The 1996 U.S. Farm Act Increases Market Orientation. By C. Edwin Young and Paul C. Westcott, Commercial Agriculture Division, Economic Research Service, U.S. Department of Agriculture, Agriculture Information Bulletin No. 726.

Abstract

The Federal Agriculture Improvement and Reform Act of 1996 (1996 Act), which was signed into law in April 1996, is a milestone in U.S. agricultural policy. The 1996 Act, in effect through 2002, fundamentally redesigns income support and supply management programs for producers of wheat, corn, grain sorghum, barley, oats, rice, and upland cotton. In so doing, it expands the market-oriented policies of the previous two major farm acts, which have gradually reduced the Government's influence in the agricultural sector through traditional commodity programs. Nonetheless, U.S. production of wheat, feed grains, and soybeans over the next 7 years is expected to be similar under the 1996 Act as under previous law. The links between government payments and producer planting decisions were already small under previous legislation, and 15-percent normal planting flexibility was generally sufficient to balance farmers' production choices among competing crops with relative price signals from the marketplace. Dairy policy changes dramatically under the 1996 Act which phases out price supports and consolidates milk marketing orders. The 1996 Act also alters the sugar and peanut programs. Aggregate net farm income is expected to be higher under the 1996 Act than it would have been with a continuation of past legislation, reflecting higher government payments. However, since government payments are now fixed, farm income could become more variable from year to year in response to supply and demand shocks. Marketing alternatives to manage risk will become more important for many farmers.

Keywords: Farm legislation, the 1996 Act, FACT Act, agricultural programs, farm income, production flexibility contracts, dairy, sugar, peanuts.

Acknowledgments

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Contents

Summary and Overview

The Federal Agriculture Improvement and Reform Act of 1996 (1996 Act) provides new farm sector law for 1996-2002. The 1996 Act accelerates trends of the previous two major farm acts toward greater market orientation that have gradually reduced the Government's influence in the agricultural sector through traditional commodity programs. U.S. production of wheat, feed grains, and soybeans over the next 7 years is expected to be similar under the 1996 Act as would have occurred with extension of previous law. The main reason is that the 1996 Act furthers the process of reorienting key segments of U.S. agriculture toward the marketplace that had been well under way over the last 10 years. Under previous legislation, the links between government payments and producer planting decisions were weakened, and 15 percent normal planting flexibility was generally sufficient to balance farmers' production choices among competing crops with relative price signals from the marketplace.

The impacts reported here are based on a comparison of commodity market projections under the 1996 Act with USDA projections made in early 1996 assuming continuation of the previous agricultural legislation. A key feature of that reference scenario is that U.S. crop producers have been increasingly responding to market signals during the last 10 years and were projected to progress further in that direction. Farm commodity programs became more market-oriented with less government involvement through features such as (1) freezing program payment yields implemented under the 1985 Farm Act, and (2) planting flexibility with 15 percent nonpayment acres in 1990 legislation. With strong market demand in the future, deficiency payments, the use of Acreage Reduction Programs (ARPs), and loan program benefits were projected to decline, reducing the role of commodity programs and furthering the trend toward market orientation.

Impacts of the 1996 Act compared with continuation of previous legislation include:

- *Decisions regarding how the Conservation Reserve Program (CRP) is implemented could greatly determine overall impacts of the 1996 Act.* With elimination of annual supply management programs, the CRP, with up to 36.4 million acres, is the principal policy instrument that limits land availability and constrains crop production. Implementation decisions for targeting of environmental goals and selection of new CRP land through contract extensions, early-outs, and new enrollments will be crucial for determining the size, commodity mix, and regional distribution of the CRP.

- *U.S. agriculture will likely be more price-competitive in world markets in the long run under the 1996 Act*. Trade programs are targeted to place more emphasis on markets with greatest potential for U.S. export gains. Expiration of authority for ARPs and suspension of the Farmer-Owned Reserve benefit exports by no longer limiting production and marketings in times of large supplies. Wheat and barley exports could decline somewhat initially, relative to USDA's projections assuming continuation of the previous legislation, reflecting reductions in Export Enhancement Program (EEP) funding. These impacts are likely to be small, however, because export subsidies add little to total exports when prices are strong. Rice exports will decline because elimination of minimum planting requirements reduces supplies.

- *The 1996 Act may have significant farm-level and regional implications.* Production patterns are expected to shift to reflect differences in comparative advantage for the production of specific crops and to address agronomic, environmental, and conservation needs. The impacts of the program will vary across regions reflecting the mix of agricultural products, the degree of diversification, and production alternatives.

- *Under the 1996 Act, aggregate planting levels for wheat, feed grains, and soybeans are expected to be similar to those projected under continuation of past legislation.* Normal planting flexibility of 15 percent under past legislation generally allowed farmers to alter planting sufficiently to balance crop-commodity production and prices among crops. With greater planting flexibility under the 1996 Act, producers are likely to change the mix of crops produced on their farms, possibly altering regional production patterns. These acreage shifts have implications for planting decisions of other farmers as they respond to changes in relative market prices, with resulting planting choices bringing land use back toward a similar aggregate cropping mix.

- *The 1996 Act brought changes to the sugar and peanut programs.* Support for sugar was reduced through a 25-percent increase in marketing assessments and sugar loans becoming recourse in years when the tariff rate quota on sugar imports is at or below 1.5 million short tons. Elimination of sugar marketing allotments may create opportunities for more efficient sugar producers to expand production. Peanut production and prices are expected to decline with elimination of the minimum poundage quota and reduction in the price support for edible-use peanuts.

- *Dairy policy changed dramatically under the 1996 Act, which phases out price supports and consolidates milk marketing orders.* Net returns to the dairy sector are expected to decline in response to phasing out price supports which will lower prices and production. Consolidating milk marketing orders will expand the size of the area where dairy farmers compete, and thus have regional price impacts by raising prices for some farmers while reducing prices for others.

- Aggregate net farm income is higher under the 1996 Act than projected under previous legislation, with favorable market conditions for U.S. agricultural products. Income support payments under the 1996 Act are higher than projected deficiency payments would have been under a continuation of previous farm law. Offsetting the gain from higher government payments are declines in net income for dairy and peanut producers.

- *Government payments are fixed under the 1996 Act, so farm income could become more variable in response to supply and demand shocks.* In the past, deficiency payments varied inversely with market prices to provide some income stability to farmers. Under the 1996 Act, production flexibility contract payments remain fixed regardless of prices. As a result, farmers will face greater risk of income volatility, reflecting more directly market price variation.

- *Farmers will consider marketing alternatives to manage risk to buffer potentially greater income volatility under the 1996 Act*. When making production, marketing, and financial decisions, increased attention will be placed on risk management to deal effectively with year-to-year fluctuations in income. Net farm income is potentially more variable under the 1996 Act because government payments are no longer linked to market prices. Loan rates, although capped at 1995 levels for most crops, continue to provide some income protection, but at relatively low levels.

- *Estimated impacts of the 1996 Act could be different if the demand for U.S. agricultural products weakens significantly.* Farm income would be lower, since with lower commodity prices, production flexibility contract payments do not increase to offset revenue losses as deficiency payments did in the past. However, increased planting flexibility and elimination of annual supply management policies permit farmers to alter production practices to more fully respond to changes in demand.