APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

Shifting Direct Payments from being a black eye to strengthening the safety net

Budget issues are central to the slowness with which the farm bill is making its way from passage by the two chambers to a conference committee and eventually to the president's desk. Both the House and Senate versions of the farm bill called for spending increases above the level provided for in the budget baseline.

The administration has threatened to veto any package that funds additional spending with a tax increase and argues that any additional spending in one part of the legislation must be offset by spending reductions in other programs.

House Ag Committee Chair, Colin Peterson has been working directly with the administration to come to some agreement on revenue increase that would broker these differences and avoid a Presidential veto. At present, reports out of Congress suggest that the increase might come in at around $9.6 billion.

One of the proposals announced by Peterson and ranking member Bob Goodlatte in mid-February was a 10-year farm bill that, among other things, would fund some of the shifts in spending by eliminating the direct payment in the ninth year, freeing up $5.2 billion.

That proposal got us to wondering why there has not been more discussion on moving direct payment monies into other elements of the farm bill.

With the present price levels in the $13 range for soybeans, $10 for wheat, and $5 for corn, prices well above the current cost of production, it is difficult to justify the spending of $5.2 billion each year in direct payments. In fact, we would argue, such payments harm the credibility of farm legislation in the minds of the general public-a public that has been willing to support disaster and emergency payments when disaster strikes or times are tough in the farm economy.

This sentiment was voiced in a column, http://www.politico.com/news/stories/0208/8714.html, by David Rogers in which he wrote, "Amid rising food costs, commodity groups risk a political backlash for not embracing more change in a Farm Bill subsidy structure that continues to pay billions to producers at a time when crop prices have risen to record levels….'It's absurd,' says Professor Bruce Babcock, an Iowa State University economist who just locked in a $5.03 per bushel price for his own 2008 corn crop and would still share in a direct payment adding to his return."

The main thing direct payments have going for them is compliance with WTO (World Trade Organization) rules, and even there a problem exists. Currently, farmers receiving direct payments are prohibited from using the land they receive payments for to grow fruits and vegetables. For the payments to be considered non-trade-distorting this prohibition would have to be eliminated.

Even if changes were made so the WTO would signoff on direct payments as being non-trade-distorting, most observers have come to the conclusion that much of the direct payments have been capitalized into land costs. This results in increased land rental rates and higher production costs.

Another problem with direct payments is that they do not provide a safety net when prices are low. The per unit of production value of direct payments is deducted when the USDA computes the counter-cyclical payment rate. In addition, direct payments are paid out whether prices are high or low, allowing farmers to include them in their annual budgeting process. In times of low prices, a safety net would provide income to farmers, over and above the normal budgeting process.

At the current level of crop prices, farmers could easily survive without the direct payments, so why not eliminate them for the next five years? That would free up $26 billion, easily funding increases in nutrition, biofuels, disaster, and conservation programs.

A key point is that eliminating the direct payments in response to high prices would not reduce the safety net for farmers if prices were to plummet. At present the direct payments are, in effect, deducted when the counter-cyclical payment rates are calculated. The elimination of direct payments would also eliminate this deduction from the counter-cyclical payment rates, which means that farmers would receive the equivalent of the direct payments if prices tank.

Of course, prices would have to decline substantially from their lofty levels of today but that could be fixed as well. Because 10-year baseline prices are projected to be well above the current counter-cyclical payment rates, those rates, and loan rates for that matter, could be increased with little effect on the projected, that is baseline, cost of the farm bill.

Those increases, along with eliminating the direct payment deductions from counter-cyclical payments, would provide farmers with a higher level of protection in the face of rising production costs without the public-relations black eye of receiving $5 billion during a period of record high commodity prices and net farm income.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.