
# Farm Safety Net Programs: Issues for the Next Farm Bill

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# Summary

Roughly every five years, Congress debates and revises omnibus legislation governing federal farm policy. Commodity provisions in the 2008 farm bill (P.L. 110-246) expire in 2012, and Congress is currently reviewing U.S. farm policy. The collection of federal farm programs, which make payments to farmers and landlords, is often referred to by the broader farming community as the "farm safety net." Some programs such as "counter-cyclical payments" (which rise when crop prices decline) contain elements of a safety net—which is usually intended to protect recipients against economic risks. Other farm program payments, such as direct (fixed) payments, are made irrespective of market prices.

As provided under the 2008 farm bill and other legislation, farm safety net programs can be divided into three main categories. *Commodity programs* provide income support and attempt to address farm price or revenue risks for selected field crops. *Risk management* (primarily crop insurance) provides protection from declines in yield or revenue for a much broader set of commodities, including many field and specialty crops and some livestock. *Supplemental disaster assistance* is available for most agricultural commodities (crops and livestock) when weather-related production losses are not covered by other programs.

Many policymakers and farmers consider federal support of farm businesses necessary for their financial survival, given the unpredictable nature of agricultural production and markets. In contrast, many environmental groups and budget hawks argue that farm subsidies encourage overproduction on environmentally fragile land and are a market-distorting use of tax dollars.

Historically, federal programs have primarily benefitted farmers (and landowners) of the major crops, such as wheat, corn, cotton, and sugar, with policy constructed over many decades by modifying or adding programs. As a result, programs sometimes overlap or work at cross purposes, generating criticism that they are not well integrated, cost too much, or do not provide adequate risk protection. Additional potential issues for Congress in the next farm bill debate include the extent of the current commodity coverage, program complexity and its impact on participation and effectiveness, and the effect of biofuel subsidies on agriculture.

The current federal budget situation is likely to prevent any increase in overall spending on a 2012 farm bill. Thus, the level of funding in the Congressional Budget Office (CBO) baseline budget for agricultural programs will be of paramount importance. Combined outlays for farm safety net programs have averaged $15.7 billion per year during FY2003 to FY2010, with a high of $20.5 billion in FY2006 and a low of $12.2 billion in FY2008. CBO's projected annual average for FY2011-FY2020 is $14.8 billion. With crop prices relatively high, counter-cyclical support has declined in recent years while crop insurance outlays (which are directly related to crop prices) have increased sharply. The pool of money for any changes to the farm safety net will likely come from the existing baseline for the commodity programs and the crop insurance program.

A constraint affecting future U.S. policy choices is the broad set of rules of the World Trade Organization (WTO), which the United States, as a founding member, has agreed to abide by. Farm bill proposals, if implemented, will affect U.S. commitments, mainly through cost, program design, implementation, and market effects. Under the WTO Agreement on Agriculture, the United States is committed to spending no more than $19.1 billion per year on "amber box" support (programs considered to be the most trade distorting). The WTO compatibility of any new proposal, such as a whole-farm safety net program, would depend on how its provisions mesh with WTO criteria for loss triggers, payment levels, and production and trade effects.

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Roughly every five years, Congress debates and revises omnibus legislation—referred to as the "farm bill"—governing federal farm and food policy.[1] Congress is currently reviewing U.S. farm policy before commodity provisions in the Food, Conservation, and Energy Act of 2008 (P.L. 110-246; the 2008 farm bill) expire in 2012. The House Agriculture Committee began a series of hearings in April 2010, and the Senate Agriculture Committee began hearings in late June. A major topic is the so-called "farm safety net".

The U.S. Department of Agriculture and the broader farming community often refer to the price and income support programs of the farm bill's Title I and the crop insurance and disaster assistance programs of Title XII as encompassing the farm safety net. While many critics of farm subsidies take issue with what does and does not constitute a safety net and whether current farm programs actually perform as such, this report uses the term safety net as a catchall descriptor rather than an assessment of the safety net merits of the various programs.

Several farm programs contain elements of a safety net, which is intended to protect farmers against risks or ensure a minimum level of economic well-being. For example, crop farmers and landowners receive counter-cyclical payments (CCP) when crop revenue declines below a certain level.[2] In contrast, one of the largest farm budget outlays—"direct payments"—delivers nearly $5 billion every year to the same set of owners of agricultural base acres irrespective of the level of commodity prices or whether the land is farmed.

This report provides a brief description of the current farm safety net programs as a background for the congressional debate that is expected to precede the next round of omnibus farm legislation in 2012. The report also examines budget and policy issues and discusses implications for U.S. farm policy in the context of the World Trade Organization (WTO).

# Farm Safety Net Overview

The federal government supports farm prices and income for major field crops such as corn, soybeans, cotton, and rice and helps farmers manage risks associated with variability in crop yields and prices through a collection of commodity programs.[3] Many policymakers and farmers consider federal support of farm businesses necessary for their financial survival, given the unpredictable nature of agricultural production and markets. In contrast, many environmental groups argue that these subsidies encourage overproduction on environmentally fragile land using excessive pesticides and fertilizers. Others, including budget hawks, have long argued that farm subsidies are an unfair market-distorting use of taxpayer dollars. In addition, farm subsidies are routinely the subject of harsh criticism from the editorial pages of many major U.S. newspapers.

As provided under the 2008 farm bill and other legislation, farm safety net programs can be divided into three main categories (as shown in **Figure 1**):

- *commodity programs* provide income support and attempt to address farm price or revenue risk for selected field crops;

[1] For more information, see CRS Report RS22131, *What Is the "Farm Bill"?*, by Renée Johnson.

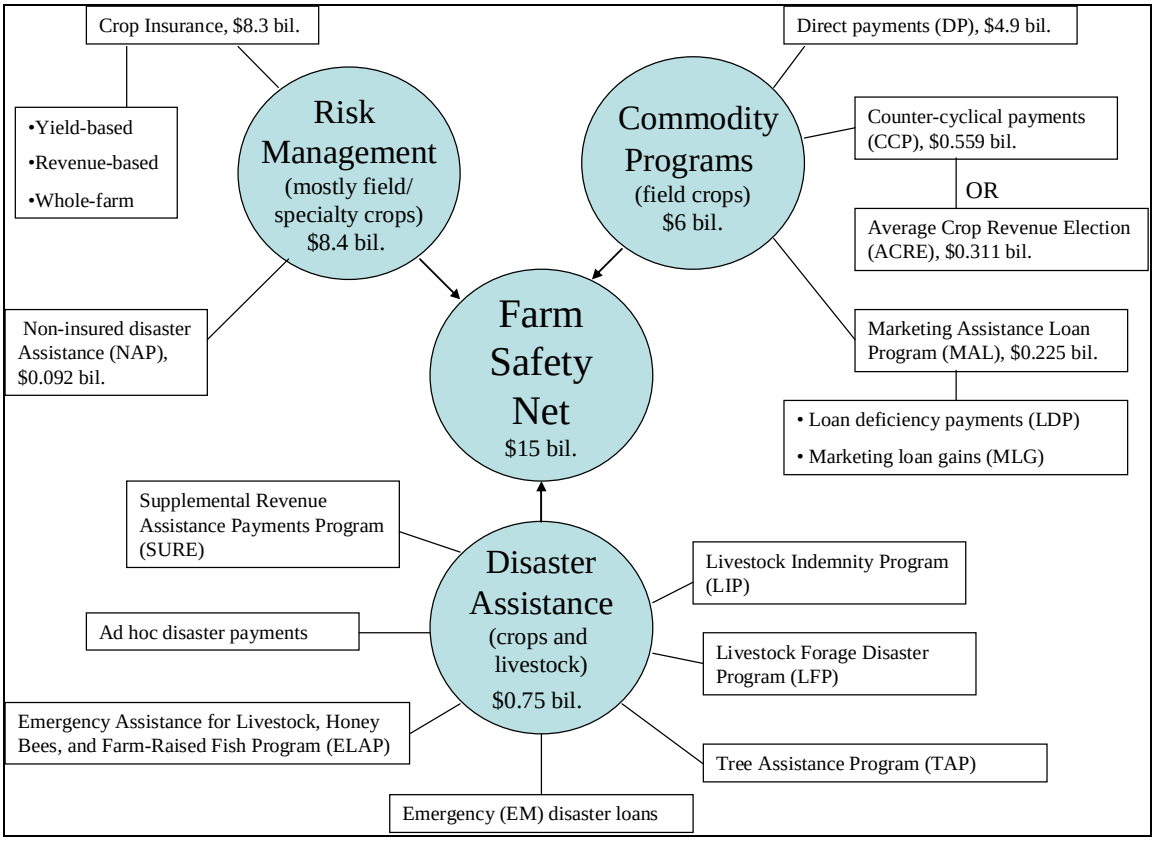
[2] However, critics have pointed out that CCP target prices for several crops, particularly rice and cotton, have been set at such high levels that payments are made nearly every year in spite of market conditions.

[3] For more information, see CRS Report RL34594, *Farm Commodity Programs in the 2008 Farm Bill*, by Jim Monke.

- *risk management* provides protection from declines in yield or revenue for a much broader set of commodities, including many field and specialty crops and some livestock; and
- *supplemental disaster assistance* is available for most agricultural commodities (crops and livestock) when weather-related production losses are not covered by other programs.

**Figure 1. Farm Safety Net Programs Authorized Under the 2008 Farm Bill and Other Legislation**

(average annual projected outlays by the Congressional Budget Office)




**Source:** Congressional Research Service (CRS)

**Notes:** The term "safety net" is used here as a catchall descriptor rather than an assessment of the safety net merits of the various programs. Time periods for average annual projections are FY2011-FY2020 for commodity programs and risk management, and FY2008-FY2012 for disaster assistance. Not shown is support for dairy and sugar producers or conservation disaster programs. Dairy support includes the Milk Income Loss Program (MILC), which provides counter-cyclical payments to dairy producers; the Dairy Product Price Support Program (DPPSP); and import restrictions. Sugar support includes import restrictions and limits on sales of domestically produced sugar (marketing allotments).

Historically, federal programs have primarily benefitted farmers (and landowners) of the major field crops, such as wheat, corn, soybeans, rice, cotton, and sugar. Milk is also included. Most of these commodities have a long history of government support dating back to the 1930s. In recent years, other crops such as dry peas and lentils have become eligible commodities. In contrast, producers of specialty crops (e.g., fruits, vegetables, horticulture crops) and livestock have generally received little or no direct government support through commodity programs, and

instead they must manage their own farm risk and/or rely on crop insurance and disaster assistance.

Payment limits control the overall level of payments made to individuals to some extent. However, farm operators or landowners have avoided payment limits in the past by subdividing individual farms into multiple operators by use of certificate exchanges for marketing loan benefits and by other means.[4]

Importantly, farm support has been constructed over many decades by modifying or adding programs. As a result, programs sometimes overlap or work at cross purposes, generating criticism that they are not well integrated, cost too much, or do not provide adequate risk protection.

Each of the three major program categories is described in the sections below. Additional program details are available in the CRS reports referenced in each section.

## Commodity Programs

Traditional commodity programs for field crops include three basic types of benefits for farmers/landowners: direct payments, counter-cyclical payments, and marketing loan benefits (7 U.S.C. 8701 *et seq.*). The first two types of payments are made under the Direct and Counter-cyclical Payment Program (DCP). Eligible DCP crops are wheat, corn, grain sorghum, barley, oats, upland cotton, rice, pulse crops,[5] soybeans, other oilseeds,[6] and peanuts.[7] In lieu of counter-cyclical payments, farmers may select the Average Crop Revenue Election (ACRE) program (see "Average Crop Revenue Election (ACRE)" below). [8]

Except for direct payments, the level of market prices relative to program parameters defined in the 2008 farm bill partly determines the payment amount to individual farmers. See **Table 1** for program parameters, and the box entitled "Commodity Program Payment Example," below, for an illustration of the relationship between market prices and commodity payments.

### Direct Payments

Direct payments are fixed annual payments based on a farm's historical plantings, historical yields, and a national payment rate. Direct payments were first established by the 1996 farm bill (P.L. 104-127), when they were called Agricultural Market Transition Act (AMTA) payments (also referred to as Production Flexibility Contract Payments). At that time, they were described as payments to transition farmers away from the previous target-price, deficiency payment

[4] For more information see CRS Report RL34594, *Farm Commodity Programs in the 2008 Farm Bill*, by Jim Monke.

[5] Pulse crops include dry peas, lentils, small chickpeas, and large chickpeas.

[6] Other oilseeds include sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, and sesame seed.

[7] All commodities except peanuts are defined as a "covered commodity" in the 2008 farm bill. Peanuts are supported similarly but are not considered a "covered commodity." All receive direct payments except pulses. Commodities eligible only for the marketing loan program include extra long staple cotton, wool, mohair, and honey.

[8] For more information on commodity programs, see CRS Report RL34594, *Farm Commodity Programs in the 2008 Farm Bill*, by Jim Monke; and CRS Report R40422, *A New Farm Program Option: Average Crop Revenue Election (ACRE)*, by Dennis A. Shields.

program. However, in the 2002 farm bill (P.L. 107-171), AMTA payments were made permanent instead of being phased out. With crop prices relatively high and farm payments low, many observers assert that a major reason for converting to fixed payments was to preserve the funding in the farm bill baseline.

**Table 1. Commodity Program Parameters in the 2008 Farm Bill**

(crop years 2010-2012)

| | Direct Payment Rate | Counter-cyclical Target Price | Marketing Loan Rate |
|---|---|---|---|
| Wheat, $/bu | 0.52 | 4.17 | 2.94 |
| Corn, $/bu | 0.28 | 2.63 | 1.95 |
| Sorghum, $/bu | 0.35 | 2.63 | 1.95 |
| Barley, $/bu | 0.24 | 2.63 | 1.95 |
| Oats, $/bu | .024 | 1.79 | 1.39 |
| Upland cotton , $/lb | 0.0667 | 0.7125 | 0.52 |
| Long grain rice, $/cwt | 2.35 | 10.50 | 6.50 |
| Medium grain rice, $/cwt | 2.35 | 10.50 | 6.50 |
| Soybeans, $/bu | 0.44 | 6.00 | 5.00 |
| Other oilseeds, $/cwt | 0.80 | 12.68 | 10.09 |
| Peanuts, $/ton | 36.00 | 495.00 | 355.00 |
| Peas, dry, $/cwt | | 8.32 | 5.40 |
| Lentil, $/cwt | | 12.81 | 11.28 |
| Sm. chickpeas, $/cwt | Not applicable | 10.36 | 7.43 |
| Lg. chickpeas, $/cwt | | 12.81 | 11.28 |
| ELS cotton, $/lb | | | 0.7977 |
| Wool, graded, $/lb | | | 1.15 |
| Wool, nongraded, $/lb | | | 0.40 |
| Mohair, $/lb | Not applicable | Not applicable | 4.20 |
| Honey, $/lb | | | 0.69 |
| Sugar, raw cane, $/lb | | | 0.1850 in 2010<br>0.1875 in 2011-2012 |
| Sugar, beet, $/lb | | | 128.5% of loan rate for cane |

**Source:** CRS, compiled from P.L. 110-246.

**Notes:** Some parameters differ for 2008 and 2009 crops. For dairy products, the 2008 farm bill specifies minimum purchase prices: block cheese, $1.13/lb.; barrel cheese, $1.10/lb.; butter, $1.05/lb.; and nonfat dry milk, $0.80/lb. The target price for milk is $16.94 per cwt.

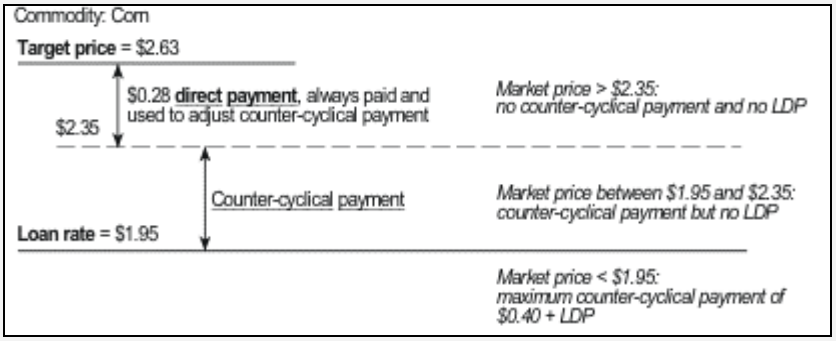
Direct payment rates vary by crop as specified in the 2008 farm bill and do not depend on market prices. To receive the payment, farmers have almost complete flexibility in what they plant (except for fruit, vegetable, and wild rice planting restrictions), but they must abide by conservation provisions that basically amount to good management practices.

In the Congressional Budget Office (CBO) March 2010 baseline projection[9] for FY2011-FY2020, direct payments total $49 billion, 77% of the Title I baseline (excluding crop insurance).[10] Direct payments are a relatively steady $4.9 billion per year on average.

### Commodity Program Payment Example

**Figure 2** illustrates three types of commodity payments in relation to market prices. (For simplicity, ACRE payments are excluded from this example.) Using corn as an example, if market prices are above $2.35/bushel, neither counter-cyclical nor marketing loan benefits (e.g., loan deficiency payments or LDPs) would apply. If market prices are between $1.95/bushel and $2.35/bushel, a counter-cyclical payment would accrue but no LDP would be available. If market prices are below the loan rate of $1.95/bushel, the maximum counter-cyclical payment of $0.40/bushel is made, and an LDP would be available equal to the difference between the $1.95/bushel loan rate and the market price. Regardless of market prices, however, the direct payment of $0.28/bushel is paid.

**Figure 2. Relationship of Commodity Payments to Market Prices**




**Source:** CRS

Some farmers depend on these payments to pay operating expenses and secure bank credit. Supporters also point out that direct payments are generally regarded as an acceptable form of subsidization by the World Trade Organization because they do not depend on current production or prices (see "WTO Compatibility of Current Farm Programs," below). Critics point out that direct payments can inflate land prices and rental rates because at least a portion of the payments accrue to the landlord (see "Eligible Producers," below). Critics also say that because direct payment rates are static and payments are made under all price, yield, and income scenarios—

[9] The baseline projection is an estimate at a particular point in time of what federal spending on these mandatory agricultural programs likely would be under current law. Actual outlays in the future may be higher or lower depending on market conditions or participation, with no corresponding additional costs or savings being charged or credited to the agriculture committees' budget scorecards.

[10] CBO March 2010 Baseline for CCC & FCIC. The March 2010 CBO baseline is the latest projection with detailed estimates by type of payment and commodity. A less detailed August 2010 baseline that is summarized by commodity is used later in this report. Changes between the March and August baselines are relatively minimal for commodity outlays, but re-estimate final savings from the Standard Reinsurance Agreement (SRA) signed by insurance companies in July 2010.

high or low—the program provides no risk protection for producers but is simply a taxpayer-financed income transfer to owners of historical agricultural base acres.[11]

## Counter-Cyclical Payments (CCP)

Counter-cyclical payments are crop-specific payments that depend on the relationship between national average farm prices and government-set target prices. When national farm prices drop below a certain threshold (i.e., a crop's target price minus the direct payment rate), participating farmers and landowners receive a payment based on their farm's historical acreage and yield. In the last five years (FY2006-FY2010), counter-cyclical payments have averaged $1.859 billion per year, ranging from $0.3 billion in FY2008 to $4.0 billion in FY2006. In the CBO 10-year baseline (FY2011-FY2020), counter-cyclical payments average only $0.559 billion per year, lower mostly because of higher price expectations but also because of some substitution by ACRE payments.

The counter-cyclical program payment rate formula depends on market prices, but it does not require the farmer to produce any of the commodity. As with direct payments, counter-cyclical payments are made to the owners of qualifying crop-specific, agricultural base acres. Thus, counter-cyclical payments are decoupled from yield and acreage, but not from market prices. As a result, the United States has classified them as "amber box" when reporting agricultural subsidies to the WTO, which are limited in size together with other amber box subsidies.

In recent years, prices for some commodities, including peanuts and cotton, have been below levels that trigger counter-cyclical payments. For other commodities, such as wheat, farm prices have been above program parameters specified in the 2008 farm bill, resulting in no counter-cyclical payments and generating concerns among farm groups that this program is providing little or no price protection for some farmers.[12]

## Marketing Assistance Loan Program

The Marketing Assistance Loan (MAL) program provides additional financial benefits to farmers in the form of a guaranteed floor price for qualifying field crops, in addition to providing short-term financing. The process begins with a government loan to participating farmers of designated crops (those listed above, plus extra long staple cotton, wool, mohair, and honey). The loan is made at a specified "per-unit" loan rate using the crop as collateral. This loan rate, in effect, establishes a price guarantee. Prior to loan maturity, if the local market price (called the "posted price") is at or above the loan rate, the farmer repays the loan principal and interest.[13] In contrast, when the posted price is below the loan rate, the farmer may repay the loan at that price (called the "loan repayment rate") and pocket the difference as a "marketing loan gain."[14] Or, rather than taking the loan when the posted price is below the loan rate, farmers may request a "loan

[11] Base acreage is a farm's crop-specific acreage eligible to enroll in the Direct and Countercyclical Payment Program.

[12] For more information about the equity (or inequity) of farm programs across commodities, see CRS Report RL34053, *Measuring Equity in Farm Support Levels*, by Randy Schnepf.

[13] The market price is the adjusted world market price for upland cotton and rice, the national posted price for peanuts, national or regional posted prices for pulse crops, and the posted county price for most other commodities.

[14] Farmers may also forfeit the crop pledged as collateral to the government at the end of the loan period. This type of loan is called nonrecourse. A few crops are eligible only for recourse loans (i.e., must be repaid at principal plus interest), including ELS cotton, seed cotton, and high-moisture grains. Recourse loans are not eligible for a subsidy but do offer low-interest financing.

deficiency payment," with the payment rate equal to the difference between the loan rate and the loan repayment rate.

Program benefits are available on the entire crop produced, which means a farmer receives no benefits in the event of a crop loss. This is in contrast to the other two programs that make payments on historical acres and yields and therefore are not dependent on current production.

Given recent price levels, the MAL program has paid only limited benefits in recent years for most crops, and some farmers have criticized loan rates as being too low relative to prevailing market prices. Raising loan rates in the next farm bill would increase projected outlays. In the last five years (FY2006-FY2010), the marketing assistance loan program has cost an average of $3.4 billion per year, ranging from $0.5 billion in FY2008 to $10.3 billion in FY2006. In the 10-year CBO baseline (FY2011-FY2020), marketing assistance loans average $0.225 billion per year, again lower than the recent past because of higher market price expectations.

Critics of the MAL program note that the absence of a payment limit encourages larger farm operations to expand at the expense of smaller producers.

## Average Crop Revenue Election (ACRE)

The newest farm program is the Average Crop Revenue Election (ACRE) program, introduced in the 2008 farm bill. ACRE payments are revenue driven rather than price driven like counter-cyclical payments and MAL benefits. ACRE is designed to protect farmers against revenue losses for each DCP crop, regardless of the cause: price decline, yield loss, or some combination of the two. As a new program, ACRE does not have a spending history. The CBO baseline projects outlays for ACRE will average $311 million per year for FY2011-FY2020.

The ACRE program pays a farmer when two conditions are met: (1) the actual state-level revenue for a crop (determined after harvest) falls below a guaranteed level (determined before harvest), and (2) the farmer experiences an individual crop revenue loss on a farm. The second trigger is required so that payments are made only to farmers who experience a revenue loss.

If farmers select the ACRE option on a farm, their selection is permanent for the remainder of the 2008 farm bill (i.e., through the 2012 crop). In addition, they forgo 20% of their direct payments; loan rates are reduced by 30%; and the participants are not eligible for counter-cyclical program payments on the farm. The program applies to all DCP crops on that farm, and payments for each crop are calculated separately. A farmer who operates more than one farm may elect to enroll one or all farms in ACRE.

Program participation has been fairly low to date. For the 2009 crop year, approximately 8% of the total number of eligible farms elected to participate in ACRE, representing nearly 13% of base acres (total program acreage). Program complexity is an issue that reportedly has limited participation. The determination of a payment under ACRE generally requires the crop year to be finished in order to calculate the season-average farm price used in the payment calculation. As a result, payments—once calculated—are not made until well after the crop has been harvested. Some farmers find it challenging to (1) determine if enrollment would be advantageous, and/or (2) explain the program to landlords. Also, some farmers and university researchers have expressed a preference for pursuing a county-wide trigger rather than a state trigger to more

effectively cover local revenue losses.[15] Separately, critics of ACRE have also said that the program can duplicate payments and coverage when low prices and/or yields result in both crop insurance indemnities and ACRE payments.

## Eligible Producers

The 2008 farm bill defines a producer (for purposes of farm program benefits) as an owner-operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to a share of the crop produced on the farm. A term commonly used in federal regulations is "actively engaged in farming," which generally means providing significant contributions of capital (land or equipment) and labor and/or management, and receiving a share of the crop as compensation. In addition, an individual must comply with certain conservation and planting flexibility rules. Conservation rules include protecting wetlands, preventing erosion, and controlling weeds. Planting flexibility rules allow crops other than the program crop to be grown, but generally prohibit planting fruits or vegetables on subsidized acreage.

Farming enterprises usually involve some combination of owned and rented land. Two types of rental arrangements are common: cash rent and share rent. Under cash rental contracts, the tenant pays a fixed cash rent to the landlord. The landlord receives the same rent, bears no risk in production, and thus is not eligible to receive program payments. The tenant bears all of the risk, takes all of the harvest, and receives all of the government subsidy. Under share rental contracts, the tenant usually supplies most of the labor and machinery while the landlord supplies land and perhaps some inputs (e.g., chemicals or seed) or management. Both the landlord and tenant bear risk in producing a crop and receive a portion of the harvest. Both are eligible to share in the government subsidy.

Even though tenants might receive all of the government payments under cash rent arrangements, they might not keep all of the benefits if landlords demand higher rent. Economists widely agree that a large portion of government farm payments passes through to landlords, and that government payments raise the price of land and cash rental rates. This increases a farm's production costs and can make it difficult for young or beginning farmers to start a farm business.

## Commodity Programs and Farm-Level Risk

The commodity programs described above generally make payments based on either an individual farm's historical yield (direct and counter-cyclical payments), current state yields (ACRE payments), or actual volume produced (Marketing Assistance Loan Program). As specified in the 2008 farm bill, payment rates are fixed levels for direct payments and variable levels based on market prices for the other programs. Given these yield and price parameters, commodity programs essentially address price or revenue risk, mostly at the national market level, for individual farmers producing specific crops. None of the programs attempt to address production risk. Crop insurance and disaster programs discussed below in the "Risk Management" section are designed to meet this need.

[15] U.S. Congress, House Committee on Agriculture, *Testimony of Bruce A. Babcock*, hearing to review U.S. agriculture policy in advance of the 2012 farm bill, 111th Cong., 2nd sess., May 13, 2010, http://agriculture.house.gov/testimony/111/h051310/Babcock.pdf; U.S. Congress, House Committee on Agriculture, *Testimony of Rodney K. Gangwish*, hearing to review U.S. agriculture policy in advance of the 2012 farm bill, 111th Cong., 2nd sess., May 18, 2010, http://agriculture.house.gov/testimony/111/h051810/Gangwish.pdf.

### Dairy and Sugar

Dairy and sugar producers also benefit from federal programs. Milk prices are indirectly supported through federal purchases of nonfat dry milk, butter, and cheese at minimum product support prices. Producers also receive counter-cyclical "milk income loss contract" (MILC) payments when prices fall below a target price (see **Table 1**). Import controls on many dairy products limit supplies and support farm prices. Some Members of Congress, dairy producers, and dairy industry associations are developing alternative proposals to current dairy polices.[16] In the past five years (FY2006-FY2010), direct payments for dairy support (excluding price support purchases) have averaged $383 million per year, ranging from $0 in FY2008 to $994 million in FY2009. The CBO projection for FY2011-FY2020 is an average of $102 million per year.

Sugar is supported through import quotas and domestic marketing allotments that artificially raise the price of sugar to consumers. No government payments are made to growers and processors.[17] The CBO baseline reflects the no net cost policy, with $0 in the baseline for FY2011-FY2020 and a $0 average outlay for the past five years (FY2006-FY2010).

## Risk Management

The federal crop insurance program provides producers with risk management tools to address crop yield and/or revenue losses on their farms.[18] Among farm safety net programs, crop insurance has perhaps the widest commodity and regional coverage. In addition, its revenue protection feature handles both price and yield risk. The Noninsured Crop Disaster Assistance Program (NAP) attempts to fill in the gaps in catastrophic coverage in counties where crop insurance policies are not offered.

Federal crop insurance has grown in importance as a farm risk management tool since the early 1990s due, in large part, to federal subsidy intervention. The federal government pays a substantial portion of the farmer's crop insurance premium. In addition, the government subsidizes the administration and delivery of crop insurance policies by private insurance companies, and underwrites a major share of the loss risk associated with the overall crop insurance pool.

### Crop Insurance

The federal crop insurance program is permanently authorized by the Federal Crop Insurance Act, as amended (7 U.S.C. 1501 *et seq.*), and is administered by the U.S. Department of Agriculture's Risk Management Agency (RMA). In 2009, crop insurance policies covered 265 million acres. Major crops are covered in most counties where they are grown. Four crops—corn, cotton, soybeans, and wheat—accounted for more than 73% of total enrolled acres. For these major crops, a large share of plantings are covered by crop insurance: corn, at 83% of plantings; cotton,

[16] See CRS Report R41141, *Previewing Dairy Policy Options for the Next Farm Bill*, by Dennis A. Shields.

[17] See CRS Report RL34103, *Sugar Policy and the 2008 Farm Bill*, by Remy Jurenas.

[18] Insurance policies are sold and completely serviced through approved private insurance companies. Independent insurance agents are paid sales commissions by the companies. The insurance companies' losses are reinsured by USDA, and their administrative and operating costs are reimbursed by the government as well. For more information, see CRS Report R40532, *Federal Crop Insurance: Background and Issues*, by Dennis A. Shields.

94%; soybeans, 83%; and wheat, 82%. Over the last five years (FY2006-FY2010), CBO data indicate that crop insurance outlays have averaged $5.2 billion per year. The August 2010 CBO baseline projection for FY2011-FY2020 reflects a growth in crop insurance costs, at an average of $8.1 billion per year, rising steadily from about $7.6 billion per year in FY2011 to $8.7 billion in FY2020.

### *Crop and Livestock Policies*

Policies for less widely produced crops are available in primary growing areas. Examples include dry peas, blueberries, citrus, and walnuts. In total, policies are available for more than 100 crops (including coverage on a variety of fruit trees, nursery crops, pasture, rangeland, and forage). Many specialty crop producers depend on crop insurance as their only "safety net," unlike field crop producers who are also eligible for farm commodity program payments.

Livestock coverage has recently become available. Relatively new or pilot programs protect livestock and dairy producers from loss of gross margin or price declines. These policies are not subsidized, which has limited producer participation.

In purchasing a policy, a producer growing an insurable crop selects a level of coverage and pays a portion of the premium, which increases as the level of coverage rises. The remainder of the premium is covered by the federal government (nearly 60% of the total premium, on average, is paid by the government). In the case of catastrophic coverage (paying 55% of the market price for losses in excess of 50% of normal historical production), farmers pay a $300 administrative fee per crop for each county where the crop is grown, but the government pays the full premium. In the absence of subsidies, farmer participation in the crop insurance program would be substantially lower.

Federal crop insurance policies are generally either yield based or revenue based. For most yield-based policies, a producer can receive an indemnity if there is a yield loss relative to the farmer's "normal" (historical) yield. Revenue-based policies were developed in the mid-1990s to protect against crop revenue loss resulting from declines in yield, price, or both. The most recent addition has been products that protect against losses in whole farm revenue rather than for just an individual crop (see "Whole-Farm Insurance Policies," below).

While the crop insurance program generally receives favorable marks from farmers, producers of some crops, such as rice, contend that current policies are of little value to them because premiums are too high relative to the insurance guarantee levels. Critics of crop insurance cite a need to control rising program costs.[19] They also contend that heavy government subsidization of crop insurance policies distorts risk markets and encourages the expansion of crop production onto highly sensitive marginal lands. Furthermore, economists have long argued that the subsidization of "actuarially sound premiums" represents a form of taxpayer-financed income transfer.[20]

[19] USDA has initiated cost-cutting changes to the crop insurance program. For details, see CRS Report R40966, *Renegotiation of the Standard Reinsurance Agreement (SRA) for Federal Crop Insurance*, by Dennis A. Shields.

[20] For example, see "Insurance & Hedging: Two Ingredients for a Risk Management Recipe," by Randall D. Schnepf and Richard Heifner, *Agricultural Outlook*, AO-263 (August 1999), pp. 15-18.

### *Whole-Farm Insurance Policies*

Adjusted Gross Revenue (AGR)-Lite is a whole farm revenue protection plan of insurance. The plan is available in 36 states and provides protection against low revenue stemming from natural disasters and market fluctuations that affect income. Most farm-raised crops, animals, and animal products are eligible.[21]

AGR-Lite (and its companion policy AGR for crops) uses a producer's five-year historical farm average revenue as reported on the Internal Revenue Service (IRS) tax return form (Schedule F or equivalent forms) and an annual farm report as a base to provide a level of guaranteed revenue for the insurance period (a one-year period corresponding with the producer's IRS tax period). Producers must have less than $2.05 million in approved gross revenue to participate and have no more than 50% of total revenue from commodities purchased for resale. Coverage levels range from 65% to 80% of historical revenue, with payment rates ranging from 75% to 90% for losses in excess of the minimum coverage level. Changes in inventory are accounted for in the revenue calculation.

To date, whole-farm insurance has seen limited use. With individual crop insurance policies already providing significant protection for many producers, combined sales of AGR and AGR-Lite were only 826 policies in 2009, a small fraction of the more than 2 million crop insurance policies sold. Also, observers say the policy is complicated in terms of compiling the information needed to consider purchasing the insurance and making the application. Others have also noted that for such a policy to be widely adopted, coverage levels need to be substantially higher than individual crop insurance policies (i.e., higher than the current 80% level) in order to provide an amount of risk protection equivalent to that afforded by individual crop policies.

## Noninsured Crop Disaster Assistance Program (NAP)

Producers who grow a crop that is currently ineligible for crop insurance may be eligible for a direct payment under USDA's Noninsured Crop Disaster Assistance Program (NAP). NAP has permanent authority under the Federal Crop Insurance Reform Act of 1994 (P.L. 103-354, as amended), and is administered by USDA's Farm Service Agency. Outlays for NAP are much smaller than for crop insurance, usually about 1%-1.5% of crop insurance outlays. From FY2006 to FY2010, NAP outlays averaged $74 million per year. The USDA projection for FY2011-FY2020 is an average of $92 million per year.

To be eligible for a NAP payment, a producer must first apply for coverage under the program by the application closing date, which varies by crop but is generally about 30 days prior to the final planting date for an annual crop. Like catastrophic crop insurance, NAP applicants must also pay an administrative fee ($250 per crop for NAP).

In order to receive a NAP payment, a producer must experience at least a 50% crop loss caused by a natural disaster or be prevented from planting more than 35% of intended crop acreage. For any losses in excess of the minimum loss threshold, a producer can receive 55% of the average market price for the covered commodity. Hence, NAP is similar to catastrophic crop insurance coverage.

[21] For more information, see USDA, Risk Management Agency, *Adjusted Gross Revenue-Lite*, Program Aid Number 1907, July 2008, http://www.rma.usda.gov/pubs/rme/agr-lite.pdf.

## Supplemental Disaster Assistance

In addition to the insurance coverage for disasters provided by crop insurance and NAP payments, the 2008 farm bill included authorization and funding for five new disaster programs to cover losses through FY2011. The new programs are designed to address the ad hoc nature of disaster assistance provided to producers during the last two decades. Since 1988, Congress has regularly made emergency financial assistance available to farmers and ranchers, primarily in the form of crop disaster payments and livestock assistance.[22] The new supplemental disaster programs are projected by CBO to cost $3.9 billion over the five-year life of the 2008 farm bill, or about $770 million per year on average. From FY2003 to FY2009, ad hoc disaster assistance averaged $1.2 billion per year, often enacted in two-year intervals.

### Supplemental Revenue Assistance Payments Program (SURE)

The largest of the new disaster programs is the Supplemental Revenue Assistance Payments Program (SURE), which is designed to compensate eligible producers for a portion of crop losses that are not eligible for an indemnity payment under the crop insurance program or NAP.[23] The program provides payments to producers for crop revenue losses due to natural disaster or adverse weather incurred on or before September 30, 2011. The program departs from both traditional disaster assistance and crop yield insurance by calculating and reimbursing losses using total crop revenue for the entire farm (i.e., summing revenue from all crops for an individual farmer).

Under SURE, a farmer's revenue from *all* crops in *all* counties is compared with a guaranteed level that is computed mostly from expected or average yields and prices. As a result, the program considers the disaster's impact on a farmer's entire enterprise and not on just the crop(s) that were adversely affected. If the actual farm revenue (including farm program payments and insurance indemnities) is less than the farm's guaranteed level, the producer receives a payment, calculated as 60% of the difference between the two amounts. In contrast, if actual whole farm revenue does not fall below the guarantee, whereby losses for one crop are offset by revenue gains for another, no disaster payment is made. Payments are limited so that the guaranteed level cannot exceed 90% of expected farm income in the absence of a natural disaster. A common criticism of SURE has been that the determination of a payment is data intensive and requires the crop year to be finished in order to calculate the season-average farm price used in the payment calculation. As a result, payments—once calculated—are not made until well after the disaster has occurred.

[22] For more information on existing programs as well as emergency disaster assistance in years immediately prior to the 2008 farm bill, see CRS Report RS21212, *Agricultural Disaster Assistance*, by Dennis A. Shields and Ralph M. Chite. Also, when a county has been declared a disaster area by either the President or the Secretary of Agriculture, agricultural producers in that county may become eligible for low-interest emergency disaster (EM) loans available through USDA's Farm Service Agency. Loan funds may be used to help eligible farmers, ranchers, and aquaculture producers recover from production losses (when the producer suffers a significant loss of an annual crop) or from physical losses (such as repairing or replacing damaged or destroyed structures or equipment, or for the replanting of permanent crops such as orchards).

[23] See CRS Report R40452, *A Whole-Farm Crop Disaster Program: Supplemental Revenue Assistance Payments (SURE)*, by Dennis A. Shields.

### Livestock and Tree Assistance Programs

The 2008 farm bill also authorized three new livestock assistance programs and a tree assistance program. The Livestock Indemnity Program (LIP) compensates ranchers at a rate of 75% of market value for livestock mortality caused by a disaster. The Livestock Forage Disaster Program (LFP) assists ranchers who graze livestock on drought-affected pastureland or grazing land. The Emergency Assistance for Livestock, Honey Bees, and Farm-Raised Fish Program (ELAP) compensates producers for disaster losses not covered under other disaster programs. Finally, the Tree Assistance Program (TAP) provides payments to eligible orchardists and nursery tree growers to cover 70% of the cost of replanting trees or nursery stock following a natural disaster.

### Additional Disaster Programs Under Discussion

While SURE and other disaster programs authorized in the 2008 farm bill are meant to replace the need for ad hoc payments, Congress is currently considering additional emergency payments for producers for 2009 crop losses because of reduced potential for payments under SURE and the time lag between actual losses and government assistance. Critics of SURE point out that renewed interest in ad hoc emergency disaster legislation indicates the inadequacy of the SURE program as currently designed.

A major question for policymakers is how well the whole-farm disaster assistance approach helps farmers manage farm-level risk. Some farmers have already complained that the whole-farm approach, as established in the 2008 farm bill, is too complicated, given the large amount of information needed to administer it. Moreover, potential recipients say SURE typically does not result in disaster payments for diversified operations because aggregating revenue across a farmer's entire operation for payment determination substantially reduces the likelihood of receiving assistance.

# Budget Issues

Recent and growing federal budget deficits have increased calls within both Congress and the Administration for fiscal restraint and government-wide spending reductions. For example, President Obama created the bipartisan National Commission on Fiscal Responsibility and Reform to propose long-term solutions for a sustainable federal budget, noting that all programs were under consideration.[24] Also, the Congressional Budget Office has said that the FY2009 deficit "was the largest as a share of GDP since the end of World War II, and the deficit expected for 2010 would be the second largest…. Under current law, the federal fiscal outlook beyond this year is daunting…. Those accumulating deficits will push federal debt held by the public to significantly higher levels."[25]

This budget situation is likely to prevent any increase in overall new spending on a 2012 farm bill. Thus, the level of funding in the CBO baseline for agricultural programs will be of paramount importance as the development of a 2012 farm bill progresses.

[24] National Commission on Fiscal Responsibility and Reform, http://www.fiscalcommission.gov.

[25] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, p. xi, http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf.

Each year, CBO issues a baseline budget projection for all federal spending under current law over a multi-year period. Projected spending in the baseline represents CBO's estimate at a particular point in time of what federal spending and revenues likely would be under current law if no policy changes were made over the projected period. The baseline serves as a benchmark or starting point for future budget analyses. Whenever new legislation (such as a farm bill) is introduced that affects federal mandatory spending, its impact is measured as a difference from the baseline. Any increase in costs above the baseline level may be subject to certain budget constraints (such as pay-go). The process of scorekeeping and estimating baselines is done in Congress by CBO, acting under the supervision of the House and Senate Budget Committees.[26]

The current, tight federal budget situation is unlike that faced by Congress when it wrote the 2002 farm bill. At that time, a brief federal budget surplus allowed Congress to spend $73 billion more than its 10-year baseline. It was relatively easy to keep existing programs and add new programs across the spectrum of the omnibus farm bill. More recently, the 2008 farm bill was held to be budget neutral, although it received additional funding from outside the agriculture committees' jurisdiction. This outside funding from changes in tax policies provided offsets for higher spending on nutrition and other non-commodity programs, and allowed the overall bill to be budget neutral while increasing total farm bill spending. However, procedural difficulties related to negotiating these offsets with other committees, such as the House Ways and Means Committee and the Senate Finance Committee, prolonged the development of the 2008 farm bill and added constituencies that were not always in line with agriculture committee priorities.

Given these difficulties, House Agriculture Committee Chairman Peterson has expressed a desire to keep the finances of the 2012 farm bill within the jurisdiction of the agriculture committees.[27] In this scenario, the level of funding in the CBO baseline would set a maximum amount of funding available for a new farm bill. Offsets to pay for any new programs—such as a new farm safety net—would need to come from within the agriculture committees' jurisdiction. To increase one program, another program would need to be decreased. Offsets could occur within titles or functions of the farm bill (e.g., from within the commodity subsidy program), or could come from transfers between titles or functions within the farm bill (e.g., between commodity subsidies and conservation programs). Thus, the political stakes could be increasingly high among the various interest groups and constituencies needed to pass the farm bill.[28]

Moreover, some believe that a baseline-neutral farm bill is a best case scenario. Some fear that budget reconciliation could be required before the 2008 farm bill expires. Budget reconciliation would require cuts in existing farm bill programs to save money before a new farm bill is written, and these cuts could make even fewer funds available in the baseline for the 2012 farm bill.[29]

[26] For more background on scorekeeping and baselines, see CRS Report 98-560, *Baselines and Scorekeeping in the Federal Budget Process*, by Bill Heniff Jr.

[27] "Peterson emphasized the bill will be written within the confines of the farm bill baseline…. All options are open in terms of changes to the farm program to provide the safety net," excerpt from Jerry Hagstrom, "Peterson: No Offset From Environmental Program," *Congress Daily* (*National Journal*), April 16, 2010, http://www.nationaljournal.com/congressdaily/eep_20100416_2225.php?mrefid=lingospot.

[28] For more on farm bill budget and baseline issues beyond the commodity programs and safety net, see CRS Report R41195, *Actual Farm Bill Spending and Cost Estimates*, by Jim Monke and Renée Johnson.

[29] For more on the effect of budget reconciliation and other reductions in the agriculture baseline, see CRS Report R41245, *Reductions in Mandatory Agriculture Program Spending*, by Jim Monke and Megan Stubbs.

For the Title I farm commodity programs in particular, additional infusions of mandatory funding are unlikely given the improbability of offsets from outside the agriculture committees. Other titles in the farm bill such as nutrition, bioenergy, and conservation have had more success in recent farm bills competing for additional funds.

Thus, the pool of money for any proposed revisions to the farm safety net may likely come from the existing baseline for the farm commodity programs and the crop insurance program. Existing programs such as direct payments, the various counter-cyclical payments, or crop insurance might be replaced, revised, or reduced to pay for new farm safety net programs.

**Figure 3** shows the actual outlays and projected CBO baseline for the farm commodity payments, crop insurance, non-insured assistance, and supplemental and *ad hoc* disaster payments from FY2003 to FY2020. Combined outlays for these broadly defined safety net and/or farm income support programs have ranged from $12.2 billion in 2008 to $20.5 billion in 2006. The average for the actual outlays from FY2003 to FY2010 is $15.7 billion per year. The projected annual average for FY2011-FY2020 in the August 2010 CBO baseline is 5.6% smaller at $14.8 billion.

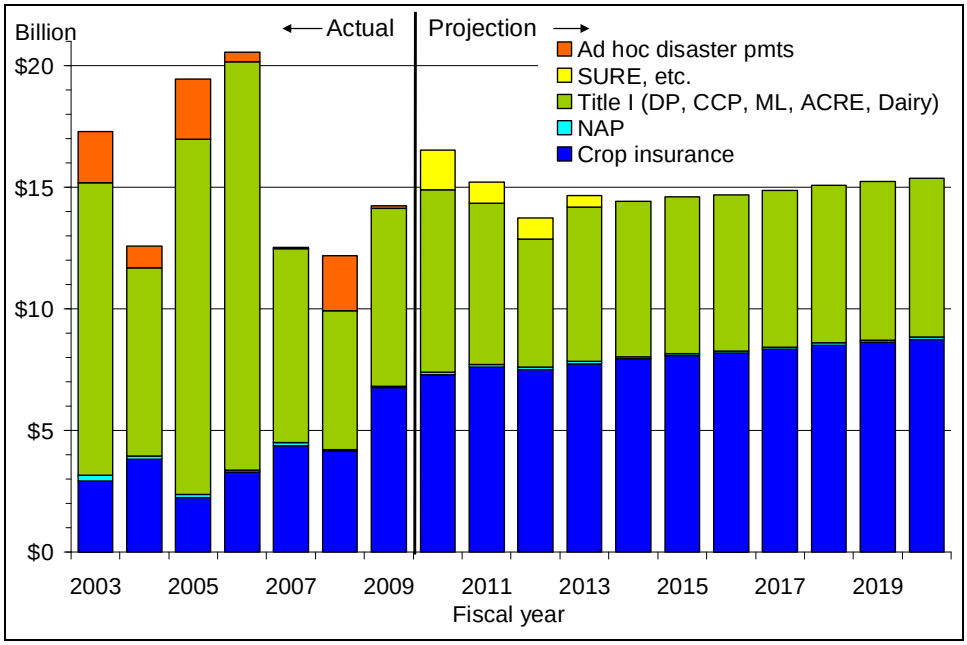
Of particular note in this analysis when comparing the baseline projection to the recent past is that crop insurance outlays have increased while counter-cyclical support has decreased. In fact, crop insurance outlays have increased more than threefold over the period, rising to an estimated $7.3 billion in FY2010 as higher policy premiums from rising crop prices drove up premium subsidies and expense reimbursements to private insurance companies.[30] These costs are projected to stay high, rising to $8.7 billion in FY2020.[31]

Conversely, Title I farm commodity program costs have had a nearly corresponding decrease since FY2003. This is because the counter-cyclical payment component has decreased as market prices for farm commodities generally have risen from levels a decade ago. The status of supplemental disaster assistance remains uncertain and unpredictable. By definition, *ad hoc* disaster payments are subject to congressional action and are not included in baseline projections. The so-called "permanent" agricultural disaster provisions (e.g., SURE) in the 2008 farm bill are authorized only temporarily and have baseline only through the end of the 2008 farm bill.

[30] For more on crop insurance costs and issues, see CRS Report R40532, *Federal Crop Insurance: Background and Issues*, by Dennis A. Shields.

[31] The crop insurance projections in the August 2010 CBO baseline reflect the final Standard Reinsurance Agreement (SRA) between USDA and the crop insurance companies. Both USDA and CBO have estimated that the SRA agreement reduces crop insurance outlays by $6 billion over 10 years. USDA asserts that about $2 billion of this may be added to other initiatives such as conservation, but CBO's baseline may or may not reflect this depending on its own assumptions. This internal reallocation within USDA is known as "administrative PAYGO" (see CRS Report R41375, *OMB Controls on Agency Mandatory Spending Programs: "Administrative PAYGO" and Related Issues for Congress*, by Clinton T. Brass and Jim Monke). The other $4 billion of savings that was removed from the baseline went to deficit reduction (see USDA press release, "USDA Releases Final Draft Crop Insurance Agreement Which Generates $6 Billion in Savings: $4 Billion for Deficit Reduction, $2 Billion for Critical Farm Bill Programs," http://www.usda.gov/wps/portal/usda/usdahome?contentidonly=true&contentid=2010/06/0316.xml).

**Figure 3. Actual and Projected Spending for Farm Commodity Programs, Crop Insurance, and Disaster Programs**

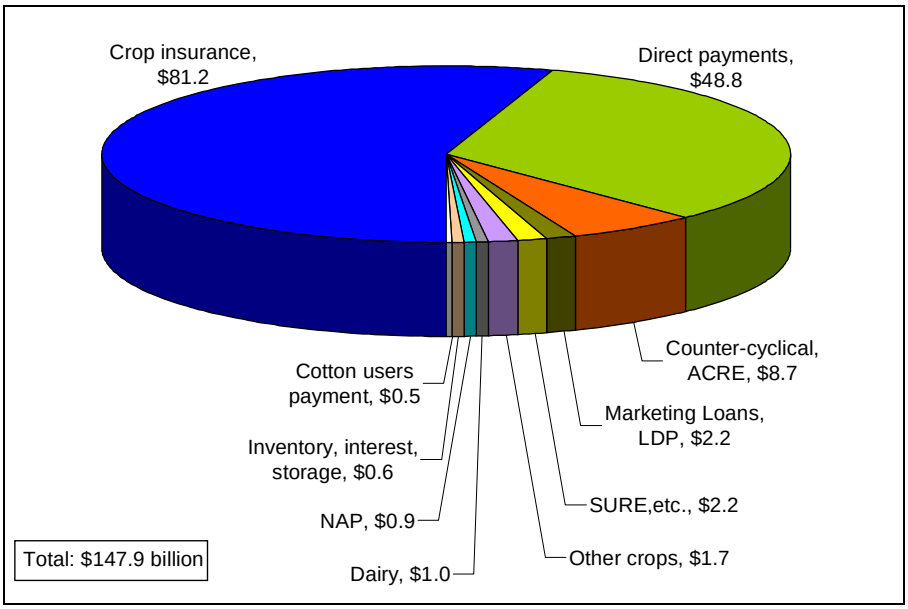



**Source:** CRS compilation, based on the August 2010 CBO baseline projections for FY2010-FY2020, and various prior-year CBO baselines for actual amounts in FY2003-FY2009.

**Notes:** Amounts for the Title I programs exclude the sugar program and tobacco buyout payments.

**Figure 4. Projected Outlays for Title I Farm Commodity Programs, Crop Insurance, and Disaster Programs, FY2011-FY2020 Total**

(dollars in billions, 10-year total)




**Source:** CRS compilation, based on the August 2010 CBO baseline for crop insurance and SURE, and the March 2010 CBO baseline for the direct and counter-cyclical programs (the latest available by type of payment).

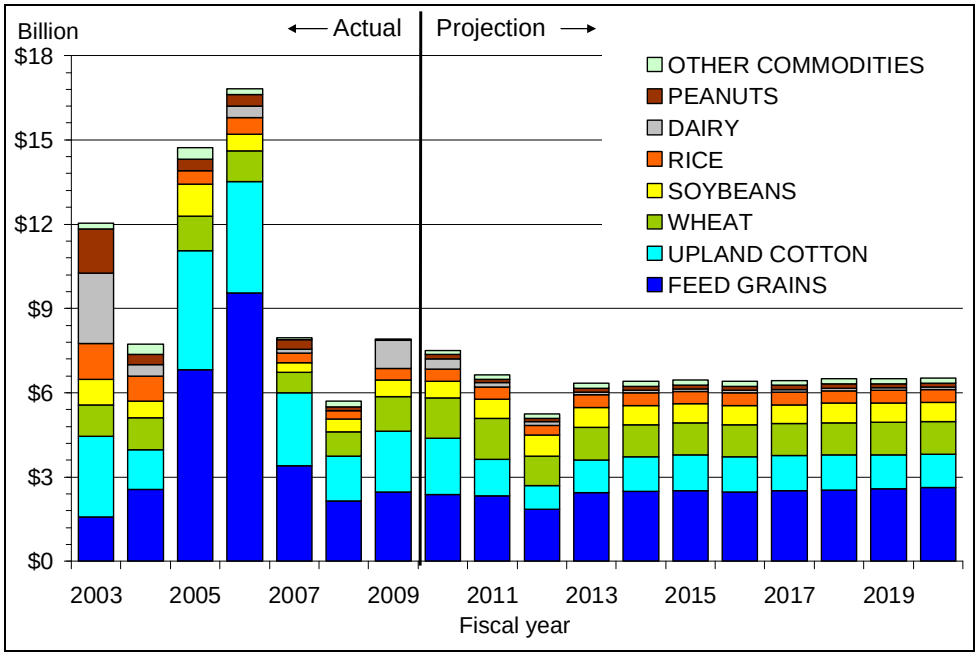
**Notes:** Excludes the sugar program and tobacco buyout payments.

**Figure 4** shows the components in the baseline projection for the Title I farm commodity programs, crop insurance, NAP, and the permanent disaster program. Crop insurance is the largest component of projected payments, comprising $81 billion of the $148 billion 10-year total. Direct payments are the next largest, at $49 billion over FY2011-FY2020. Counter-cyclical and ACRE payments are the third-largest component, with nearly $9 billion over 10 years. Cotton accounts for about 55% of the combined counter-cyclical and ACRE payment projection, with ACRE payments for corn rising near the end of the period and accounting for 17% of the projection.

Whether or not direct payments are considered part of the farm safety net (because they are fixed and not tied to changes in prices or revenue), their magnitude in comparison to counter-cyclical payments makes it likely that some proposals for a new safety net could include funding offsets from direct payments.

**Figure 5** shows how the Title I farm commodity payments are allocated by commodity (including direct payments, counter-cyclical payments, ACRE, and the marketing loan programs; that is, the green bars of **Figure 3**). Corn is the commodity receiving the most support, both in the FY2003-FY2010 period and in the FY2011-FY2020 projected period. Cotton is the next-highest supported commodity in total terms, but is planted on comparatively fewer acres. Wheat, soybeans, and rice round out the top five supported commodities, which together account for 93% of the Title I baseline. While commodity allocations are not directly associated with the design of a safety net, these shares nonetheless reflect some of the support and influence in the commodity title (for example, that corn growers were the primary advocates for the development of the ACRE provisions in the 2008 farm bill).

**Figure 5. Actual and Projected Spending on Title I Farm Commodity Programs, by Commodity**




**Source:** CRS compilation, based on the August 2010 CBO baseline projections for FY2010-FY2020, and various prior-year CBO baselines for actual amounts in FY2003-FY2009.

**Notes:** Amounts exclude the sugar program and tobacco buyout payments that are included in the baseline. Crop insurance subsidies are also excluded from this chart.

# Policy Issues

Besides budget issues, several policy questions are being raised to assess the current farm safety net programs and consider potential changes. How well does the multitude of programs support farmers and/or help them manage overall business risks? What are the holes in the farm safety net with respect to commodities, regional coverage, or farm size? Is it money well spent, or is there a better combination of programs that would meet the objectives of policymakers?

For supporters of farm programs, continued calls for wide-scale emergency disaster relief are an indication that the farm safety net is not functioning as well as producers and policymakers would like. Two programs with the most genuine safety net features, the SURE and ACRE programs, have been criticized as being too complex, which reportedly has limited participation, while providing too few benefits for farmers who face economic hardship. Also, some farmers have complained, both recently and prior to the 2008 farm bill, that MAL benefits and counter-cyclical payments do not provide enough assistance because trigger levels are mostly below current and expected price levels. Production costs relative to current levels of support are also a concern for many farmers, including dairy producers.

Critics of farm programs have long questioned the need for farm subsidies, contending that resources for agriculture could be better spent advancing environmental goals or improving agricultural productivity. Others cite an economic argument against the farm commodity programs: like any subsidy, farm programs distort production, capitalize benefits to the owners of the resources, encourage concentration of production, and comparatively harm smaller domestic producers and farmers in lower-income foreign nations.

Several issues might shape any potential changes to farm safety net programs in the next farm bill debate.

- **Managing farm risk**—Crop insurance has very high participation rates, a result driven in part by the high subsidization levels but also because the program in fact reduces both yield and revenue risks. Some Members of Congress and policy observers have wondered if crop insurance might be the only element of the farm safety net that remains in the distant future if farm programs are rationalized and funding is reduced.

  Farm policy observers have identified significant overlap between farm programs. For example, the ACRE program and crop insurance both address revenue variability. Also, the current farm program mix has several variations of "counter-cyclical-style" payments, including marketing loan benefits, traditional (price) counter-cyclical payments, ACRE (revenue) payments, revenue-type crop insurance, and whole-farm insurance. In the view of some, a different array of programs might reduce farm risk in a more cost-effective way.

- **Commodity coverage**—The extent of the current commodity coverage is primarily a result of the historical and evolving nature of farm policy. Producers of major commodities such as wheat, corn, soybeans, rice, cotton, and milk have benefited the most from farm programs because farmers and policymakers representing those commodities shaped the programs from their inception. Since then, most other commodity advocates have not had the interest or sufficient political power to add their commodities to the mix. Commodity coverage could be increased by changing the commodity mix for current programs or by

developing a whole-farm program or insurance policy that could be more comprehensive than USDA's current insurance policy and eliminate potential overlap of coverage across the various existing programs.

- **Biofuels subsidies**—The federal government has enacted an increasing number of programs that support the use of agriculture-based biofuels, foremost of which is corn-based ethanol.[32] In the past decade, corn use for ethanol has expanded corn demand by nearly 30%, driving corn prices higher. In 2009, biofuels subsidies totaled nearly $6 billion, and corn has not been the only beneficiary. The increased demand for corn has contributed to an expansion of corn area into non-traditional crop areas, raising prices for other major field crops. Many federal budget watchers argue that the expanding biofuels subsidies should be counted with the pool of agricultural price and income subsidies since this has been one of their major effects.
- **Complexity**—The program structure for ACRE and SURE requires a substantial amount of individual farm data, assumptions, and calculations. As a result, determining whether or not the programs benefit an individual producer is not readily apparent beforehand, which affects participation. Similarly, the complexities of such programs require significant setup and ongoing administrative costs. The complexity has arisen, in part, from budget responsibility that requires actual losses to be determined after the end of the marketing year—possibly for the whole farm, rather than making payments sooner on less comprehensive information.
- **Program limits and farm size**—Payment limits for the farm commodity programs, with the exception of the marketing assistance loan program, either set the maximum amount of farm program payments that a person can receive per year or set the maximum amount of income that an individual can earn and still remain eligible for program benefits (a means test). The payment limits issue is controversial because it directly addresses questions about what size farms should be supported, whether payments should be proportional to production or limited per individual, and who should receive payments. Some policymakers want limits to be tightened to save money and reduce the possibility of encouraging expansion of large farms at the expense of small farms. Others say larger farms should not be penalized for the economies of size and efficiencies they have achieved. Crop insurance has no payment limits, a feature that some policymakers say makes crop insurance an attractive centerpiece of farm policy because it helps small and large farms alike, with neither apparently gaining at the expense of the other.

# WTO Compatibility of Current Farm Programs

A major constraint affecting future U.S. policy choices is the broad set of rules and disciplines of the World Trade Organization (WTO), which the United States, as a founding member, has agreed to adhere to and abide by. As one of the world's largest agricultural producers and trading nations,

[32] For more information, see CRS Report R41282, *Agriculture-Based Biofuels: Overview and Emerging Issues*, by Randy Schnepf.

the United States routinely sees its domestic and trade policies subjected to the scrutiny of foreign competitors and the news media. U.S. farm policy is constantly being evaluated against WTO rules.

In particular, U.S. domestic agricultural policy is subject to commitments made under the WTO's Agreement on Agriculture (AA)[33] and, to the extent that domestic policy effects spill over into international markets, U.S. farm policy is also subject to certain rules under the Agreement on Subsidies and Countervailing Measures (SCM). Policies or programs found to be in violation of WTO rules may be subject to challenge by another WTO member under the WTO dispute settlement process.[34]

The importance of WTO rules and commitments has been made salient by the so-called "Brazil cotton case," in which a WTO dispute settlement panel ruled against both the U.S. cotton and GSM-102 export credit guarantee programs.[35] The United States is expected to bring both programs into WTO compliance or be subject to WTO-sanctioned retaliation. Since most governing provisions over U.S. farm programs are statutory, new legislation could be required to implement even minor changes to achieve compliance.

So, a key question that policymakers will ask of virtually every existing farm program, as well as new farm proposals, is how will it affect U.S. commitments under the AA, and U.S. compliance with SCM rules? The answer rests not only on cost, but also on the proposal's design, implementation, and market effects. This section briefly discusses how U.S. farm programs, particularly Title I price and income support programs, would possibly comply (or not) with the WTO's AA and SCM.

## Does U.S. Farm Program Spending Stay Within WTO Limits?

Regarding domestic farm programs, the AA categorizes programs by the extent to which they have the potential to distort production and trade. Annual government support made under the most trade-distorting programs is measured by the aggregate measurement of support (AMS) index. Outlays under such programs are known as amber box subsidies.[36] Under the AA, the United States is committed to spending no more than $19.1 billion per year on AMS amber box support. WTO members have committed to operating amber box programs so as to keep spending within the WTO limit.

## Does the Program Result in Adverse Effects?

Even if a farm program stays within its WTO spending limit, it may be subject to WTO challenge under the rules of the Agreement on Subsidies and Countervailing Measures (SCM). The SCM

[33] For more information, see CRS Report RL32916, *Agriculture in the WTO: Policy Commitments Made Under the Agreement on Agriculture*, by Randy Schnepf.

[34] For more information, see CRS Report RS22522, *Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview*, by Randy Schnepf.

[35] For more information, see CRS Report RL32571, *Brazil's WTO Case Against the U.S. Cotton Program*, by Randy Schnepf.

[36] For more information, see CRS Report RS20840, *Agriculture in the WTO: Limits on Domestic Support*, by Randy Schnepf.

establishes formal definitions and rules for trade-related subsidies; however, SCM rules also pertain to domestic policies that have international market effects. In the case of U.S. farm commodity programs, the most likely SCM concern is compliance under "actionable subsidy" rules. Actionable subsidies (i.e., those subsidies that are not expressly prohibited but against which legal action may be taken) are broadly defined as those subsidies which cause "adverse effects" to the interests of other members (i.e., (1) injury, (2) nullification or impairment of benefits, or (3) serious prejudice to the interests of another member).[37]

An agricultural subsidy may be challenged under claims of adverse effects in agricultural markets—even if the subsidy remains within specified spending limits. Any amber box program is potentially vulnerable to scrutiny and challenge based on SCM rules. This is because the primary amber box-qualifying criteria of being "market distorting" leaves the program vulnerable to the charge of leading to adverse effects in the marketplace under the SCM agreement.

Trade analysts have argued that the adverse effects criteria of "serious prejudice" represent a lower threshold for achieving successful challenges to agricultural support programs than the injury requirement under a countervailing duty claim.[38] Three principal criteria must be established to verify the existence of adverse effects:

1. the subsidy constitutes a substantial share of farmer returns or covers a substantial share of production costs,
2. the subsidized commodity is important to world markets because it forms a large share of either world production or world trade, and
3. there is a causal relationship between the subsidy and adverse effects in the relevant market.

When measured against these criteria, available evidence suggests that all major U.S.-subsidized program crops, particularly crops receiving benefits under both the counter-cyclical payments program and the marketing assistance loan program, are potentially vulnerable to dispute settlement challenges.[39] In spite of U.S. vulnerability, there are reasons why challenges may rarely be filed—disputes are economically and diplomatically costly, and a lost challenge can help to legitimize the disputed program. Some policy measures that are likely to attract future scrutiny and possibly lead to WTO consultations or challenges include the following:

- Arbitrarily setting revenue targets at fixed values that are significantly above historical levels. This is most easily avoided by using a historical moving-average of prices or revenues to reflect market conditions.
- Establishing a low threshold trigger for a loss payment such that it will be tripped during years of normal or slightly below normal revenue outcomes.
- Linking payments to costs of production. An industry's cost structure determines its competitiveness relative to both foreign competitors and to other industries or sectors that might have more productive uses for that industry's resources.

[37] SCM Article 5. Articles 5(c) and 6.3(b) of the Agreement on Subsidies and Countervailing Measures (SCM) deal with subsidies that result in adverse effects in other WTO-member countries.

[38] For more information, see CRS Report CRS Report RL33697, *Potential Challenges to U.S. Farm Subsidies in the WTO*, by Randy Schnepf.

[39] Ibid.

## Is the U.S. Farm Program Exempt from WTO Limits?

The AA also includes three categories of programs—green box, blue box, and *de minimis*—that are exempted from AMS spending limits.

- Green box policies are presumed to be less or minimally trade or production distorting.
- Blue box policies are payments made under a production-limiting program based on historical area, yield, or production data or a fixed number of livestock.
- The *de minimis* exemption is spending that is sufficiently small (less than 5%)—relative to either the value of a specific product or total (i.e., non-product-specific) production—to be deemed benign.

### Farm Programs Under the Green Box

Annex 2 of the AA includes a list of potentially exempt agricultural support programs: general farm services (e.g., research and extension), food security stockholding, domestic food aid, decoupled income support (e.g., direct payments), income insurance or income safety net programs, relief from natural disaster, structural adjustment through producer or resource retirement or investment aids, environmental program payments, and regional assistance program payments.

The United States has consistently notified its direct payments outlays as green box exempt. However, this status was found lacking (due to the planting restriction on fruits, vegetables, and wild rice) by a WTO panel during the course of the WTO Brazil cotton dispute.[40] A WTO challenge of their green box eligibility could potentially result in the disqualification of direct payments from exemption and push U.S. AMS spending over its WTO limit.[41]

The green box rules most relevant for Title I-type programs are those programs that provide for government financial participation in either an income insurance or income safety net program or in a natural disaster relief program.

With respect to *income insurance or income safety net programs*, eligible payments require an agricultural income loss exceeding 30% of average gross income (or the equivalent in net income terms) in the preceding three-year period (or the preceding five-year period, excluding the highest and lowest years—the so-called Olympic average), with such payment compensating for less than 70% of the income loss in the year of eligibility. Payments must be based solely on income—not production, price, or input factors. In addition, total annual payments made under this program and under natural disaster relief cannot exceed 100% of a producer's total loss.

Under green box rules, eligible payments (whether direct or through government crop insurance) for *natural disaster relief* must be based on formal government recognition of the disaster. Payments must be determined by a production loss exceeding 30% of production in the preceding three-year (or five-year Olympic average) period; be applied only to losses of income, livestock,

[40] For more information, see "Claim 2" and "Finding 2" in CRS Report RL32571, *Brazil's WTO Case Against the U.S. Cotton Program*, by Randy Schnepf.

[41] Ibid., see the discussion under the section entitled, "Direct Payments Classification," pp. 30-31.

land, or other production factors; and not be for more than the total replacement cost. Total annual payments under this and the income safety net programs cannot exceed 100% of a producer's total loss.

To the extent that any crop-specific income or whole farm safety net program payments are triggered by any loss smaller than 30%, or provide reimbursement or indemnification of more than 70% of the loss, then the program does not qualify for green box exclusion and must either seek exemption under another "box" or be counted against the AMS limit. For example, under USDA's adjusted gross revenue insurance polices, producers may insure gross revenue coverage of up to 80% of historical revenue, and payments are triggered on losses of as little as 20% from historical average revenue. As a result, U.S. crop insurance subsidies (net indemnities) do not qualify for inclusion in the green box. Instead, they are notified to the WTO as amber box AMS, although they have always been exempted under the non-product-specific *de minimis* exclusion (see below).

### Farm Safety Net Under the Blue Box

The United States has not notified any program spending under the blue box since the old target-price deficiency payments that ended with the 1996 farm law (P.L. 104-127). A key feature of deficiency payments was their link to land set-aside requirements, thus meeting the "production-limiting" characteristic of the blue box. It is unlikely that a whole-farm safety net program or crop-specific income program could be designed (without some notable land or resource constraint) that would meet current AA blue box criteria.

### Farm Safety Net Under the *De Minimis* Exemption

The United States has traditionally made only minor use of the product-specific *de minimis* exemption, in large part because any qualifying program accounts for less than 5% of the product's annual production value.

In contrast, a whole-farm safety net proposal, by definition, would involve an aggregation of all farm-related income generating activities. As such it could not be considered for exclusion under the product-specific *de minimis*, but instead must determine the potential for qualification under the "non-product-specific" *de minimis* exemption.

To qualify for the non-product-specific *de minimis* exemption, the annual outlay of the whole-farm, safety net program must be added to the value of support provided by all other non-product-specific AMS measures (e.g., certain irrigation subsidies, state credit programs, counter-cyclical payments, and farm storage facility loans). If the total annual cost is less than 5% of the value of total U.S. agricultural production, then all such support—including the whole-farm safety net—would be exempted from the U.S. total annual AMS spending limit; otherwise it must be counted toward the $19.1 billion annual limit. Through 2007 (the data year for its most recent notification), the United States has notified all of its crop insurance subsidies under the "non-product-specific" *de minimis* exemption category.

## A Whole-Farm Safety Net Under the WTO

The WTO compatibility of a whole-farm safety net program would depend on many things. First, will it meet green box exemption criteria with a 30% loss trigger and payments of no more than

70% of a loss? Second, if it is deemed an amber box program, will it replace existing amber box programs or be added to them? Additive programs are likely to increase AMS spending, possibly bringing the AMS limit into play. Third, will the program influence producer decision making beyond simple risk reduction? Will the program have adverse market effects? Is it likely to encourage greater production (and lower prices) than would occur in its absence? A yes answer to any of the questions in this third category could result in a WTO challenge.

# Conclusion

Several forces are acting on policymakers as Congress considers revising the farm safety net. These include the historical development of farm programs and the accompanying political process, concerns about the budget deficit, biofuel and energy policy in general, and U.S. commitments under the WTO. How these and other forces play out during the farm bill debate will determine what if any changes are made to the farm safety net.

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