CATO HANDBOOK FOR CONGRESS

POLICY RECOMMENDATIONS FOR THE 108TH CONGRESS

CATO INSTITUTE
Washington, D.C.

30. Agricultural Policy

Congress should

- reduce greatly the per farm subsidy cap as a first step to control the excesses of federal agriculture subsidies;
- repeal the new crop price supports included in the 2002 farm law, which are unnecessary add-ons to existing subsidy mechanisms;
- phase out other crop subsidies, a process that began under the 1996 Freedom to Farm Act;
- move toward a system of private insurance and use of other financial instruments to protect farmers against market and weather fluctuations; and
- eliminate federal controls that perpetuate producer cartels in markets such as those for milk and sugar.

Reversal of the 1996 Reforms

With strong support from the Bush administration, Congress passed a huge farm bill in 2002 that moved away from the ''Freedom to Farm'' reforms of 1996. Farm subsidies are now projected to cost taxpayers more than $180 billion over the next decade. The costs may end up being much higher; subsidies under the 1996 farm law were expected to cost $47 billion over seven years but ended up costing about $123 billion.

The landmark 1996 farm law aimed to move agriculture away from the command-and-control regime in place since the 1930s. The law increased farmers' flexibility to plant and eliminated some crop price supports. The law was supposed to phase down subsidy levels between 1996 and 2002. But after enactment, Congress ignored agreed-upon subsidy limits and passed huge supplemental subsidy bills every year beginning in 1998. As

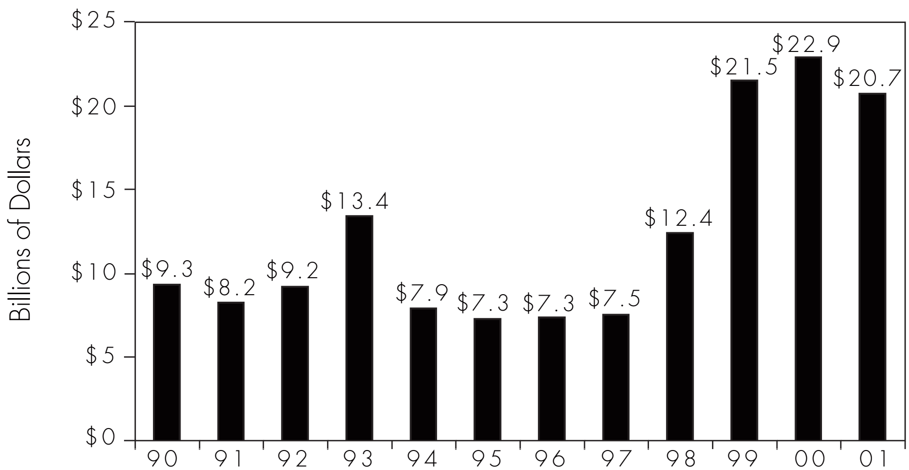
a result, direct farm subsidies have soared to more than $20 billion per year from an average of $9 billion per year in the early 1990s (see Figure 30.1). Since the passage of the 2002 bill, some lawmakers have already clamored for further supplemental spending because of drought conditions in some regions.

Politically Favored Crops

Not all farmers receive direct subsidies from the federal government. Indeed, commodities that get federal payments account for just 36 percent of U.S. farm production. Commodities, such as fruits and vegetables, that are not on the federal dole account for 64 percent of U.S. farm production. More than 90 percent of direct federal subsidies go to farmers of just five crops—wheat, corn, soybeans, rice, and cotton.

In addition to those direct subsidies, the U.S. Department of Agriculture runs a massive array of marketing, loan, statistical, research, and other support programs. Also, legal restrictions and tariffs manipulate markets for products such as sugar and dairy foods. All in all, about 70,000 employees of the USDA work on farm-related programs. No other industry in America is so coddled.

Figure 30.1
Direct Federal Farm Subsidies, 1990–2001



Source: Calendar year USDA farm income data at www.ers.usda.gov/data/farmincome.

The Structure of Crop Subsidies

Large-scale federal manipulations of agriculture began as ‘‘temporary’’ measures in the 1930s under the New Deal. Farm programs have flourished ever since, despite a dramatic drop in the importance of agriculture to the U.S. economy. Crop subsidies have usually been delivered in the form of price supports, which create chronic problems of crop overproduction, which necessitate other programs to control output.

Prior to 1996, the main farm subsidy program paid ‘‘deficiency’’ payments based on legislated price levels called target prices. Eligible commodities included major field crops, such as wheat, corn, and rice. Farmers were paid for their base acreage in each particular crop and were stuck producing certain crops if they wanted to get the full subsidy. To stem overproduction, the government paid farmers not to farm on set-aside land.

The resulting absence of planting flexibility and land idling created large ‘‘deadweight’’ economic losses or inefficiency costs. The most efficient selection of crops was not being planted, and farmland was going unused. Those inefficiencies provided an important justification for the 1996 reforms. At that time, a combination of high commodity prices and the Republican takeover of Congress created support for reducing government intervention in the farm sector under the 1996 farm law.

1996 Reforms

The centerpiece of the 1996 farm law was the replacement of price support payments with production flexibility contracts (PFCs) that were fixed payments decoupled from market prices. The government set total PFC subsidy payments on a declining scale from $6 billion in 1996 to $4 billion in 2002.

The reforms affected farmers of corn, wheat, grain sorghum, barley, oats, cotton, and rice. Farmers of those crops were now allowed to plant any crop they chose and their subsidy payment would be at a fixed level decoupled from planting decisions. The new rules under the 1996 law led to significant reductions in deadweight economic losses and allowed farmers to better respond to changing market conditions.

Nonetheless, the new PFC subsidies still promote oversupply since they increase farmer wealth and income, thus encouraging farm expansion. Also, oversupply incentives continue under programs not reformed in 1996, such as the marketing loan program. That program was designed to provide short-term financing to farmers before crops were sold, but it

has morphed into another multi-billion-dollar subsidy program. Eligible crops include corn, wheat, cotton, rice, sorghum, oats, barley, and soybeans. The program's cost has exploded to more than $5 billion per year in recent years.

Yet another major direct subsidy program for farmers is the conservation reserve program (CRP), which was created to idle millions of acres of farmland by paying farmers not to farm. The taxpayer cost of the CRP has averaged about $1.5 billion per year. Almost one-third of land idled under the CRP is owned by retired farmers, so many recipients do not even have to work to get subsidies. A simpler way to reduce overproduction and help the environment would be to eliminate all government farm subsidies.

Welfare for the Well-to-Do

Politicians love to discuss the plight of the small farmer. Yet the bulk of direct farm subsidies goes to the largest farms. For example, the largest 7 percent of farms received 45 percent of all farm subsidy payments in 1999. Much of the farm subsidy payout goes to individuals and companies that clearly do not need taxpayer help. A Washington, D.C., think tank has posted individual farm subsidy recipients on its Web page at www.ewg.org to illustrate the unfairness of farm welfare for the well-to-do. Farm subsidy recipients include Fortune 500 companies, members of Congress, and millionaires such as Ted Turner.

USDA figures show that, compared with other Americans, farmers are quite well off. The average farm household income was $61,947 in 2000, which is 8.6 percent higher than the average U.S. household income of $57,045. Commercial farms, as defined by the USDA, get about half of all farm subsidies, had average household incomes of $118,450 in 2000, and received an average subsidy of $43,379. So even if one accepts the notion that the government should redistribute wealth from rich to poor, farm subsidies do the reverse by giving taxpayer money to those with above-average incomes.

2002 Farm Bill—Taxpayers Take Bipartisan Beating

The 2002 farm bill is expected to cost taxpayers more than $180 billion in subsidy costs over the next 10 years. The ultimate taxpayer cost will be higher if Congress doles out further supplemental spending.

Aside from the taxpayer costs, the 2002 farm bill reverses progress made in 1996 toward reducing agriculture market distortions by introducing new price supports. Experts widely agree that price supports are counterproductive. Indeed, the USDA noted in a major report in September 2001 that ''government attempts to hold prices above those determined by commercial markets have simply made matters worse time after time'' by encouraging unneeded output and inflating land prices. Nonetheless, the president signed into law the 2002 farm bill, which added a new price support, or ''countercyclical,'' program to provide big subsidies when prices are low. In addition, the marketing loan program, which also acts as a price support, was expanded in the 2002 bill to cover chickpeas, lentils, dry peas, honey, wool, and mohair.

The 2002 bill also retains the multi-billion-dollar PFC subsidy program. The intent of the PFC program introduced in 1996 was to gradually wean farmers from subsidies. Instead, the 2002 farm bill simply turns the program into yet another long-term handout.

Many other agricultural products received continued support under the new farm bill. Protectionist sugar measures that cost consumers billions of dollars are kept in place. Complex milk supports and regulations are retained, and an additional National Dairy Program is created that will cost taxpayers millions more dollars. The quota system for peanuts is being bought out at great taxpayer expense, and peanut farmers are now eligible for direct subsidies under other farm programs.

A final taxpayer insult of the 2002 bill was the audacious defense of the law after enactment in a glossy full-color booklet titled ''The Facts on U.S. Farm Policy,'' published by the House Agriculture Committee. The propaganda piece attacks the ''myths'' of people who dared question the bill. Throughout the booklet are pictures of famous Americans from Thomas Jefferson to Ronald Reagan with assorted quotes meant to imply that these great men would have supported the profligate farm bill.

Repealing Farm Subsidies Is Economically and Politically Feasible

Despite the reversal in 2002, farm reform efforts will return because economic reality always intrudes on the best-laid plans of the central planners. During the debate over the 2002 farm bill, Sen. Richard Lugar (R-Ind.) offered an interesting alternative to the current system. His plan would have phased out current subsidies and replaced them with a voucher system promoting reliance on insurance and other financial instruments.

While Lugar's reforms would not go far enough, they indicate that with some innovative thinking and political courage Congress may eventually come around to real reforms.

The experience of New Zealand in the 1980s shows that complete subsidy removal makes sense economically and politically. In 1984 New Zealand's Labour government took the dramatic step of ending all farm subsidies. That was a remarkably bold policy action since New Zealand's economy is roughly five times more dependent on farming than is the U.S. economy.

Subsidy elimination in New Zealand was swift and sure. There was no extended phaseout of farm payments, as was promised under U.S. reforms in 1996. Although the plan was initially met with massive protests, the subsidies were ended and New Zealand farming has never been healthier. The value of farm output in New Zealand has soared since subsidies were repealed, and farm productivity has grown strongly.

Forced to adjust to new economic realities, New Zealand farmers cut costs, diversified their land use, sought nonfarm income, and altered production as market signals advised. As a report by the Federated Farmers of New Zealand noted, the country's experience ''thoroughly debunked the myth that the farming sector cannot prosper without government subsidies.'' Reformers in Congress should continue working to eventually debunk that myth in this country.

Suggested Readings

Edwards, Chris, and Tad DeHaven. ''Farm Reform Reversal.'' Cato Institute Tax & Budget Bulletin no. 2, March 2002.

______. ''Farm Subsidies at Record Levels As Congress Considers New Farm Bill.'' Cato Institute Briefing Paper no. 70, October 18, 2001.

Federated Farmers of New Zealand. ''Life after Subsidies.'' www.fedfarm.org.nz/homepage.html.

McNew, Kevin. ''Milking the Sacred Cow: A Case for Eliminating the Federal Dairy Program.'' Cato Institute Policy Analysis no. 362, December 1, 1999.

Orden, David. ''Reform's Stunted Crop.'' *Regulation* 25, no. 1 (Spring 2002).

Orden, David, Robert Paarlberg, and Terry Roe. *Policy Reform in American Agriculture: Analysis and Prognosis.* Chicago: University of Chicago Press, 1999.

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