

# TRADE HOT TOPICS

# Commonwealth

Issue No.12

## U.S. Farm Bill—Back to the Future?\*

On May 13, 2002 President Bush signed into law the *Farm Security and Rural Investment Act of 2002*. The new U.S. farm bill is described by the *Washington Post* as an “election-year” initiative that will “shower billions of dollars in new subsidies on bread-basket states that will help determine control of Congress in November”.

Estimated by the non-partisan Congressional Budget Office to cost about US\$180 billion over the next 10 years or about US\$87 billion more than the cost of the current farm programs, reaction to the new farm bill by America’s major trading partners has been both swift and highly critical.

### PREVIOUS FARM BILLS

The United States has had a long history of farm support programs that date back to the early 1930s when according to U.S. Department of Agriculture estimates about 25% of the population lived on about 6 million farms. By comparison, the USDA estimates that today only about 2% of the population lives on about 2 million farms, and only 8% of those farms account for approximately 72% of the agricultural sales.

Traditionally, farm support programs in the United States have been based on direct commodity-specific deficiency payments designed to compensate eligible farmers for any shortfall between government determined target prices and commodity-specific market prices.

In short, traditional farm support programs were tied to current commodity-specific market prices that generally provided guaranteed price support to eligible farmers during periods of depressed world prices.

### U.S. Farm Bill, 1996

The U.S. Farm Bill of 2002 replaced the *Federal Agriculture Improvement and Reform Act of 1996*. The U.S. Farm Bill of 1996 signalled a major policy shift in the administration of direct farm support programs in the United States.

Instead of the old system of commodity-specific target prices and commodity-specific deficiency payments related to current market prices, farmers would be sent an annual payment based on historical payments received under the old system, whether or not the farmer plants any crops in the future and regardless of current commodity-specific prices. To receive these payments, eligible farmers had a one-time opportunity to enroll acreage in a 7-year *production flexibility contract* that obliged the farmer to abide by certain conservation compliance requirements. There was an annual limit on the amount of commodity-specific farm support, and the level of annual payments were to decline over time, in

\* Prepared for the Commonwealth Secretariat by Mr. Allan Turnbull, International Partner of Baker & McKenzie, a Toronto, Canada, based law firm.

exchange for which farmers would have few restrictions on what they could plant. As a result, the republican sponsored U.S. Farm Bill of 1996 became known as the *Freedom to Farm Bill*.

The *Freedom to Farm Bill* was intended to transition farmers away from the old system of commodity and price-specific deficiency payments through declining annual payments; provide greater flexibility to encourage farmers to make planting decisions in response to market forces; and provide for an income safety net. The safety net was to be in the form of marketing loan and loan deficiency assistance that started to move away from direct price supports in favour of income supports unrelated to current production and prices.

The decoupling provisions of the *U.S. Farm Bill of 1996* represented a significant first step towards addressing the most market distorting elements of traditional U.S. farm support programs. Ironically, since the decoupling provisions were implemented during a period of near-record high prices, U.S. domestic farm support under the 1996 farm bill would increase significantly compared to what would have been paid out on the basis of the previous commodity-specific deficiency payments relative to current market prices.

Even though the move towards decoupled income support was less disruptive of market forces, the Clinton administration was initially criticised at the time for the introduction of a new wasteful subsidy program that would confer a US\$15-20 billion windfall on American farmers over the seven-year period from 1996 to 2002.

### **Emergency Domestic Support**

The policy change reflected in the *U.S. Farm Bill of 1996* with respect to domestic farm support was quickly stalled and undermined with the sharp decline in market prices that began in 1998.

The U.S. Congress responded by the provision of “temporary” emergency bailouts in each of the last four years to compensate farmers for depressed prices in the total amount of about US\$30 billion over and above the farm support payments provided under the *U.S. Farm Bill of 1996*.

### **URUGUAY ROUND AGREEMENT ON AGRICULTURE**

The *U.S. Farm Bill of 1996* was enacted against the backdrop of the Uruguay Round Agreement on Agriculture (“URAA”). The URAA addressed significant agricultural trade issues such as market access; domestic support; export subsidies; and special and differential treatment for developing countries.

With respect to domestic support, the URAA distinguishes between green box and amber box support programs. Green box domestic support programs are measures that have minimal or no trade distorting affect, while amber box domestic support programs are measures that are considered to distort trade.

The total value of trade-distorting domestic support was calculated for the base period 1986-88 for each member of the WTO. The United States and other developed countries were to reduce their total base period aggregate measure of domestic support by 20% in the period 1995 to 2000 and developing countries were to reduce their total aggregate measure of domestic support by 13 1/3% over the 10-year period from 1995 to 2004.

The maximum allowable level of trade distorting domestic support for the United States is currently capped at US\$19.1 billion relative to about 2 million farmers, compared to a cap of about US\$60 billion for the European Union relative to more than 7 million farmers. The maximum allowable level of trade distorting domestic support for Japan is currently capped at about US\$30 billion.

The question of whether or not a domestic support program is trade distorting and subject to reduction commitments can be complex. The URAA provides two basic overriding general criteria for green box programs followed by additional policy-specific criteria depending upon the type of program being considered. The basic criteria require that the domestic support be publicly funded through a government program that does not involve transfers from consumers; and that the domestic support shall not have the “effect” of providing price support to farmers.

In the case of “decoupled” income support, aside from satisfaction of the two basic criteria outlined above, eligibility for payments must also be determined in relation to a defined and fixed base period; and the amount of such payments in any year must not be related to the type or volume of production, market prices, or to input factors used in production, in any year after the base year. As a result, whether or not an income support program is truly “decoupled” within the meaning of the URAA can readily be a matter of debate.

Despite inherent weaknesses, the URAA was an important first step towards the stated objective of a fair and market-oriented trading system in agriculture. While further progress in pursuit of that goal has been made through the mandated negotiations required under the URAA, much more needs to be done.

A new multilateral round of trade negotiations is necessary if significant progress is to be made in the liberalization of trade in agriculture.

## **DOHA DEVELOPMENT ROUND**

In November of 2001 the WTO Ministerial Conference approved the accession of China and Taiwan to the WTO and agreed to launch a new round of global trade talks in an effort to continue the process of multilateral trade liberalization over the next three years.

The new round of global trade talks has been labeled the Doha Development Agenda in recognition of the WTO’s commitment to economic growth and reduction of poverty in developing countries. More than 75% of WTO members are developing countries and most of these countries have a major stake in agriculture trade liberalization.

With respect to agriculture, the Doha Development Agenda commits WTO members to comprehensive negotiations aimed at:

- substantial improvements in market access;
- reductions of, with a view to phasing out, all forms of export subsidies; and
- substantial reductions in trade-distorting domestic support.

The Doha mandate also reflects the agreement of WTO members that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations in agriculture.

## **U.S. FARM BILL, 2002**

The U.S. *Farm Bill of 2002* was enacted against the backdrop of the Doha Development Agenda for the new multilateral round of global trade talks and in particular against the backdrop of the important subsidy-related issues that are to be addressed as part of the negotiations in agriculture. According to the Chair of the WTO General Council, developed countries currently expend about US\$1 billion in market distorting subsidies every day. These subsidies amount to more than four times the total development assistance that is provided to developing countries.

The new U.S. Farm Bill is very detailed and complex, and covers a variety of matters including commodity programs, as well as conservation, trade, nutrition, farm credit, rural development and agri-energy related programs, that are beyond the scope of this paper.

### **Domestic Support**

At the risk of over-simplification the legislation provides for three types of domestic support payments.

First, the legislation continues direct assistance payments to eligible farmers who enter into production flexibility contracts for the period 2002-2007. The new farm bill updates and legislates the program commodity rates to increase payments to producers of grains and cotton; extends the reach of the program to include soy beans, other oilseeds and peanuts; and provides farmers with a one-time opportunity to update the acreage used to calculate program payments.

Second, the legislation continues marketing loan and loan deficiency payments when the market price falls below the established loan rate under which a producer receives a benefit equivalent to the difference between the two. The new farm bill legislates new loan rates that have been increased for most of the eligible commodities; and extends the reach of the program to now cover peanuts, wool, mohair, honey, small chickpeas, lentils and dry beans.

Finally, the legislation includes a new counter-cyclical program payment that will be triggered when market prices are low. These counter-cyclical payments are designed to replace and effectively lock-in the temporary emergency bailouts that were used to supplement program payments under the previous *Farm Bill of 1996* for the period 1998 to 2001.

### **Conservation**

Farmers who enter into *production flexibility contracts* under the new farm bill will continue to be obliged to abide by certain conservation compliance requirements to receive the contract payments.

The legislation reauthorizes and increases the maximum acreage that can be enrolled under the conservation reserve and wetlands reserve programs.

In addition, the *Farm Bill of 2002* introduces a new conservation security program that enables farmers to receive payments in exchange for implementing certain conservation practices.

### **Country-of-Origin Labels**

The new farm bill also introduces “country-of-origin” labeling for meat, fruit and vegetables, fish and peanuts. The labels are voluntary for two years and become mandatory in September of 2004. In the case of beef, by way of example, “country-of-origin” labels would mean that only meat products from cattle born, raised, slaughtered and processed solely in the United States could be labeled to be of U.S. origin.

The manner in which this program is implemented and administered could well be an unjustified barrier to trade.

## **IMPACT OF NEW U.S. FARM BILL**

After President Bush recently signed into law the *Farm Security and Rural Investment Act of 2002*, the *Washington Post* editorialized that the new farm bill “represents a low point in his presidency – a wasteful corporate welfare measure that penalizes taxpayers and the world’s poorest people in order to bribe a few voters”.

In contrast, the newspaper reported that in October of 2001 the White House had declared that the House version of the farm bill “locked in too much long-term federal spending and would increase the disparity between large producers and small farmers”. In a similar vein, the *Washington Post* further reported that U.S. Agriculture Secretary Veneman had commented in November of 2001 that the House version of the Farm Bill “creates pressure for more government payments, thereby creating a self-defeating and ultimately unsustainable cycle”. For his part, President Bush acknowledges that the new farm bill is “not a perfect bill”.

The combination of generally higher support rates, extended coverage to additional commodities, and the locking-in of counter-cyclical payments under the *Farm Bill of 2002* will mean more domestic support payments for U.S. farmers for the period 2002 through 2007. The Cairns Group estimates that the new farm bill represents a “massive 80 per cent increase in farm subsidies” compared to the base support levels provided under the previous *Farm Bill of 1996*.

Despite earlier pronouncements, Secretary Veneman defends the legislation on the basis that it continues “roughly” the same amount of domestic support that had been provided to U.S. farmers under the previous *Farm Bill of 1996*, as supplemented by the emergency bailouts. The Secretary of Agriculture insists that the new farm bill will be WTO compliant and that the level of trade-distorting

domestic support will come within the U.S. cap commitment of US\$19.1 billion. The new farm bill also gives the Secretary of Agriculture the power to make any necessary adjustments “to the maximum extent practicable” to ensure that the United States meets its WTO domestic support commitments. Unfortunately, the new farm bill seems to treat the URAA cap commitment on trade distorting domestic support more as an invitation to spend US\$19.1 billion than as a true ceiling. And, despite the power conferred upon the Secretary of Agriculture to make sure the United States meets its WTO obligations, should the US\$19.1 billion cap be exceeded it is not likely to be “practicable” to claw back subsidies that may have already been paid out to American farmers.

Moreover, whether or not the United States is able to stay within the \$19.1 billion cap depends in part on the extent to which the domestic support programs are determined to be amber box trade distorting measures within the meaning of the URAA, which could prove to be quite contentious.

### **Developing Countries**

What does the new U.S. Farm Bill mean to developing countries? Whether or not the *Farm Bill of 2002* is WTO compliant, the anticipated significant increase in domestic support will likely further increase U.S. agricultural production; further increase subsidized exports; further reduce market prices for agricultural goods; and thereby further increase the level of subsidy payments to be provided under the new farm bill. The result is a vicious circle that in the words of Secretary Veneman creates a “self-defeating” and “ultimately unsustainable cycle”.

The combined prospect of increased surplus production and even lower market prices undermines the agricultural competitiveness of developing countries in export markets and in their own domestic markets, and further impedes the economic growth of developing countries.

The Cairns Group expressed deep regret about the new U.S. Farm Bill in a recently issued statement that provided in part as follows:

“At US\$180 billion over the next decade, the sheer size of this package will hurt farmers around the world. The impact will be particularly damaging on developing countries, net food exporters and importers alike, many of which are heavily reliant on their agricultural sectors for their economic development and are looking to the Doha Development Agenda to reform world agricultural trade.”

Most developing countries recognise that liberalised trade through progressively open markets is a positive strategy to achieve sustainable economic growth and development. But, they also recognise that “counter” trade policy that obliges them to progressively open their markets to agricultural imports at heavily subsidised low prices, that effectively precludes access for their agriculture products to attractive markets in more developed countries and at the same time destabilises their domestic markets, is a counterproductive strategy that is contrary to sustainable economic growth and development for developing countries.

### **DOHA Development Agenda**

What does the new U.S. Farm Bill mean for the potential success of the Doha Development Agenda? Agriculture is critical to the economic growth of many developing countries. Undoubtedly, a positive outcome to the agriculture negotiations under the Doha Development Agenda is essential to the successful conclusion of the Doha Round.

Leadership is required on the part of the United States and the European Union to succeed in the agriculture negotiations, and overall to successfully complete the Round. For many, the perception created by the new U.S. Farm Bill – aided by U.S. measures on softwood lumber and steel – is that the United States has given in to domestic politics and protectionism, and has damaged its credibility, at a time when American leadership is urgently required.

In that regard, the Cairns Group stated in part as follows:

“The new [farm] legislation makes the U.S. Administration’s task of continuing to take a leading role in the Doha Round more difficult. It will provide comfort for those WTO members who are determined to resist meaningful reform of the agricultural sector.”

At a minimum, farm bill legislation that commits the United States to make substantial support payments to their farmers into 2007 would seem to signal that a successful conclusion to the agriculture negotiations and the Doha Round by January 1, 2005 is not likely.

Since the European Union will not move ahead of the United States on agriculture issues, the U.S. must demonstrate leadership through its actions – and not just through its words – on domestic support and farm subsidies. It is vital that the European Union and the United States not allow their transatlantic trade differences to further fuel protectionist policies and undermine the Doha Development Agenda. Such a result would hurt developing and developed countries alike and could threaten global economic recovery.

### **Some Closing Thoughts**

While this paper is not intended to address all of the significant issues related to the *Farm Bill of 2002*, the issues raised in regard to domestic support are fundamental to developing countries. Developing countries may wish to carefully review and pursue these and other related farm bill issues through the WTO or risk:

- that their agricultural products will be undermined at home and in export markets by low-priced produce supported by massive subsidies;
- the bleak prospect of competing against US\$1 billion in daily subsidies from developed countries;
- a lost opportunity to secure substantial agricultural trade reform through the Doha Round; and
- collapse of the Doha Round and with it a lost opportunity to pursue sustainable economic growth, development and poverty reduction through trade liberalization.

Apart from the debate about whether the new farm bill signals green or amber measures, the legislation is viewed by many as sending the *wrong* signal, and in that sense the *Farm Bill of 2002* is a step backwards that may not bode well for the future.



### *Commonwealth* **TRADE HOT TOPICS**

Produced by the Economic Affairs Division of the Commonwealth Secretariat.

For further information or copies, please contact:

Economic Affairs Division, Commonwealth Secretariat, Pall Mall, London SW1Y 5HX, UK

Tel: 020 7747 6231/6288 Fax: 020 7747 6235

Email: [i.mbirimi@commonwealth.int](mailto:i.mbirimi@commonwealth.int) or [e.turner@commonwealth.int](mailto:e.turner@commonwealth.int)