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Farm Subsidies at Record Levels As Congress Considers New Farm Bill

by Chris Edwards and Tad DeHaven

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After six decades of rising subsidy levels and expansive regulatory controls, it appeared that Washington's role in agriculture would be reduced with the enactment of the 1996 Federal Agriculture Improvement and Reform Act. That act aimed to decrease subsidies over seven years and to move farming toward greater reliance on market supply and demand.

Unfortunately, that promise collapsed in an orgy of supplemental spending bills that have increased federal farm subsidies to all-time highs. Total direct subsidy payments to farmers have soared to more than $20 billion per year the past three years, up from an average of $9 billion per year in the early 1990s.

There is little justification for the special hold that the agricultural industry has on taxpayers' wallets. Other industries, such as the high-tech industry, are also risky and subject to large price swings but do not receive large-scale government subsidies. Moreover, farm households have higher incomes, on average, than do nonfarm U.S. households, and subsidies are skewed toward the largest and wealthiest farm businesses. Farm subsidies also subvert their own goal: farmers demand subsidies because of low market prices for their products, but subsidies themselves contribute to lower prices.

As Congress works to reauthorize farm programs, it threatens to move further away from reform by institutionalizing high levels of farm welfare. Instead, Congress should push the farm sector back into the market economy by repealing federal farm subsidies.

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Federal farm subsidies have exploded during the past three years.

Introduction

On April 5, 1996, the *New York Times* ran the headline: "Clinton Signs Farm Bill Ending Subsidies."[1] After more than 60 years of government intervention in the agricultural sector, it appeared that Washington's role would be reduced with the enactment of the Federal Agriculture Improvement and Reform Act of 1996, also called the Freedom to Farm Act.[2] The law aimed to reduce crop price manipulations and subsidy levels over seven years and move the farming community toward greater reliance on market supply and demand.

Unfortunately, that promise collapsed in an orgy of supplemental spending bills that have increased federal farm subsidies to all-time highs. Total direct subsidy payments to farmers have soared to more than $20 billion per year the past three years, up from an average of $9 billion per year in the early 1990s. Congress has passed huge supplemental farm bills every year since 1998; the most recent bill, passed in July, has a taxpayer price tag of $5.5 billion. As Congress works to reauthorize farm programs, it appears set to move further away from reform.

In addition to the fact that high and rising farm subsidies are costly to taxpayers, they also create vicious cycles in agricultural markets. In particular, subsidies induce overproduction, which pushes down prices and creates demands for further subsidies. Farmers have come to assume that regular subsidies and special emergency bailouts will keep flowing, and thus they continue producing in the face of long-term declines in commodity prices.[3]

This paper documents the explosion of farm subsidies that has occurred in recent years, discusses the background to the FAIR Act, assesses the law's major policy changes, and examines who receives the bulk of federal subsidy payments.

The Farm Subsidy Explosion

Federal farm subsidies have exploded during the past three years, reaching $22.9 billion in 2000 and a projected $20.4 billion in 2001 (Figure 1). Total agricultural spending, including both direct subsidy payments and expenditures of other Department of Agriculture farm programs, was $37 billion in fiscal 2000.[4] This paper examines just the direct subsidy payments.

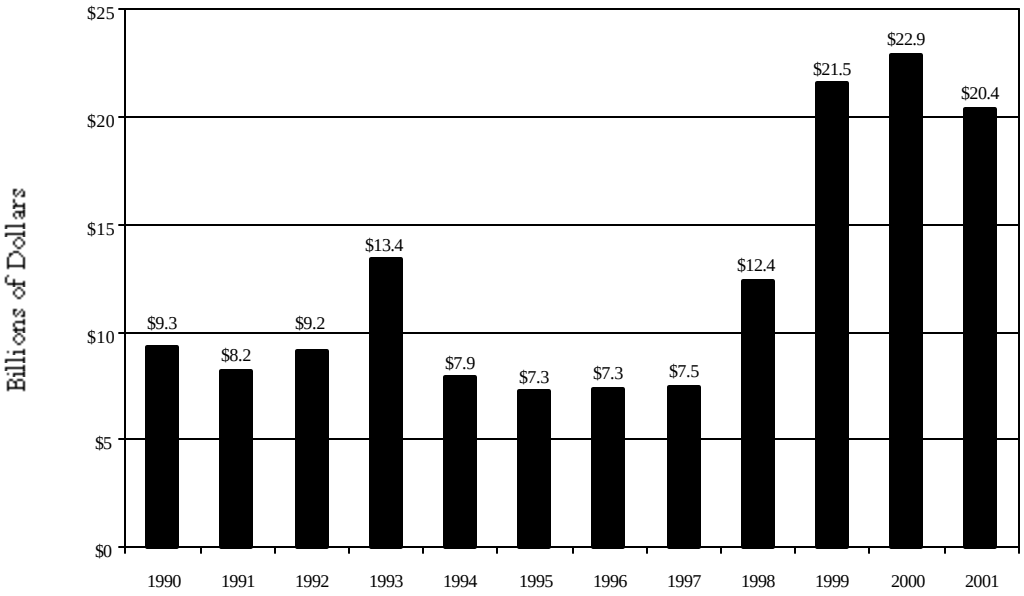
The 1996 farm reforms had aimed to gradually reduce subsidies, but market prices for many crops began to fall in 1998 and Congress responded with the first of many emergency spending bills to provide additional cash to farmers. President Bush signed the most recent emergency subsidy bill, which has a cost of $5.5 billion to federal taxpayers, into law in July.

When the FAIR Act was passed, the Congressional Budget Office projected that $47 billion would be spent on direct farm subsidies during its seven-year authorization.[5] Instead, direct farm subsidies will end up costing $118 billion, including projected spending for fiscal 2002, over seven years.[6] So instead of marking a scaling down of federal farm subsidies, the FAIR Act launched an era of rising farm welfare spending, and passing farm emergency bills became routine for Congress.

When most people think of farm "emergencies," they think of droughts or other natural disasters. But 80 percent of the emergency funds dished out to farmers between 1998 and 2000 were intended simply to boost farm incomes when prices were low, not to be aid in response to natural disasters.[7] It is very unusual for the federal government to step in and compensate private industries simply for swings in prices. Other industries, such as the high-tech, energy, and mining industries, experience wide fluctuations in prices but generally do not receive federal bailouts year after year.

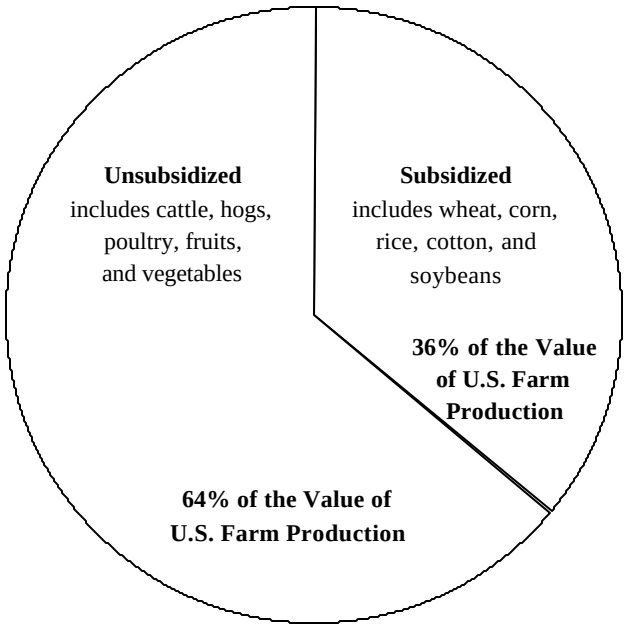
Within the agricultural sector, it is only a minority of farmers that are singled out for both regular subsidies and emergency bailouts. Farm products that receive large-scale subsidies account for just 36 percent of U.S. agricultural production, while 64 per-

Figure 1
Direct Government Payments to Farmers, 1990–2001



Source: U.S. Department of Agriculture, Economic Research Service, www.ers.usda.gov/data.
Note: Years are calendar years. Figure for 2001 is estimated.

Figure 2
Share of U.S. Farm Output by Subsidized and Unsubsidized Products, 1999



Source: Geoffrey S. Becker, "RS20848: Farm Community Programs: A Short Primer," Congressional Research Service, March 19, 2001. Statistics are for 1999.

cent of farm production is not on the subsidy gravy train (Figure 2).[8] In fact, more than 90 percent of direct federal subsidies go to farmers that raise just five crops—wheat, corn, soybeans, rice, and cotton.[9]

The Structure of Farm Subsidies and the 1996 Reforms

Large-scale federal manipulations of agricultural markets began as temporary measures under the New Deal in the 1930s.[10] Like many "temporary" measures introduced in response to crises, farm programs have proved to be long lasting and have principally taken the form of price supports and output controls. Providing federal subsidies in the form of price supports creates the chronic problem of crop overproduction, thus necessitating other federal programs to place controls on output.

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Problems Precipitating the 1996 Reforms

Before 1996 the main farm subsidy program paid "deficiency" payments based on legislated price support levels called target prices. Eligible commodities included major field crops such as wheat, corn, and rice. Deficiency payments were based on the difference between the national average market price and the national target price for a crop. This meant that even though local market prices varied between North Dakota and Illinois, for example, farmers with the same acreage received the same subsidy.[11]

Farmers were paid deficiency payments for their base acreage in each particular crop. So farmers were stuck producing certain crops if they wanted to get their full subsidy. To stem overproduction, the government would pay farmers to set aside land in an acreage reduction program. This meant that if farmers wanted federal payments they were obligated to not use all their land.

The resulting absence of planting flexibility and large-scale land idling created large deadweight economic losses. The most efficient selection of crops was not being planted, and much good farmland was going unused, thus creating large output losses. Those losses provided an important justification for the 1996 reform legislation.[12]

In 1995 a combination of high commodity prices and optimism about export markets sparked the possibility of serious reform.[13] High prices meant that price support payments under the existing system were not expected to be large in the next few years. In addition, the Republican takeover of Congress in 1994 created political support for reducing government intervention in the farm sector. Those factors culminated in the passage in 1996 of the FAIR Act, which restructured some of the main farm subsidy programs under a seven-year authorization.

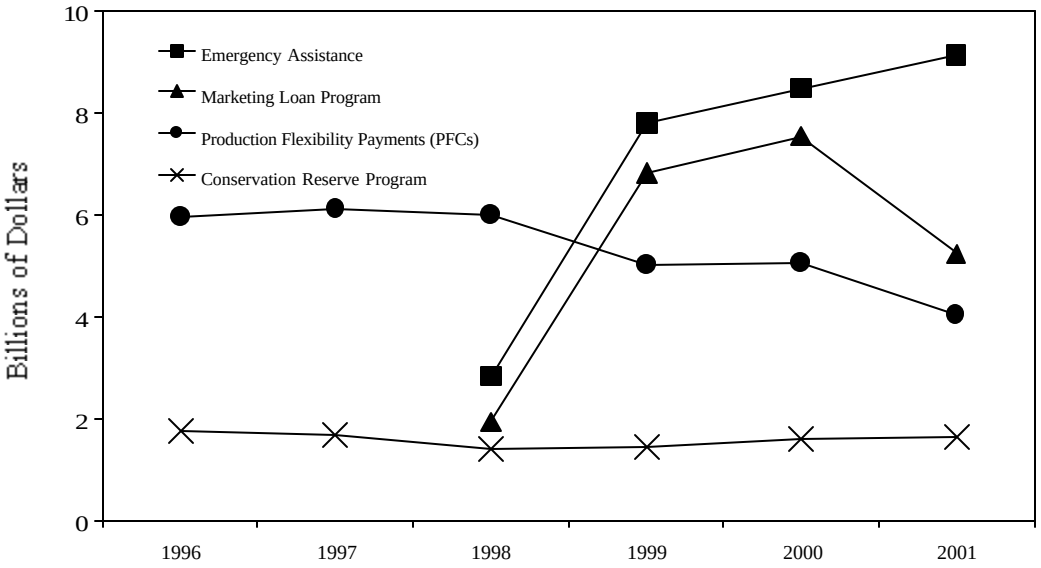
Transition Payments Replace Price Supports in 1996

The centerpiece of the 1996 farm law was the Agricultural Market Transition Act. The word "transition" implied that farmers would be weaned from 60 years of government intervention and increase their reliance on market supply and demand. The AMTA replaced 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 (Figure 3).

The AMTA affected farmers of "program" commodities, which include corn, wheat, grain sorghum, barley, oats, cotton, and rice. For those crops, deficiency payments, target prices, acreage reduction programs, and government stockpiles were eliminated. Farmers of those crops were allowed to plant any crop they chose and their subsidy payments would be at a fixed dollar level uncoupled from their planting decisions.[14] The introduction of greater planting choice gave the 1996 bill its informal name, Freedom to Farm Act.

The new rules under the 1996 law led to significant reductions in deadweight losses to the economy. The reduction in land idling created by the 1996 law produced an estimat-

Figure 3
Direct Farm Subsidies by Federal Program, 1996–2001



Source: U.S. Department of Agriculture, Economic Research Service, www.ers.usda.gov/briefing/farmincome/data/GPT7.htm.
Note: Years are calendar years. Values for 2001 are estimated.

ed efficiency gain of about $4 billion per year, according to University of Maryland professor Bruce Gardner.[15] By 1999, 20 to 30 million acres that would have been wastefully idled under prior rules were in production.[16] The greater planting choice under the 1996 law allowed farmers to respond to changing market conditions. For example, since 1996 about 12 million acres of soybeans have been added while wheat acreage has been reduced by about 10 million acres.[17] New planting flexibility has allowed farmers to change crops in response to changing prices and climate conditions.[18]

Nonetheless, although the new PFC subsidy payments are formally independent of production, they still encourage oversupply. For example, PFC subsidies increase farmers' wealth and income, thus making it easier for them to get loans for expansion. Farmers are more willing to expand production and take on more debt because guaranteed government payments reduce the risk of not earning a decent return on investment.[19] Oversupply incentives also continue under other programs not reformed in 1996, such as the marketing loan program discussed below.

Aside from its economic effects, the new subsidy regime has proven to be very costly to taxpayers. With high prices in 1996, price support payments under the prior law were expected to be low. Thus supporters of big subsidies hoped that the new fixed PFC payments would boost subsidy levels at least in the short term. Prices did remain high the first two years after the 1996 law was enacted, and farmers pocketed $11 billion more than they would have under the old price support system.[20]

But as commodity prices began to slide in 1998, Congress quickly threw in the towel on the fixed subsidy schedule agreed to in 1996 and passed the first of four large emergency supplemental appropriations. The overly generous payments of the first couple of years of the FAIR Act unfortunately whetted the appetite of farmers for federal subsidies. John A. Schnittker, former assistant secretary of agriculture, noted, "The farm lobbies and Congress

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have insisted that the farm income threshold established in 1996 and 1997 must be matched year after year, whatever the cost."[21]

Marketing Loan Program

The marketing loan program has been a key part of federal farm subsidies since the New Deal. This program was designed to provide short-term financing to pay farm expenses before crops were sold, but it has morphed into simply another multi-billion-dollar subsidy program.[22] Eligible crops include all of those eligible to receive PFC payments (corn, wheat, cotton, rice, sorghum, oats, barley) plus soybeans.

Originally, farmers would repay marketing loans plus interest after crops were sold in the market. However, the government set up marketing loans to be "nonrecourse" loans, so farmers can default on the loans without penalty.[23] When prices were high, farmers would sell their crops on the market and repay the government. When prices were low, farmers were allowed to simply keep the loan without any "recourse," except to forfeit their low-value crop to the government. Taxpayers were stuck paying both the loan costs and the costs of maintaining government commodity stockpiles.[24]

Changes to the marketing loan program under the FAIR Act removed the need for farmers to forfeit crops to the government. Subsidies are now delivered through marketing loan gains and loan deficiency payments. In the first case, farmers put some of their crop in storage as collateral and receive a loan at a certain per unit rate. But farmers are allowed to repay loans at lower government loan repayment rates. The difference between the original loan rate and the lower repayment rate is the marketing loan gain, which is a direct subsidy to farmers and a direct cost to taxpayers.[25]

The second new option, loan deficiency payments (LDPs), reaches the same costly result in a less complex way. LDPs allow farmers to bypass the loan process and receive a subsidy payment, which represents the marketing loan gain, without actually dealing with the loan process. Farmers can maximize their gains by taking loan subsidies when market prices are low and selling the crops later on when market prices are higher.[26]

The marketing loan program is essentially a large-scale price support program that survived the FAIR Act reforms. The program's cost has exploded to more than $5 billion per year during the past three years (Figure 3).[27] In this year's debate over the new farm bill, there are demands that Congress add yet another price support or "counter-cyclical" program to provide even larger subsidies when prices are low. That seems entirely duplicative of the marketing loan program.

In addition to the taxpayer costs, marketing loan subsidies create incentives for excessive crop production. In 2000 an estimated 4 to 5 million additional acres were planted in the eight crops covered by the marketing loan program because of the distorted incentives that program creates.[28] Another study estimated that soybean plantings are 1 million acres higher because of distortions created under the marketing loan program.[29] In general, with lower prices in recent years, one would expect farmers to reduce production, but that has not occurred partly because of the subsidies.[30]

The Conservation Reserve Program

The other major farm program that provides direct subsidies is the conservation reserve program (CRP). The CRP was created in 1985 to idle millions of acres of environmentally sensitive farmland. Under CRP, farmers are paid on a per acre basis to not grow crops for a fixed period of 10 to 15 years. In addition, the government pays farmers half of the cost of growing ground cover, such as grass or trees, on the retired acres.[31]

The cost of paying farmers to not farm has averaged about $1.5 billion per year. As an added unfair blow to taxpayers, almost one-third of land idled under the CRP is owned by retired farmers who don't even have to work to get the subsidies.[32]

Like the other farm subsidy programs, the CRP creates deadweight losses, or economic

waste, by keeping productive land out of use. Before 1996 land-idling programs left up to 58 million acres unplanted in some years.[33] But even after the 1996 reforms, 33 million acres still remain idled under the CRP today.[34]

The CRP is an attempt to respond to environmental concerns about overproduction on marginal farmland. A much simpler and more effective way to reduce overproduction would be to simply eliminate all government farm subsidies. U.S. agricultural policy creates endless vicious circles by encouraging overproduction with subsidies and then paying more subsidies to reduce overproduction and to shore up farmers' incomes as prices fall. Returning U.S. agriculture to reliance on market incentives is the way out of these counterproductive policy circles.

Where Does the Money Go?

Recipients of Farm Subsidies

There are about 2 million farms in the United States, based on the government definition of "farm" as any place with farm sales of more than $1,000. But there are fewer than 1 million farms with sales of more than $10,000.[35] When farm programs began in the 1930s, there were 7 million farms, and 25 percent of the population lived on farms.[36] Today just 2 percent of the population live on farms.[37]

These figures indicate that the federal government channels a huge chunk of taxpayer money, more than $20 billion per year, to a very small segment of the population. Indeed, only 42 percent of farmers receive direct government subsidies.[38] And the producers of just five crops—wheat, corn, soybeans, rice, and cotton—have somehow secured a direct pipeline to more than 90 percent of federal farm handouts.[39] Other farmers, such as sugar producers, do not grab taxpayer dollars directly but instead impose billions of dollars of costs on consumers with supply restrictions that push up prices.

Federal subsidies are concentrated on just a few hundred thousand large farms that have high incomes. In 1999 the largest 7 percent of farms received 45 percent of all government subsidy payments.[40] By contrast, the 76 percent of farms that are classified as small received just 14 percent of subsidies.[41] One study covering 1996 to 1998 found that 61 percent of subsidies went to just 144,000 large farms.[42] So while politicians love to discuss the plight of the small farmer, they actually dole out the bulk of subsidies to the largest farms (Figure 4).

Note also that it is landowners, not farm workers or operators, who generally benefit from subsidies. That is because farm subsidies largely get capitalized in higher farm and land values.[43] That has created another vicious policy circle as high farm prices caused partly by subsidies make it difficult for young people to break into farming. Of course, the federal government has responded to this problem it helped create by setting up new programs to help young farmers afford to farm.[44]

Federal Welfare for the Well-to-Do

Certainly redistributing more than $20 billion every year from taxpayers to just a few hundred thousand businesses in one particular industry is not an appropriate government function. Statistics indicate that farmers are not even in particular need of this government largesse. Consider farm wealth levels. Department of Agriculture data show that the average net worth of farm households was $564,000 in 1999, compared to $283,000 for nonfarm households in 1998 (the most recent year for which data are available).[45] The figures also show that the net worth of farm households increased faster than that of nonfarm households during the 1990s.

Statistics on household income reveal a similar pattern. For family farms, average household income was $64,347 in 1999, 17 percent higher than the $54,842 average for all U.S. nonfarm households.[46] By contrast, when large-scale federal farm subsidies began in the 1930s, farmers' incomes were only half of the national average.[47] Although farm commodity prices have fallen during the past six decades,

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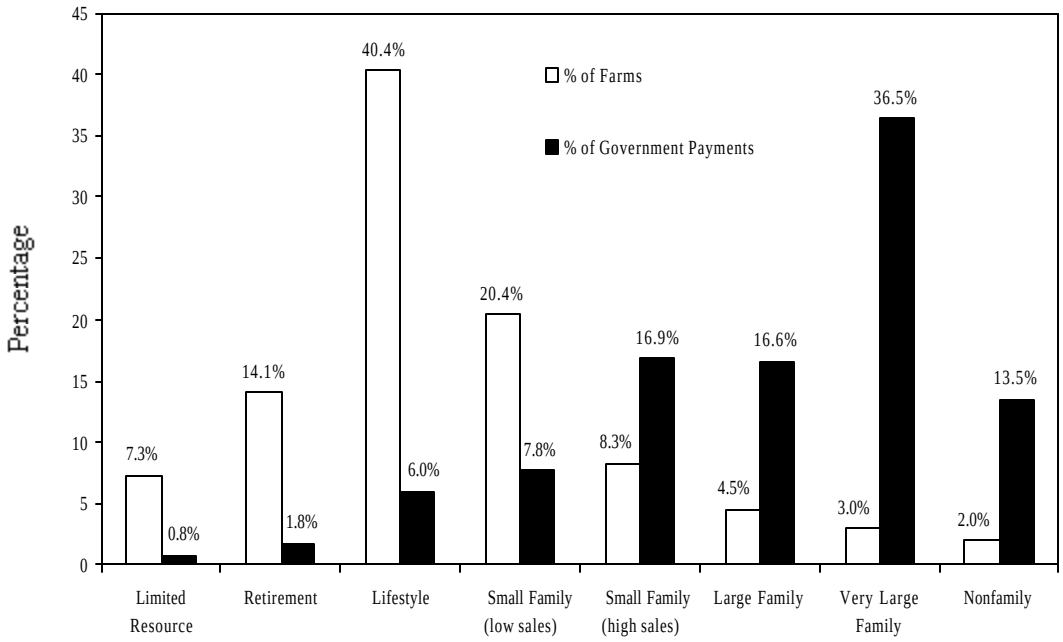
Figure 4
Share of Farms and Government Payments by Farm Type, 1998



Source: Robert A. Hoppe, ed., *Structural and Financial Characteristics of U.S. Farms: 2001 Family Farm Report*, U.S. Department of Agriculture, Economics Research Service, Agriculture Information Bulletin no. 768, May 2001, p. iv.

Nonfarm income is a huge stabilizing force for farm household finances today.

farm production costs have fallen even faster as productivity has risen, with the result that farmers' incomes have continued to rise.[48] Farm households have the additional advantage that the cost of living in rural areas is lower than in the rest of the country.

Another measure of the agricultural community's well-being is solvency. The Department of Agriculture found that the rate at which farms were going out of business in the 1990s was between 2 and 3 percent per year.[49] By contrast, the rate of failure for nonfarm businesses was between 13 and 16 percent.

More evidence points to the sound financial condition of most farmers. The Department of Agriculture classifies a farm's finances as favorable if it has a positive net farm income and a low debt/asset ratio. A farm is classified as vulnerable if it has negative net farm income and a high debt/asset ratio. Fifty-nine percent of farms are in the favorable category, and only 5 percent are categorized as vulnerable.[50]

Even farms that face a few years of low crop prices may not be in financial trouble because many farm households earn the bulk of their income from nonfarm sources. Nonfarm income is a huge stabilizing force for farm household finances today.[51] Most farm families have at least one spouse who works off the farm. Government figures show that in 1999 only 38 percent of farm households considered farming their primary occupation, and a majority of income for even those households came from nonfarm sources.[52]

Those statistics indicate that the farming community is in relatively good financial condition. There is little evidence to suggest that the agricultural sector is in a crisis that requires a perpetual taxpayer bailout of more than $20 billion per year.

Outlook and Conclusion

Farm subsidies not only impose huge costs on taxpayers; they also keep the agricultural sector from adjusting to continually changing economic realities. Subsidies aim primarily to shield farmers from low commodity prices. But real prices of major farm commodities have been falling for the past 50 years because of advances in technology and economies of scale.[53] That trend is expected to continue.[54] Farms that cannot adjust should exit the industry.

Congress, which has handed out more than $100 billion in subsidies since passing the 1996 reform bill, now has another chance to enact a real reform of farm programs. Unfortunately, the House of Representatives' version of the new farm bill goes in the opposite direction. Its projected cost would be $170 billion over the next 10 years, or $74 billion above 10-year baseline spending projections.[55]

There would be more money all around under the House bill. PFC payments would be extended with payment rates increased and new crops added to the dole. The counter-cyclical marketing loan program would be retained with more commodities eligible for subsidies. And a new counter-cyclical subsidy program, reminiscent of the price supports in place before 1996, has been added to offset low prices.

On the Senate side, Agriculture Committee chairman Tom Harkin (D-Iowa) and ranking member Richard Lugar (R-Ind.) have expressed concern about the House bill. Senator Harkin would like to see more money directed toward conservation programs and away from income supports. So disagreement on farm subsidies in Congress is not about how much taxpayer money to spend but about how to dish out subsidies.

Ranking House Agriculture Committee member Charlie Stenholm (D-Tex.) proclaimed that the proposed legislation was "a good deal for agriculture and a good deal for the taxpayer."[56] It is not a good deal for U.S. agricultural production to be distorted by such large subsidies, and it is certainly not a good deal for U.S. taxpayers who foot the bill. After six decades of government intervention and rising subsidies, it is time for Congress to phase out the farm welfare state.

It is time for Congress to phase out the farm welfare state.

Notes

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2. Public Law 104–107 (April 4, 1996).

3. Paul C. Westcott and C. Edwin Young, "U.S. Farm Program Benefits: Links to Planting Decisions and Agricultural Markets," U.S. Department of Agriculture *Agricultural Outlook,* October 2000, p. 13.

4. Office of Management and Budget, *Mid-Session Review FY 2002* (Washington: Government Printing Office, August 22, 2001). This is the total spending in the agriculture budget function and does not include nonfarm Department of Agriculture programs such as food stamps.

5. Cited in David Orden, Robert Paarlberg, and Terry Roe, *Policy Reform in American Agriculture: Analysis and Prognosis* (Chicago: University of Chicago Press, 1999), p. 152.

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7. Commission on 21st Century Production Agriculture, *Directions for Future Farm Policy: The Role of Government in Support of Production Agriculture* (Washington: U.S. Department of Agriculture, January 2001), chap. 1, Minority View, pp. 14–15, http://www.usda.gov/oce/21st-century/report. pdf.

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9. U.S. General Accounting Office (GAO), "Farm Programs: Information on Recipients of Federal Payments," GAO-01-606, June 2001, p. 22.

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15. Gardner, "Agricultural Policy."

16. Gardner, "Agricultural Relief Legislation in 1998," p. 34.

17. Bruce L. Gardner, Statement before the House Budget Committee, 107th Cong., 1st sess., March 14, 2001, http://www.house.gov/budget/hearings/gardnerstmnt.pdf.

18. Vincent H. Smith and Joseph W. Glauber, "The Effects of the 1996 Farm Bill on Feed and Food Grains," Trade Research Center Policy Issues Paper no. 3, September 1997, p. 16.

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20. Gardner, "Agricultural Relief Legislation in 1998," p. 32.

21. Schnittker, p. 3.

22. Commission on 21st Century Production Agriculture, chap. 1, p. 9.

23. U.S. Department of Agriculture, Economic Research Service, "Farm and Commodity Policy: Basic Mechanisms of Programs," Briefing Room, www.ers.usda.gov/briefing/FarmPolicy/malp.htm.

24. Ibid.

25. U.S. Department of Agriculture, Economic Research Service, "Farm and Commodity Policy: Questions and Answers," Briefing Room, www.ers.usda.gov/briefing/FarmPolicy/questions.

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27. U.S. Department of Agriculture, Economic Research Service, "Farm Income and Costs: Farm Income Forecasts," Briefing Room, http://www.ers.usda.gov/Briefing/FarmIncome/Data/GP_T7.htm.

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30. Bruce L. Gardner, "The Farm Economy Today," Statement before the House Committee on Agriculture, 107th Cong., 1st sess., February 14, 2001, http://agriculture.house.gov/hearings/h10214w1.htm.

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33. Gardner, "Agricultural Relief Legislation in 1998," p. 31.

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36. Commission on 21st Century Production Agriculture, Introduction, p. 2.

37. Commission on 21st Century Production Agriculture, chap. 1, Minority View, p. 22.

38. Mitchell Morehart, James Ryan, and Robert Green, "Farm Income and Finance: The Importance of Government Payments," Paper presented at Agricultural Outlook Forum 2001, sponsored by U.S. Department of Agriculture, Arlington, Virginia, February 22, 2001, www.usda.gov/oce/waob/oc2001/speeches/morehart.PDF.

39. Figure based on data from GAO, p. 22; and Hoppe, p. 71.

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47. Orden, Paarlberg, and Roe, p. 33.

48. Ibid., pp. 26, 44.

49. Morehart et al., p. 18.

50. Hoppe, p. 52. High debt/asset ratios are above 40 percent, low ratios are below 40 percent.

51. Gardner, "The Farm Economy Today."

52, Morehart et al., p. 17.

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54. Ibid., p. 204. See also Kevin McNew and John E. Frydenlund, "Bleak Harvest: Will Congress Renege on 1996 'Freedom to Farm' Reforms?" Heritage Foundation, Heritage Lecture no. 644, August 6, 1999, p. 3.

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