriculture Improvement and Reform Act of 1996 (1996 Farm Act), written in the shadow of the conclusion of the Uruguay Round negotiations, and with a desire to control farm programmes, as part of the overriding policy concern to reduce the federal budget deficit, accelerated trends towards greater market orientation. The 1996 Farm Act fundamentally changed US agricultural programmes by eliminating supply management and introducing income supports for "contract crops" (wheat, maize, grain sorghum, barley, oats, rice and upland cotton), based on historical acreage and yields of those commodities.

In particular, the 1996 Farm Act initiated four changes in US farm policy compared to the previous legislation. First, it discontinued supply management programmes (acreage reduction programmes) for producers of wheat, maize, grain sorghum, barley, oats, rice, and upland cotton.

Second, it replaced the previous system of deficiency payments, which had been based on the difference between a pre-set target price and the market price, with a system of fixed Production Flexibility Contract (PFC) payments – no longer tied to current prices or current production. PFC payments were based on historical acreage and yields for seven commodities, which were independent of current market prices and farmers' planting decisions. The PFC's stated purpose was to support farming certainty and flexibility, while ensuring continued compliance with farm conservation and wetland protection requirements.

Third, as the PFC payments were independent of current production, farmers benefited from almost complete flexibility in making production decisions (or deciding not to produce at all) than previously. Although payments were made on the basis of specific historically produced crops, production was not required or restricted to any commodity: payments were tied to 85% of fixed base area (*i.e.* an average of the historical acres planted or prevented from being planted for covered crops of wheat, feed grains, rice and cotton) and to fixed, historical, payment yields.[2] Producers were free to allocate their land to any crops on the "contract acres", except fruits and vegetables, but were required to maintain

their land in "agricultural use". Hence, producers were to depend more heavily on the market and also bear greater risk from increased price variability.

Fourth, although the Act retained marketing loan provisions, the price guarantees made to crop producers for any amount of output through loan rates were capped at nominal levels well below the market prices prevailing at the time, and the Secretary of Agriculture retained the authority to set rates even lower (based on the Olympic average formula of past market prices). Maximum loan rates are specified in the new law for wheat, maize, upland cotton, soybeans, and minor oilseeds. Allowing repayment of loans at the lower of the loan rate plus accrued interest or market prices, was retained, thus continuing some income protection at relatively low prices for the contract commodities and helping to limit accumulation of government-owned stocks as a result of collateral forfeited through defaulted loans.

Fifth, the legislation makes changes for dairy, sugar and peanuts. Historically, support to producers of these commodities has taken the form of price supports, rather than income supports. The Act foresaw the end of the dairy price support programme, without making explicit provisions for facilitating the adjustment that would be required as a result of this policy reorientation. Authority for sugar marketing allotments was repealed and market price support levels were effectively reduced. Support for peanuts was reduced.

Finally, the FAIR Act created new environmental programmes, especially with a new cost share programme for environmental improvements, the Environmental Quality Improvement Programme (EQIP) (see Chapter 6, *Agri-environmental Policies*).

Notwithstanding the above achievements, the 1996 FAIR Act did not secure permanent reform of farm programmes. A sharp decline in commodity prices in the late 1990s and the emergence of a federal budget surplus triggered policy events that reversed much of the achievements of the 1996 Farm Act. First, market prices fell below the loan rate, resulting in a large rise in marketing loan benefits, including loan deficiency payments. Second, emergency payments were introduced through special legislation to supplement PFC payments at a level approximately equal to 50% of PFC payments in 1998 and 100% of PFC payments in 1999, 2000 and 2001.

A.4. 2002 Farm Act

The Farm Security and Rural Investment Act of 2002 (2002 Farm Act), which was enacted in a market context characterised by low US commodity prices and a federal budget surplus, did not make as much progress on the path of reform as the previous three Farm Acts. Some new policies were introduced to the existing array of agricultural commodity programmes; support rates were increased; and payment rules created larger production incentives, especially compared with what might have been had the United States continued on the policy path established by the 1985 Farm Act.

Annual average net Commodity Credit Corporation (CCC) outlays under the 2002 Farm Act were USD 16.8 billion over FY2002-07, which is equivalent to around one billion dollars more than the annual average for the previous six fiscal years.[3] CCC outlays nearly doubled between 2004 and 2006, to USD 20.2 billion, reflecting low commodity prices and higher disaster and emergency assistance. They declined from 2007, as commodity prices sharply increased.

Overall, the 2002 Farm Act reinforced the change in direction that had been initiated in the *ad hoc* legislation from 1998-2001. First, the 2002 Farm Act continues marketing

assistance loans (which are based on current production and prices) and cover loan deficiency payments, marketing loan gains and certificate exchange gains. It increased several loan rates, allowed updating of base acreage and payment yields, allowed soybean acreage to be added to the base, and introduced three more crops into the loan rate scheme. These "loan rates", which are used to determine the magnitude of marketing loan benefit rates, apply to all production of the programme crop on eligible farms. Therefore, the marketing loan programme provides a clear incentive to increase or maintain production of the programme crop.[4]

Second, it replaced PFC payments with fixed Direct Payments (DP), although the essential characteristics of the payments remained. The main changes were that payment rates were fixed over time (rather than scheduled to decline) and producers were given the option to update area bases. Direct payments provided annual payments to producers based on a farm's historical plantings, historical yields and a national payment rate. Direct payment rates vary by crop and do not depend on market prices. Payments were available for nine commodities, which are those that were covered by the PFC programme, including upland cotton, plus soybeans and other oilseeds (referred to in the legislation as "covered commodities").[5] There are special provisions for peanuts. Because these payments are not related to current market prices or most farm-level production decisions, they do not have a direct effect on a producer's cropping decisions.

Third, it institutionalised the market loss assistance payments (*ad hoc* emergency payments) into a new "counter-cyclical" scheme, where payments are also based on historical acreage and yields, but are triggered when prices fall below pre-determined levels. Counter-cyclical payments (CCP) are available on historical acreage of covered commodities (wheat, feed grains, rice, upland cotton, oilseeds, and peanuts) whenever the effective price is less than the target price. The target price is set by legislation; the effective price is the amount producers will receive from direct payments and from either market prices or the marketing loan program, depending on whether prices are below the loan rate.

CCP payments depend upon current national average farm prices of covered crops, with their payment rate varying inversely with the price of the covered crop. The programme does not require farmers to plant base land to the programme crop. For some farmers these may be perceived as payments offsetting the low prices of the specific programme crop. The CCP payments formula is somewhat similar to that used for the deficiency payments for programme crops that were in place until the 1996 Farm Act, but payment eligibility and the payments themselves are fundamentally different because producers do not have to plant to receive CCP payments and cannot affect the size of their payment through their production decision.

Fourth, it allowed farmers to update their historical acreage used for DP and CCP payments, and historical yield used for CCP payments. The updating allowed producers to alter base composition and increase payments and may have encouraged expectation of future updates.

Fifth, a farmer is not obligated to grow the covered commodity to receive a DP or CCP payment for that commodity (*e.g.* a farm may plant soybeans on maize base acres and receive the DP or CCP payment for maize). The rationale for this planting flexibility is to allow farmers to respond to market signals when choosing crops. While a wide range of agricultural uses (including leaving the land fallow) is allowed for maintaining eligibility of

DP and CCP payments, producers lose eligibility for these payments if the base area is shifted out of agriculture altogether and may temporarily be ineligible if the base area is used for fruits, tree nuts, vegetables, melons or wild rice.

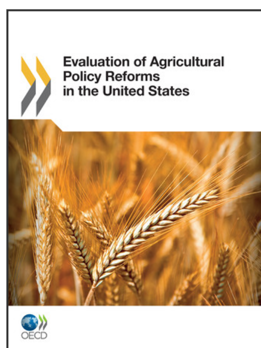
Sixth, the 2002 Farm Act made fundamental change to the peanut support programme. The long-standing marketing quota and price support programmes were eliminated ("bought out") and quota owners those with the right to sell the commodity at a regulated support price – were compensated with temporary payments for their loss of quota rights. Peanut quota owners received buyout payments of around USD 1.3 billion. Peanut farmers also became eligible for the same type of commodity support programmes – marketing loans, DP and CCP – available to "programme" commodities.

A buy-out reform was also undertaken in 2004 for tobacco under Equitable Tobacco Reform Act of 2004, although tobacco producers did not become eligible for marketing loans, DP and CCP payments. Tobacco quota owners and active producers received a total of USD 9.6 billion over 10 years, paid from assessments on tobacco product manufacturers and importers. (For more information on the buy-out experience in the peanut and tobacco sectors see Dohlman, Foreman and Da Pra, 2009; Orden, 2003).

Seventh, previous price support programmes for milk and sugar remain in place, while a new deficiency payment programme for dairy products was created in response to low prices in that sector. The government, however, continued to forego annual land set-asides, market price supports, and government stock accumulation. The 2002 Farm Act also re-authorised the CRP and EQIP and instituted new environmental programmes, notably the Conservation Security Programme (CSP) (see Chapter 6, *Agri-environmental Policies*).

Notes

1. The term "loan rate" is derived from the original 1930s farm price support programmes in which the option for farmers to forfeit crops pledged as collateral to the government for loans created a floor under market prices. The forfeiture policy was continued for most supported crops in the 1985 Farm Act, but a rate-setting formula was adopted to keep loan rates below market prices under most circumstances. This formula allowed the Secretary of Agriculture to set future rates based on a five-year "Olympic" moving average of past prices (dropping the highest and lowest years).
2. PFC payments were made on 85% of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield, which was the yield established for the 1995 crop.
3. CCC outlays do not include crop insurance payments.
4. ERS results indicate that changes in loan rates under the marketing assistance loan programme of the 2002 Farm Act have a greater influence on production choices than occurred under the 1996 Farm Act (Young and Westcott, 1996; 2000).
5. The term "other oilseed" includes sunflower seed, rapeseed/canola, safflower, flax, mustard and any other oilseed designated by the United States Secretary of Agriculture. A direct payment of USD 36 per tonne is available to peanut producers on eligible base period (1998-2001) peanut production.



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