31. Agricultural Policy

Congress should

- reauthorize the Federal Agricultural Improvement and Reform (FAIR) Act of 1996 (known as the ''Freedom to Farm Act''), replacing deficiency payments with a fixed schedule of decreasing payments that reach zero in 2008;
- eliminate government crop insurance programs; and
- eliminate government support of producer cartels in the milk, tobacco, peanut, and sugar markets.

Since the New Deal, the government has taken steps to guarantee that prices for crops sold by farmers do not fall below a politically determined level that in most years has been above, and in some years far above, the free-market level. And the government has created explicit producer cartels in milk, peanuts, sugar, and tobacco.

From 1973 to 1996, the principal legislated price for grains and cotton was the "target" price, fixed periodically by Congress. The guarantee to farmers was fulfilled by "deficiency" payments equal to the difference between the target price and the nationwide market price. Payment was made for a quantity administratively assigned to each farmer (and not affected by the quantity the farmer actually harvested). The nationwide price was not adjusted to reflect the circumstances of any individual or area. Thus the growers of wheat in North Dakota, who received an average price of $5.05 per bushel in 1995, got the same payment per bushel as Illinois growers, whose price averaged $3.89. Deficiency payments totaled $30 billion, or $6 billion per year, from 1991 to 1995.

The deficiency payment program created surpluses that were exacerbated by U.S. agricultural export promotion programs. The budgetary costs of both price support and export programs led to continuing pressure in Congress to regulate farm output in order to reduce U.S. production and thereby increase market prices and reduce deficiency payments. In 1990, 58 million acres—about a third of the grain and cotton acreage harvested—were idled under farm programs. Limited reforms of the 1990 Farm Act had, by the end of 1996, reduced idled cropland to 33 million acres, most of them in the Conservation Reserve Program. Farmers can "enroll" in that program land that is considered highly erodible, but is also productive, if they agree to not grow crops on that land for 10 years. Farmers receive rental payments each year in addition to any payments that are received from other programs. Those rental payments have averaged about $50 per acre, totaling $1.7 billion annually during the 1990s.

Agricultural programs transfer less money to farmers, or, more precisely, owners of farm property, who have grown the supported commodities, than consumers pay in taxes and higher prices. The difference between the amount taxpayers and consumers lose and the amount farmers gain is called deadweight loss by economists. Idled acreage is the main contributor to the annual deadweight loss of several billion dollars that commodity support programs cost the United States as a whole. Acreage idling leaves a valuable resource unused and thus has deadweight losses much greater than, for example, those of the peanut program, which reduces output, as would a monopolist. Reduced peanut acreage goes into some other crop and thus provides some valuable output, even if less valuable at the margin than peanuts. Such alternative crop uses are not permitted in most of the grain and cotton set-aside programs, and the idled land generates negligible output. Export programs that provide U.S. commodities at lower prices abroad while making commodities scarcer for U.S. consumers are another source of deadweight losses.

The 1996 Reforms

The Federal Agricultural Improvement and Reform (FAIR) Act of 1996 replaced deficiency payments with a fixed seven-year schedule of payments of $43 billion, starting with $5.7 billion for crops harvested in 1996 (just about the average annual level of 1991–95) and then declining gradually to $4.0 billion in 2002.

Under FAIR Act reforms, each farmer was assigned a share of the national total of the new fixed seven-year subsidies. on the basis of the level of payments to which that farmer had been entitled under the deficiency payment program. Fixed in dollar amount, those payments remove the pressure for supply management to reduce the budget costs of deficiency payments and therefore reduce the deadweight losses associated with holding productive land idle. (And in case the administration was tempted to impose acreage set-asides anyway, the FAIR Act removed the authority of the secretary of agriculture to impose them.) More important for the long term, the FAIR Act's payments were seen as a transitional measure leading to a permanent reduction or even elimination of commodity support programs after 2002.

Retreat from the 1996 Reforms

Commodity prices for the 1996 and 1997 crops remained high enough that deficiency payments would have been quite small if the old program had been continued, so farmers duly pocketed about $11 billion more in Agricultural Market Transition Act (or AMTA, as the reform section of the FAIR Act came to be called) payments than they would have received in deficiency payments.

In 1998, however, commodity markets weakened, as the Congressional Budget Office had predicted they would. In late summer, corn and wheat prices fell even lower than had been forecast. At the same time, areas of the Southeast and Texas suffered from drought, and wheat scab took a heavy toll in North Dakota for the third year in a row. There were calls for congressional hearings on what to do about this "economic emergency."

Notwithstanding claims that farmers were losing their safety net, the pre-1996 marketing-loan program was maintained in the FAIR Act. That program makes farmers eligible for payments whenever market prices in their county fall below a "loan-rate" price. That price is substantially lower than the target price and, unlike the target price, is adjusted for local market conditions. The marketing-loan program has advantages for producers that are not available in the deficiency payment program. A farmer can obtain a payment for the whole quantity produced and has the opportunity to select the day on which he believes the market price is lowest (typically during the harvest period), then collect a "loan-deficiency" payment based on that day's price and hold the grain for sale at a higher market price later in the year. Loan-deficiency payments are less than the target-price deficiency payments would have been, but when they are combined with AMTA payments, the federal government still provides a sizable economic cushion to farmers at taxpayers' expense.

Nonetheless, in September 1998, Congress approved its Agricultural Relief Package. The overall cost of the relief package is $6.6 billion. Together with ongoing AMTA payments, loan-deficiency payments, and

Conservation Reserve Program payments, that relief package brings government payments to farmers in fiscal year 1999 to a total of $14.5 billion, the largest sum ever paid in a year through commodity programs. In October 1999, Congress approved $8.7 billion in relief aid in addition to the AMTA and loan-deficiency payments already approved for fiscal year 2000.

Implications for Reform

The key question left unanswered in the FAIR Act in 1996 was what policies would follow its expiration in 2002. Proponents of reform pushed for, and early versions of the legislation contained, a provision that would have ended all the traditional commodity programs in 2002. But opponents of reform prevailed in their insistence that after 2002, if Congress enacted no further farm legislation, policy would revert to the price-support measures of the late 1940s that establish price-support levels much higher than the target prices that expired in 1995. That strategic maneuver increased the likelihood that Congress will enact a payment or subsidy program of some kind in 2002. But one might still have expected the subsidy level after 2002 to be nearer the $4 billion with which the FAIR Act ends than the $6 billion of 1991–95. And there remained an expectation that payments until 2002 would be limited to those stipulated in the FAIR Act payment schedule.

The actions of Congress and the Clinton administration since July 1998 have dashed those expectations. Those actions signal an increased likelihood, not only that farm commodity programs will continue in 2002, but also that their magnitude will not be significantly cut.

Moreover, it is now evident that earlier reforms of crop disaster assistance programs have not worked out as reformers had hoped. Flood-related and other crop losses resulted in $2.5 billion in U.S. Department of Agriculture budget outlays on disaster assistance for farmers in 1994. Following that episode, Congress made a renewed effort, repeating attempts made periodically since 1980, to get farmers to buy subsidized but less costly crop insurance rather than to rely on ad hoc crop disaster assistance. The events of 1998 reveal that the effort has failed, and again we are spending $2.5 billion in disaster assistance (in addition to several hundred million dollars in annual subsidies for crop insurance purchased by the minority of farmers who bought it).

Although the events of the last two years seem to offer very little positive news to people who favor reform, those who wanted to raise market price-support levels and essentially declare the FAIR Act dead did not prevail against (primarily) Republicans, who wanted to maintain the spirit of the AMTA payments by simply providing a one-time supplement. Maintaining the transition-payment structure may be only thin gruel to offer the forces of reform, but it is better than the alternative of explicitly restoring regulated market prices. And Congress refused to extend the life of the Northeast Dairy Compact run by the six New England states in 1999, letting the changes to the Milk Marketing Order System proposed by Secretary of Agriculture Dan Glickman go into effect.

Future reform efforts, to be debated in the 107th Congress, are likely to address combining crop insurance and income protection against low prices in some form of revenue insurance or other all-risk management tool. The private sector has developed several such tools. Put options that can guarantee their purchaser a selling price for a crop and crop yield options have both already been traded on futures exchanges, with substantial success for the price options (but not because they have been bought by farmers). Experiments are in progress with revenue insurance and, in Canada, even a net-income insurance program.

The difficulty with all private-sector approaches is that farmers have to pay for them. Farmers would prefer to receive even an inferior risk-management tool provided free of charge (or with a subsidy equal to the billions they now receive). Although many proposals and pilot programs have been tried since 1980, all have run afoul of that problem. It is a political problem, in the sense that farm commodity interests seem to have effectively acquired a proprietary right to about $10 billion of each year's federal budget (including commodity payments, subsidies for crop insurance and disaster payments, and Conservation Reserve Program rental payments).

Indeed, agriculture gets as much in real terms from commodity programs now as in the New Deal of the 1930s or the New Frontier of the 1960s. In the 1930s farm people were 25 percent of the population and relatively poor, with the average farm income about half the U.S. average. Today farm people are 2 percent of the population and relatively well off. According to USDA's estimates, the average farm household in 1997 had an income of $52,350 compared with $49,700 for the average U.S. household.

Agricultural programs promote neither market efficiency nor equity. They should be terminated.

Suggested Readings

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