31. Agricultural Policy

Congress should

- phase down and terminate all crop subsidies, a process that was supposed to begin with passage of the 1996 Freedom to Farm law;
- move farmers toward use of market-based insurance and other financial instruments to protect against price and weather fluctuations;
- eliminate federal controls that create producer cartels in the dairy, tobacco, and sugar markets; and
- eliminate trade protections on agricultural goods while working through the World Trade Organization to pursue liberalization in global markets.

Enriching the Few at the Expense of the Many

Much of the U.S. agricultural sector operates in a fairly free market environment. Products that account for 64 percent of U.S. farm production, such as fruits and vegetables, generally do not receive federal subsidies. Products that account for the other 36 percent of farm production receive roughly $20 billion of direct subsidies each year. More than 90 percent of those subsidies go to farmers of just five crops—wheat, corn, soybeans, rice, and cotton.

The federal government also imposes restrictions and import controls on products such as sugar and milk. Those rules enrich a few producers at the expense of American consumers. For example, sugar prices are three times higher in the United States than elsewhere because of federal controls. Another problem is that farm subsidies and controls are an

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impediment to world trade negotiations, which are designed to bring greater prosperity to every country.

In addition to subsidies and controls, the U.S. Department of Agriculture (USDA) runs a huge array of marketing, loan, statistical, and research programs for farmers. The USDA has 110,000 employees and 7,400 offices scattered throughout the country. No other industry in America is so coddled.

Reversal of the 1996 Reforms

With the backing of the Bush administration, Congress passed a new farm law in 2002 that moved away from the ''Freedom to Farm'' reforms of 1996. Direct farm subsidies and related support programs will cost taxpayers $104 billion during FY05 to FY09, according to the federal budget. The costs may end up being higher; subsidies under the 1996 farm law were projected to cost $47 billion over seven years but ended up costing more than $120 billion.

The 1996 farm law aimed to move agriculture away from the command-and-control regime in place since the 1930s. The law increased planting flexibility, eliminated some crop supports, and was supposed to phase down subsidies. But after enactment, Congress ignored agreed-upon subsidy limits and passed a number of large supplemental subsidy bills. As a result, farm subsidies have soared to about $20 billion annually in recent years from less than $10 billion annually in the mid-1990s.

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 overproduction.

Prior to 1996 the main farm subsidy program paid ''deficiency'' payments based on legislated price levels called target prices. Eligible commodities included crops such as wheat, corn, and rice. Farmers were paid for their base acreage in each crop, which they were stuck producing 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 flexibility and land idling created large ''deadweight'' economic losses, or inefficiency costs. The most efficient selection

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of crops was not being planted, and good farmland was going unused. Those inefficiencies provided an important justification for the 1996 reforms. A combination of high commodity prices and the Republican takeover of Congress created support for cutting intervention in the farm sector under the 1996 farm law.

1996 Reforms

The centerpiece of the 1996 farm law was the replacement of price supports 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 were allowed to plant any crop they chose and their subsidy payment would be at a fixed level. The new rules led to significant reductions in deadweight economic losses and allowed farmers to respond to changing market conditions.

Nonetheless, farm subsidies continue to promote oversupply because they increase farmer wealth and thus encourage farm expansion, and they prop up marginal farms that should be allowed to fail. Also, the marketing loan program was not ended and it continues to promote oversupply.

Another continuing subsidy program is the conservation reserve program (CRP), which idles millions of acres of land by paying farmers not to farm. 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. Instead of the CRP, a simpler way to stop overproduction and conserve the environment would be to eliminate all farm subsidies.

Undoing Reforms with the 2002 Farm Bill

The 2002 farm bill reversed progress made in 1996. It added a new price support, or ''countercyclical,'' program to provide bigger subsidies when prices are low. In addition, the marketing loan program, which acts as a price support, was expanded in the 2002 bill to cover chickpeas, lentils, dry peas, honey, wool, and mohair.

Congress ignored the experts, who generally agree that price supports are counterproductive. For example, the U.S. Department of Agriculture 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 causing overproduction and inflating land prices.

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

The 2002 bill continued other Soviet-style farm policies. Protectionist sugar measures that cost consumers billions of dollars were kept in place. Complex milk supports and regulations were retained. Peanut farmers are now eligible for direct subsidies.

When passed, the 2002 farm bill was expected to cost taxpayers $190 billion over 10 years. The ultimate cost will be higher if Congress continues its bad habit of passing expensive supplemental farm spending bills.

Welfare for the Well-to-Do

Politicians love to discuss the plight of the small farmer, but they actually give most farm subsidies to the largest farms. For example, the top 10 percent of recipients received 65 percent of all farm subsidies in 2002. Much of the subsidy payout goes to wealthy individuals and companies that clearly do not need taxpayer help, as data from the Environmental Working Group shows (see www.ewg.org). Farm subsidy recipients include Fortune 500 companies, well-off members of Congress, and millionaires such as David Rockefeller and Ted Turner.

USDA figures show that farmers have above-average incomes. The average farm household income was $65,757 in 2002, which is 14 percent higher than the average U.S. household income of $57,852. Even if one accepts the notion that the government should redistribute income from rich to poor, farm subsidies do the reverse.

Also, as there is in virtually all government giveaway programs, there is a great deal of fraud and abuse in farm subsidies. In April 2004 the General Accounting Office reported that millions of dollars of subsidies were going to people who should not receive them due to lax USDA oversight. Some money is going to people who have only a very marginal involvement in farming. In other cases, farm businesses have concocted schemes to get around legal subsidy limits through complex organizational structures. Those abuse problems are a further reason to end farm subsidies.

Repealing Farm Subsidies Is Economically and Politically Feasible

Despite the policy reversals of 2002, efforts to reform farm subsidies will come back on the agenda because of the continuing unfairness and

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distortions that they cause. In addition, global trade agreements may be successful in bringing down farm subsidies both here and abroad.

During the debate over the 2002 farm bill, Sen. Richard Lugar (R-IN) offered an interesting alternative to the current system. His plan would phase out current subsidies and replace them with a voucher system that would promote reliance on insurance and other financial instruments. Although Lugar's proposals did not go far enough, they suggest that with some political courage Congress might take some innovative steps forward.

The experience of New Zealand in eliminating its farm subsidies in the 1980s shows that full subsidy removal makes economic and political sense. In 1984 New Zealand's Labour government ended all farm subsidies in that country. That was a remarkably bold policy 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. Although the plan was initially met with massive protests, the subsidies were quickly ended. New Zealand farming has never been healthier than it is today. The value of farm output 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 debunk that same myth in this country.

Suggested Readings

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

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