

An Analysis of the Effect of Removing the Planting Restrictions on Program Crop Base

Executive Summary

The 2002 Farm Bill provides valuable and important benefits to producers of program crops (i.e. most food and feed grains, rice, peanuts, cotton and oilseeds) in the form of payments that are not tied to current production of particular crops. Direct payments alone account for more than \$5 billion in annual payments to farmers and landowners with a documented history of program crop production, and counter-cyclical payments—while still dependent on current market prices—have averaged more than \$2 billion per year across the crops for which payments have been made. Eligibility to receive these payments does not require the production of any particular crop, but participants are restricted (except in a few special cases) from producing fruits, vegetables or wild rice (i.e. specialty crops) on any of their program crop base acreage. However, a recent ruling by the WTO found that these planting restrictions violate the definition of decoupled support programs, so there is increasing pressure to eliminate them even if the other basic provisions of the Direct Payment (and possibility Counter-Cyclical) Program remain unchanged.

This planting restriction is designed to ensure that federal subsidies intended for producers of program crops do not get diverted to support the expansion of specialty crops on subsidized land. Since specialty crops receive no type or level of support similar to the Direct and Counter-Cyclical Program, without the restrictions existing specialty crop producers would be forced to compete directly with the subsidized producers that enter the specialty crop industry. At a minimum, this would suggest inequity in the treatment of different producers of the same crops, where subsidies would be available to producers that do not have a history of producing these crops, but unavailable to the producers with a long and established history of specialty crop production.

The planting restrictions also indirectly support specialty crop markets by limiting the supply from domestic producers. By providing a strong disincentive for program crop farmers (without a history of specialty crop production) to enter the specialty crop industry on even a small scale, specialty crop acreage and production is suppressed somewhat, supporting prices and reducing volatility. Removing this restriction would increase supplies, and lead to lower market prices for the affected specialty crops.

This research attempts to quantify effect on the specialty if the planting restrictions are eliminated. It considers the two factors identified above: the potential for cross-subsidization of new specialty crop acreage if the restrictions are lifted (i.e., the *primary* effect that the restrictions are intended address) and the market impact (in terms of reduced prices and revenues) that existing specialty crop producers would likely face as a

result of the increase in supply expected following the elimination of the planting restrictions (i.e. the *secondary* effect of decades-long policies that have discouraged program crop farmers from entering the specialty crop market). The costs to the specialty crop sector from these two factors combined are estimated at nearly \$4 billion.

Cross-Subsidization of Specialty Crops

Removing the planting restrictions on base acres, while retaining the program benefits at current levels, would allow program crop producers to continue to receive decoupled support payments even if they produced specialty crops on any or all of their program crop base acreage. The result would be that this new specialty crop acreage would be directly subsidized with payments originally intended to support program crops, while existing growers (without a program crop base) would receive no similar benefits—placing them at a competitive disadvantage to their new competitors. As long as decoupled payments continue without the planting restrictions, specialty crop producers without a program crop base would remain at a revenue disadvantage (all else equal) relative to the specialty crop producers that enter the industry with the benefit of decoupled payments.

To measure this disadvantage, we calculate the average DCP payment available to program crop producers that could be used to support specialty crop production. Applying a similar per-acre benefit to specialty crop land illustrates the amount by which revenues for existing specialty crop producers must grow simply to offset the revenue advantage that would be available to program crop farmers able to market specialty crops while continuing to receive decoupled support. Since direct and counter-cyclical payments vary considerably across the eligible commodities—and therefore across geography based on where different program crops tend to be produced—our estimates are weighted by the proportion of fruit and vegetable acreage in each state and the average DCP benefit, per acre, received by program crop producers in those states.

Applying these weights to the average DCP by state suggests a US average program benefit of **\$76.04 per acre**, including \$42.79 associated with direct payments, and \$33.25 associated with the average counter-cyclical payment received over 2002-2004. Providing equivalent benefits to existing fruit and vegetable producers to avoid unfairly subsidizing only part of the industry (i.e. program crop producers expanding into fruit and vegetable production) would imply the following:

$\$76.04/\text{acre} \times 10.594 \text{ million acres} = \mathbf{\$805.57 \text{ million}}$ for existing fruit and vegetable producers.

Market Impact of Removing the Planting Restrictions

In addition to the revenue disadvantage that existing specialty crop producers would face relative to producers that could receive DCP payments, removing the planting restrictions would also result in a realignment of market forces that have long influenced the total supply of specialty crops. By providing program crop producers, full flexibility to enter

specialty crop markets without penalty (with or without the existence of subsidies currently available as decoupled payments) supply is almost certain to increase compared to current levels with the restrictions in place. The larger supply without a corresponding increase in demand will lead to lower prices—and a direct reduction in revenues—faced by existing specialty crop producers. Even though the planting restrictions were not designed with the intent of limiting supply, they have nevertheless become incorporated into the range of factors that affect production decisions among all producers. Removing them would force existing specialty crop producers to absorb the market adjustments (i.e. larger supplies and lower prices) that will necessarily occur once the range of viable cropping decisions available to program crop farmers is expanded to include specialty crops.¹

Estimating the market impact of removing the planting restrictions is complicated by many factors, including the broad range of crops that could potentially be affected and the various agronomic and market forces that ultimately determine which crops can feasibly—and profitably—be produced in different locations. But for all specialty crops, even small changes in supply—given the small acreage already devoted to specialty crop production—could have large market impacts. With over 220 million acres of land currently enrolled in the Direct and Counter-Cyclical program, if only 1% of this land shifted to specialty crops it would translate into a more than 20% increase in specialty crop acreage. Given the inelastic demand conditions that tend to characterize most specialty crop markets, even modest increases in supply can have proportionately much larger impacts on prices and total revenues.

We estimate the potential for program crop acreage to shift to specialty crops by examining the forces that have guided acreage allocation decisions by program crop farmers that already have a history of specialty crop production, recognizing that these producers already face relatively small penalties for expanding their specialty crop acreage. Without the restrictions, all program crop farmers will face similar incentives—or disincentives—to produce specialty crops.

Removing the planting restrictions is predicted to attract roughly 1.03 million acres into production of specialty crops. While this accounts for less than one half of 1 percent of the total program crop acreage base, it represents a 10% increase in total specialty crop acreage. The 15 states where the greatest expansion of acreage is expected alone account for about 88% of the new specialty crop acreage. Key observations include:

- The greatest potential for new specialty crop acreage is in California, reflecting the already large and diverse specialty crop industry that resides there. However, the more than 230,000 acres in the state we predict could shift to specialty crops is still less than 6% of existing specialty crop acreage. This also represents about

¹ This adjustment is analogous to the situation recently faced by tobacco farmers with the elimination of production quotas. Although these quotas were specifically intended to limit supply and therefore support prices, removing them was controversial due to the impact on existing growers, and resulted in the need to compensate existing quota holders for the value of future lost revenues associated with this protected market.

a 12% decline in program crop acreage in the state, which we expect to come mainly from cotton and rice.

- The states with the largest percentage increase in specialty crop area include Idaho and Colorado. Especially in Idaho, this represents almost entirely new potato acreage. Potatoes are also likely to dominate the acreage shifts in Washington and North Dakota.
- Relatively little expansion of specialty crop acreage is expected in most Corn Belt States, reflecting the competitive dominance of program crops in these areas and limited existing specialty crop acreage and infrastructure.
- Across the United States, the expected increase in specialty crop acreage would be distributed among many individual crops, reflecting existing geographic production patterns. Along with potatoes, crops that are expected to see an increase in acreage of 10% or more include peas, pears, sweet corn, apples, onions, cabbage, snap beans, berries, cherries, pumpkins, asparagus, cucumbers and squash.

Using conservative methods, we find that the increase in supply estimated above would reduce the revenues of existing specialty crop producers by slightly over **\$3.1 billion per year**, relative to levels with the planting restrictions remaining in place. It is important to note that this represents solely a decline in revenue to *existing* producers of specialty crops, and does not consider the increases in specialty crop revenues expected by those program crop producers expected to enter the industry or expand existing specialty crop production.

Potential Policy Remedies

The two basic impacts of removing the planting restrictions—the potential for inequity in the level of support provided to new and existing specialty crop producers, and the impact on market revenues for existing growers from an increase in supply—are closely related but are not the same. Each addresses a unique concern associated with the market adjustments that will occur if and when the planting restrictions are lifted. As a result, each suggests a unique policy response in order to minimize harm to existing growers.

The potential for cross-subsidization of specialty crops on land historically devoted to program crops raises basic issues of equity among farmers that compete in the same markets and produce the same products. Without the planting restrictions, current or former program crop producers could enter the specialty crop market in a preferred position relative to existing growers by benefiting from a guaranteed stream of government payments unavailable to traditional specialty crop farmers. Alleviating this inequity suggests providing an equivalent level of fixed, guaranteed subsidies to existing specialty crop farmers.

Based on current direct payment rates and historic average counter-cyclical payments, we estimate that a program designed to provide roughly \$76/acre to existing specialty crop farmers—for as long as similar payments are also available to program crop farmers—would reduce or eliminate this inequity and obviate the potential competitive advantage

that new specialty crop producers could have as a result of the decoupled subsidies they already receive. However, this also suggests that if decoupled payments available for program crop farmers eventually change (either higher or lower) the payment to specialty crop producers should also change accordingly.

Addressing the effect on specialty crop markets and revenues for existing producers (i.e. the market supply impact) is an issue separate from the potential for cross-subsidization, and therefore requires unique policy attention. Indeed, even if decoupled payments were eliminated for program crop producers after the planting restrictions were removed, while concerns about cross-subsidization would go away, the market supply impact (and potential for reduced revenues to current producer) would still remain. This impact ultimately reflects the need for markets to readjust after decades of interference imposed by the planting restrictions and other disincentives to grow specialty crops on program crop acreage. The market supply impact—in terms of expected lost revenues to existing growers—is conservatively estimated here to exceed \$3.1 billion. This calculation is based on the expected amount by which prices would be expected to decline given the supply increase we predict, and given *existing levels of consumer demand*.

Minimizing the impact on existing growers suggests policy remedies aimed at expanding markets (i.e. consumer demand) by amounts that would at least offset the increase in supply. Examples could include expanded purchases of fruits and vegetable for use in federal nutrition and income assistance programs, greater funding of advertising and promotion efforts aimed at increasing fruit and vegetable consumption, and any other activities that can increase consumer access to and consumption of fruits and vegetables. Since existing producers are harmed ultimately by the reduction in price given that production costs remain unchanged, policy responses aimed at lowering production costs (perhaps through federally-funded research activities) could also play a role in helping to alleviate the impact of removing the planting restrictions. Regardless of the particular policy responses adopted, funding should be calibrated to result in an expansion of existing markets in line with the amount by which supply is expected to increase following the removal of the planting restrictions.