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CENTER FOR TRADE POLICY STUDIES

# *Ripe for Reform*

## *Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers*

**by Daniel Griswold, Stephen Slivinski, and Christopher Preble**

## Executive Summary


U.S. agricultural policies have remained fundamentally unchanged since the 1930s. Today the U.S. government continues to subsidize certain farm commodities through direct price supports and tariff rate quotas that limit imports. Americans pay a high price for this ongoing government intervention in agricultural markets.

Reducing farm subsidies and trade barriers would benefit Americans in six important ways. One, reform would deliver lower food prices to tens of millions of American households, especially low-income families that spend a large share of their income on food. Last year U.S. farm programs transferred $16.2 billion from U.S. food consumers to producers.

Two, reform would lower costs for U.S. industries, such as confectioners and other food processors, that use agricultural commodities in their final products and would promote trade negotiations to open markets abroad for U.S. exporters.

Three, reducing farm subsidies would save U.S. taxpayers tens of billions of dollars during the next decade. Many of those subsidy payments currently go to large farms and agribusinesses, not to smaller "family farms."

Four, agricultural reform would enhance the environment by reducing the amount of top soil lost and damaging fertilizers and pesticides used by American farmers. It would liberate farmland to be used for reforestation, recreation, and other more environmentally friendly purposes.

Five, agricultural reform would benefit farmers themselves by promoting production of crops that are in demand by consumers. Farm reform would stimulate innovation and productivity gains on the farm and promote more economic diversity and dynamism in rural communities.

Six, lower farm trade barriers would raise incomes of farmers in poor countries, reduce global poverty, create a more hospitable climate abroad for U.S. foreign policy, and enhance U.S. security.

Congress and the president should seize the opportunity presented by the Doha Round negotiations of the World Trade Organization and the next reauthorization of the farm bill to fundamentally reform U.S. agricultural policy.


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**Farmers in OECD member countries received $279 billion in production-related support from their governments in 2004. That support represented 30 percent of total farm income.**

## The History and Scope of Government Intervention in Agriculture

Agricultural policies in the United States have remained fundamentally unchanged for nearly three-quarters of a century. Despite the transformation of the American and global economies during that time, the U.S. government continues to subsidize the production of certain crops and restrict imports to maintain artificially high domestic prices. Competition, integration, and innovation define a growing share of the global economy today, but large sectors of America's farm economy have been effectively shielded from those forces of change.

Congress enacted the first Agricultural Adjustment Act in 1933, in the depths of the Great Depression. Since then, in various ways and to varying degrees, Congress has sought to raise farm income through a combination of commodity-specific price supports and supply controls, mainly import restrictions. In the 1980s and 1990s, Congress attempted to "decouple" government payments and farm production to reduce market distortions, culminating in the more market-oriented farm bill of 1996, the Federal Agricultural Improvement and Reform Act (a.k.a. the Freedom to Farm Act).

Confronted with slumping global commodity prices in the late 1990s, Congress retreated from any semblance of market reform by passing a series of supplemental "emergency" farm bills that dramatically increased subsidies and price supports over the baselines that had been established by the 1996 farm bill. Congress codified the higher level of farm spending in the 2002 Farm Security and Rural Investment Act, which also introduced countercyclical payments triggered by lower prices based on historical, rather than current, production levels.[1]

In the United States today, the federal government subsidizes and protects the production of rice, milk, sugar, cotton, peanuts, tobacco, and other commodities. The main means of restricting import competition is tariff rate quotas, which allow a limited amount of a commodity to be imported from certain foreign producers at low or zero tariffs while applying a prohibitively high tariff rate to any imports above the quota. Tariff rate quotas drive domestic prices above world market prices by limiting domestic supply of the protected commodity. Although direct subsidy payments are the most visible form of government intervention in agriculture, trade barriers are far more disruptive of global markets. According to the World Bank, "Border barriers are the major tool of [agricultural] protection and account for about 70 percent of total protection in OECD countries."[2]

Intervention in global agricultural markets is widespread and costly. According to a recent report by the Organization for Economic Cooperation and Development, the think tank in Geneva sponsored by rich-country governments, farmers in OECD member countries received $279 billion in production-related support from their governments in 2004. That support represented 30 percent of total farm

**Table 1**
**Government Support for Farm Production in 2004**

| | Total Producer Support* | Support as a Share of Farm Income |
|---|---|---|
| European Union | $133.4 | 33% |
| Japan | $48.7 | 56% |
| **United States** | **$46.5** | **18%** |
| South Korea | $19.8 | 63% |
| Turkey | $11.6 | 27% |
| Switzerland | $5.8 | 68% |
| Canada | $5.7 | 21% |
| Mexico | $5.4 | 17% |
| Australia | $1.1 | 4% |
| New Zealand | $0.3 | 3% |
| **OECD Total** | **$279.5** | **30%** |

Source: OECD.
*Producers support estimate, billion U.S. dollars.

income.[3] In effect, almost one-third of farm income in OECD countries comes from government rather than markets. In the United States, 18 percent of farm income last year came through government support, somewhat below the OECD average. In Canada, the comparable figure was 21 percent, in the European Union 33 percent, in Japan 56 percent, and in South Korea 63 percent. In contrast, government support as a share of farm income was only 4 percent in Australia and 3 percent in New Zealand.[4] In total, U.S. farmers received $46.5 billion in 2004 in production support from government. (See Table 1.)

Rice, sugar, and milk are the most heavily supported commodities in the United States and most other advanced economies. In OECD countries, government support accounts for 80 percent of income for rice farmers, 54 percent for sugar farmers, and 40 percent for dairy farmers.[5] Government policies of direct taxpayer subsidies, barriers to imports, and (primarily in the European Union) export subsidies act together to depress global farm prices, thus distorting markets even in lower-income countries where agricultural production is relatively unsubsidized.

For most of the post–World War II period, agriculture was exempted from the liberalizing trade rules established through the General Agreement on Tariffs and Trade. While tariffs on manufactured goods have declined steadily among GATT members in the past half century, they have remained stubbornly high on farm goods. The Uruguay Round Agreements of 1994 established modest limits on farm subsidies and barriers and at last brought agriculture under the framework of the GATT/World Trade Organization process, but any movement toward comprehensive farm trade liberalization since then has stalled.

Policymakers in Washington will soon face growing pressure to reform U.S. agricultural policy. Success of the current round of negotiations in the WTO, the Doha Development Round, will hinge on progress in reducing agricultural trade barriers. A critical ministerial meeting in Hong Kong in December 2005 will determine how serious WTO members are about reducing those barriers. In two recent WTO cases, U.S. cotton subsidies and the European Union's sugar program were found in violation of rules all members agreed to follow in the Uruguay Round Agreements, with implications for other rich-country farm programs. Meanwhile, the U.S. farm bill will come up for renewal in 2006 or 2007, forcing Congress to reexamine its own trade barriers in light of global trade negotiations as well as the substantial budgetary costs of U.S. farm programs.

This study examines the full price Americans pay for current U.S. agricultural policies and the potential benefits of reform. The benefits of reducing and eliminating farm subsidies and barriers—to American consumers, businesses, taxpayers, the environment, many farmers themselves, and U.S. foreign policy—provide Congress and the administration with six good reasons to move U.S. farm policy toward a free and open market.

## Reason no. 1: Lower Food Prices for American Families

The first and foremost reason to curtail U.S. farm subsidies and protection would be to benefit American consumers. By protecting the U.S. market from global competition, U.S. farm programs raise the cost of food and with it the overall cost of living for more than 100 million American households. Those programs drive up domestic prices by artificially restricting the supply of goods or commodities available in the U.S. market.

For millions of American families, U.S. farm programs mean higher prices for milk, sugar, peanuts, rice, cotton, and the products that contain them. According to the recent study by the OECD, higher domestic food prices caused by U.S. farm programs had the effect in 2004 of transferring $16.2 billion from American consumers to domestic agricultural producers.[6] That amounts to an annual "food tax" per U.S. household of $146, collected whenever we shop at a grocery store or dine at

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a restaurant. That consumer tax is paid over and above what we pay in higher direct taxes to farmers through the federal budget. (For the budgetary impact, see Reason no. 3 below.)

The U.S. sugar program provides a textbook example of the negative impact on consumers. Because of subsidies and protection for the U.S. sugar industry, American consumers pay more than double the world price for sugar. The sugar program guarantees domestic producers a price of 22.9 cents per pound for beet sugar and 18 cents for cane sugar, while the world spot price for raw cane sugar is currently about 10 cents per pound.[7] A study by the General Accounting Office in 2000 estimated that Americans paid an extra $1.9 billion a year for sugar because of U.S.-imposed import quotas, with about half of that cost borne by household consumers.[8] (For the cost to sugar-consuming industries, see Reason no. 2 below.)

American families also pay more for their milk, butter, and cheese, thanks to federal dairy price supports and trade barriers. The federal government administers a Byzantine system of domestic price supports, marketing orders, import controls, export subsidies, and domestic and international giveaway programs. As the U.S. International Trade Commission staff concluded in its biannual study of the cost of significant U.S. import barriers, "A consequence of government intervention has been to raise U.S. domestic [dairy] prices substantially above world market prices."[9] According to the USITC study, between 2000 and 2002 the average U.S. domestic price of nonfat dry milk was 23 percent higher than the world price, U.S. cheese prices were 37 percent higher, and the price of U.S. butter was more than double the world price.[10] U.S. trade policies also drive up domestic prices for peanuts, cotton, beef, orange juice, canned tuna, and other products.[11]

Consumers also pay higher prices because of "tariff escalation," in which nations with more advanced economies impose on goods escalating tariffs that are based on the amount of processing. Those tariffs offer more protection for jobs in the higher value-added stages of production. The result for consumers is even higher prices up and down the food chain. Lower prices for protected farm commodities would lead to lower prices for processed foods that use those commodities as inputs. A lower domestic price for sugar, for example, would put downward pressure on the prices we pay for candy, soft drinks, bakery goods, and other sugar-containing products.

The burden of higher domestic food costs falls disproportionately on poor households. As the OECD concluded in its recent study, those higher prices "can bear heavily on low-income consumer households, for whom food constitutes a larger share of their total expenditures."[12] In that way, U.S. trade barriers against farm products act as a regressive tax. Higher prices at the grocery store negate some or all of the income support the government seeks to deliver to low-income households through such programs as food stamps.

If U.S. farm subsidies and trade barriers were significantly reduced, tens of millions of American households would enjoy higher real incomes. They could spend less on food and would have more left over to save or spend on other goods and services.

## Reason no. 2: Lower Costs and Higher Exports for U.S. Companies and Their Workers

A second good reason to fundamentally reform U.S. farm programs would be to benefit U.S. manufacturers and other producers who export their goods to the rest of the world or who use agricultural inputs to produce their final products for consumers at home and abroad. Farm reform would benefit Americans not only as consumers but as investors and workers.

When government intervention raises the domestic price for raw materials and other commodities, it imposes higher costs on "downstream" users in the supply chain. Those higher costs can mean higher prices for consumers, reduced competitiveness for U.S. exporters in global markets, lower sales, less investment, and ultimately fewer employment opportunities and lower pay in the affected industries. If domestic prices for a key commodity become too expensive, domestic producers may be forced to go out of business or to move production to other countries where they can buy the commodities at lower prices. Import restrictions can also disrupt deliveries, just-in-time inventory management, and production cycles by forcing domestic users to rely on a smaller number of suppliers.

Once again, sugar provides an example of the damage done by a domestic commodity market shielded from global competition. A domestic price for raw sugar that is double the world price raises costs for refined sugar, candy and other confectionary products, chocolate and cocoa products, chewing gum, bread and other bakery products, cookies and crackers, and frozen bakery products. In the past two decades the number of sugary refineries in the United States has dropped from 23 to 8, in large part because of the high cost of domestic raw sugar.[13] In the past decade, thousands of jobs have been lost in the confectionary industry, with losses especially heavy in the Chicago area. [14] In 2002 Kraft Inc. announced that it was closing a Lifesavers candy factory in Holland, Michigan, and relocating production to Canada, where the company could buy sugar at world market prices.[15] Industry representatives repeatedly cite the high price of domestic sugar as one of the reasons for the exodus of productive capacity and employment from the United States.

Representatives of the sugar industry claim those jobs have left, not in search of lower sugar costs, but because of lower labor, utility, and other costs of doing business in developing countries such as Mexico. Lower all-around costs would indeed help explain the relocation of some U.S. companies to less-developed countries, but they would not explain relocation of confectionary companies to Canada, where wages, regulations, and other costs of doing business are comparable to those in the United States. The one clear difference is access to globally priced sugar. And if other costs of production are less abroad, the sharp difference in the price of sugar only adds to the attractiveness of moving production offshore. Like other U.S. companies, America's sugar-consuming industries should be able to buy the inputs they need at the most competitive global prices.

Higher commodity prices also affect the bottom line for restaurants and other food-preparation sectors. Higher costs for food translate into higher final costs for customers, lower sales, less investment, and lower employment in the sector than if commodities could be purchased at global prices. In a dynamic and flexible economy such as ours, whatever modest job losses might occur in farm sectors newly exposed to global competition would soon be offset by the creation of new jobs in the food-consuming and food-processing industries.

Nonagricultural businesses would also benefit from reform through increased exports. U.S. and other rich-country farm trade barriers remain the single greatest obstacle to a comprehensive agreement on trade liberalization in the WTO. The current round of talks, the Doha Development Round, came to a halt in Cancun in 2003 when the Group of 20 developing countries demanded more serious reform by the rich countries as a condition of progress. Talks began to move forward again only after progress was made on agricultural export subsidies with the so-called July Framework agreement in 2004 and the agreement on tariff formulas in 2005.

Progress on reducing trade-distorting farm policies would bring a comprehensive WTO agreement closer to reality and lower foreign trade barriers to U.S. exports of industrial products and services. The economic payoff to U.S. exporters and the U.S. economy would be substantial. A 2003 study estimated that even a one-third cut in tariffs on agricultural, industrial, and service trade would boost annual global production by $686 billion, including $164 billion in the United States—or about $1,477 per U.S. household.[16] Some of America's most competitive sectors, such as information technology, financial services, insurance, consulting, and education, could be expected to increase their share of global markets if the Doha Round were successful. That success depends on real reductions in U.S. intervention in agricultural trade.

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A common argument against reform is that the United States should hold on to its agricultural trade barriers as "bargaining chips" in WTO negotiations. If we were to reduce our barriers unilaterally, other countries would supposedly lose any incentive to give up their barriers. But that argument fails to consider the ongoing cost to Americans—as consumers and producers—of maintaining our own barriers. Reducing our barriers would not be primarily a "concession" we made to other countries; it would be a favor for ourselves, regardless of what other countries did. And by reducing our own farm barriers and subsidies, we would set a good example and create goodwill in global negotiations, inviting other countries to join us in realizing the benefits of lower domestic food costs.

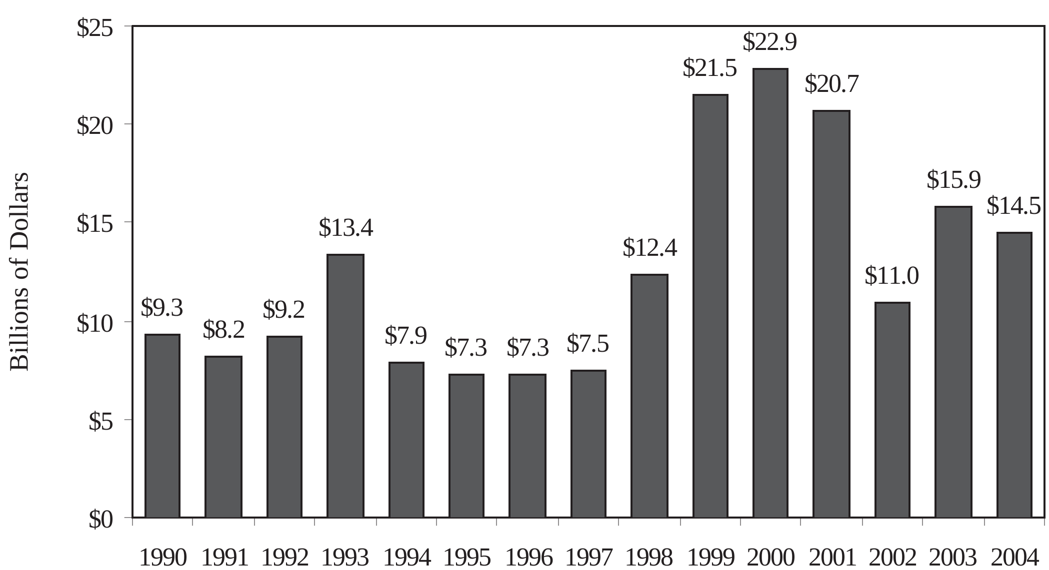
## Reason no. 3: Budget Savings and Equity for U.S. Taxpayers

A third reason for sweeping agricultural reform would be to lower the cost of government for U.S. taxpayers. The Office of Management and Budget estimates that taxpayers will foot the bill for $26 billion in direct agricultural subsidies in fiscal year 2005.[17] That's the biggest single-year expenditure on farm subsidies since 1986.[18] Just nine years ago, Congress vowed to phase out farm subsidies by 2003. Instead, the opposite has occurred: a series of so-called emergency subsidy bills and the resurrection of a price support program in 2002 have hiked total government payments to farmers to near-record highs.

Figure 1 shows the trend of farm subsidy payments between 1990 and 2004. The years in which farm subsidies were the lowest (1994 through 1997) correspond with two key events: (1) a rise in global commodity prices and (2) the passage of the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, often referred to as the Freedom to Farm Act.

Subsidy levels before 1996 were set by a formula that triggered an increase in farm subsidies when crop prices fell. Starting in 1995 crop prices began to rise, thereby causing a lower payment from the federal government. The Freedom to Farm Act, passed in 1996 when commodity prices were high and

**Figure 1**
**Direct U.S. Government Payment to Farmers, 1990–2004**




Source: U.S. Department of Agriculture, Economic Research Service, www.ers.usda.gov/data.
Note: Figure for 2004 is estimated.

demand for subsidies low, ended the price support program and replaced it with a declining fixed payment unrelated to market prices. Farm subsidies were scheduled to decline from $5.6 billion in 1996 to $4 billion by 2002.[19] After that, crop subsidies were set to disappear.

The scheduled phaseout remained intact for about two years until Congress reversed course in 1998. When global crop prices began to decline that year, Congress passed a large "emergency" supplemental appropriation bill that hiked total farm subsidies to $12.4 billion. Subsequent supplemental legislation spurred farm subsidies to new heights; they amounted to a total of more than $76.1 billion between 1999 and 2002. That's $57 billion more than the Freedom to Farm Act's phaseout of crop subsidies would have allowed if subsidies had been cut as promised.[20]

In May 2002 President Bush signed into law a new six-year appropriation that put the final nail in the coffin of the Freedom to Farm Act's commitment to weaning farmers from taxpayer support. Instead of zeroing out farm subsidies, the legislation created a new version of the old price support program, which was estimated to cost taxpayers $99 billion in direct subsidies over six years.[21] The first three fiscal years following the enactment of the 2002 farm bill have already seen an estimated $55.5 billion spent on farm subsidies.[22]

To put this in perspective, for the money that the federal government paid farmers between 1995 and 2003—roughly the time between the passage of the Freedom to Farm Act and the enactment of the 2002 farm bill—the government could have purchased outright more than a quarter of all farms in the United States.[23]

There persists, however, the conventional wisdom that federal agricultural programs are vital to preserving impoverished and beleaguered family farms in the United States. The reality is quite different from the popular notions about farming in America today. Most farmers are relatively wealthy. Average household income for family farms in 2001 was $64,465. That's 10.7 percent more than the average U.S. household income.[24] By contrast, when large-scale federal farm subsidies began in the 1930s, farmers' incomes were only half the national average.[25] As the Department of Agriculture reports, "Farm households have higher incomes, greater wealth, and lower consumption expenditures than do other U.S. households."[26]

Most farmers don't receive direct subsidies from the federal government. The taxpayer-financed handouts go to only one-third of the nation's farmers,[27] mainly to large agribusinesses and the richest farmers. In 2003, the most recent year for which comprehensive statistics are available, 68 percent of all subsidy payments went to only 10 percent of recipients.[28] The top 5 percent of recipients collected 55 percent of all subsidies.

Take, for instance, Riceland Foods, Inc., in Stuttgart, Arkansas, which collected more in subsidies than any other recipient of farm welfare. In 2003 it received $68.9 million in subsidies for producing rice, soybeans, wheat, and corn. To put this into perspective, Riceland Foods received more in farm subsidies than did all the farmers in Rhode Island, Hawaii, Alaska, New Hampshire, Connecticut, Massachusetts, Maine, Nevada, and New Jersey combined.[29]

The second-largest recipient of farm welfare in 2003 was Producers Rice Mill, Inc., also in Stuttgart, Arkansas. It received $51.4 million in subsidies. To see how lopsided the distribution of farm subsidies is among a few select companies, consider this: the third-largest recipient of subsidies in 2003—Farmers Rice Co-op in Sacramento, California—received only about a third of that ($17.9 million). The average subsidy payment to the top 1 percent of all recipients (in terms of subsidies collected) was $214,088 in 2003.[30]

Many Fortune 500 companies also receive farm welfare checks. Most of the corporate recipients are agricultural or farm-centered companies (such as Archer Daniels Midland, International Paper, and Tyson Foods). Others, however, are companies most people don't associate with farming, such as Chevron and Texaco. Even though they might still receive a small portion of the overall farm subsidy budget, taxpayers should certainly wonder why the federal government is subsidizing any aspect of a profitable company's bottom line.

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From the taxpayer's perspective, there is no good reason for the federal government to continue to subsidize farmers or companies, including those that can remain profitable on their own.

Employment in and the share of gross domestic product produced by the farm sector continued to shrink during the 50-year period when farm subsidies went through periods of record highs and temporary phasedowns. Federal subsidies have arguably been more effective at propping up unprofitable farms than at halting the progress of technology that has led to the large productivity increases of modern farming. In addition, many other industries today survive and prosper without subsidies. Congress should cease giving taxpayer money to the farm industry.

## Reason no. 4: More Environmentally Friendly Land Use

Yet another benefit of reducing farm subsidies and trade barriers would be enhanced environmental quality. Although many farmers are conscientious stewards of the environment, the distortions and perverse incentives of U.S. agricultural policies can lead to practices that damage the environment.

Agricultural trade barriers harm the environment by stimulating production on marginal land, leading to overuse of pesticides, fertilizers, and other effluents. A central if unstated purpose of U.S. farm policy is to promote production of commodities that would not be economical under competitive, free-market conditions. That often means producing selected crops under conditions less favorable than those afforded by the land and climate in other countries. As a result, trade barriers intensify production in countries that do not have a comparative advantage, necessitating more intense use of fertilizers and other inputs. That fact explains why farmers in Japan, Korea, and Switzerland on average use far more fertilizer per acre than those in Australia, New Zealand, or less-developed countries where the same crops can be grown under more naturally favorable conditions.[31]

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Overuse of fertilizers and pesticides adds them to runoff as pollutants of rivers, lakes, and even oceans. According to the World Resources Institute, agriculture is the biggest source of pollutants of rivers and lakes in the United States.[32] A study by the U.S. Environmental Protection Agency found that 72 percent of U.S. rivers and 56 percent of lakes surveyed suffer from agriculture-related pollution. Areas of the Gulf of Mexico off the U.S. coast have become "dead zones" because of the runoff of nutrients from farms in the Midwest.[33] Even where fertilizers and pesticides are not used intensively, the mere act of plowing soil eliminates forest and grass cover, leaving soil exposed for weeks at a time and vulnerable to erosion. Erosion can result in the build-up of silt in nearby rivers and downstream lakes.

A prime example of environmental damage from farm-related effluent involves sugar cane and the Florida Everglades. As noted above, federal protection of domestic sugar producers has rewarded them with a price for their product that is far above what they would receive in a free and open world market. That higher price has in turn stimulated artificially high domestic production. One unintended result has been that cane farms in central Florida use water from the Everglades and return it with phosphorous content far above a level consistent with maintenance of the surrounding ecosystem. The high runoff has seriously reduced periphyton, such as algae, that support bird and other animal life.[34] Congress has allocated billions of federal tax dollars in an attempt to repair the damage caused to the Everglades by the protected sugar industry.

Distortions caused by U.S. farm programs also lead to waste of scarce water resources. Worldwide, agriculture accounts for two-thirds of fresh water use, mostly for irrigation of cropland.[35] In the United States, subsidies for agricultural water use amount to $2 billion or more annually.[36] Those subsidies prop up uneconomical types of farming, such as growing cotton in the Arizona desert; divert water from residential and industrial users who would be willing to pay market rates; and further damage the environment. According to one study, 25 percent of irrigated farmland in the United States suffers from excessive salinity caused by irrigation.[37] Ending farm subsidies and protection, as well as related water subsidies, would reduce environmental damage and free water resources for more economically justifiable uses.

Farm protection also crowds out more environmentally friendly land use by artificially driving up land prices. A sizable share of the increased income that protection and subsidies deliver to farms becomes "capitalized" through higher land values, because the subsidies make the land more valuable by increasing the stream of income it can produce. Higher prices for farmland, in turn, render it more expensive to acquire and maintain environmental preserves, riverside buffers, parkland, forests, or land for other uses that would be more likely to preserve habitat and biodiversity.[38]

Americans have witnessed that tradeoff firsthand during the past century. The shift of economic activity away from farming to manufacturing and service industries has led to a reclaiming of farmland for other uses, including reforestation. The number of forested acres in the northeastern United States increased dramatically in the last century, from 59.6 million acres in 1907 to 85.5 million by 1997—primarily because of the decline in the number of farms and farm acres in the region.[39] By keeping marginal farmland under cultivation, U.S. agricultural policies have slowed reforestation.

New Zealand has also experienced the same tradeoff of farmland for forests and other uses. After the government dramatically reduced farm trade barriers and subsidies in the mid-1980s, including subsidized irrigation, farmland values fell sharply. Although that was painful in the short run for some farmers and related businesses, the lower land values allowed marginal land to return to such uses as forestry and ecotourism. Since the liberation of agriculture from government control in New Zealand, "the use of fertilizer has declined and there was a halt to land clearing and overstocking [over-grazing], which had been responsible for widespread soil erosion."[40]

Skeptics of globalization raise the concern that free trade in agriculture would merely shift environmental problems from rich to poor countries, leading to deforestation elsewhere. But such worries are misplaced. Most logging and deforestation in poor countries today is driven by demand for fuel and charcoal, not farmland.[41] Expanding trade with poor countries would help to raise incomes among the world's rural poor, allowing farmers and other residents to shift to more environmentally friendly forms of energy and increasing the resources and technology available to better manage environmental quality.

## Reason no. 5: Larger Markets for U.S. Farmers, Economic Diversity for Rural America

A sizable minority of U.S. farmers clearly benefit from federal farm programs. If that were not true, certain farmers and their political representatives would not fight so tenaciously to preserve their protected status. But existing federal farm programs also work against the interests of many other farmers and arguably undermine the economic viability of a large swath of rural America.

U.S. farmers themselves pay a heavy price in lost export opportunities because of high trade barriers abroad. American farmers need access to global markets to prosper. After all, 95 percent of the world's food consumers live outside the United States. Yet U.S. agricultural exporters face average tariffs abroad that are several times higher than the average tariffs on manufactured products. The most promising opportunity to lower those barriers would be through a multilateral agreement in the current Doha Round negotiations in the WTO, and such an agreement is unlikely without significant reductions in our own agricultural subsidies and trade barriers.

High global barriers to farm trade have stunted export growth. While global exports of manufactured goods accelerated from an annual growth rate of 5.7 percent in the 1980s to 6.7

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percent in the 1990s, exports of agricultural goods decelerated from 4.9 percent to 3.4 percent.[42] The exceptions to the trend have been fruits and vegetables, fish and seafood, and alcoholic and nonalcoholic beverages, sectors in which trade barriers tend to be low and demand high in richer countries.[43] Trade restrictions have also "thinned" global markets, reducing competition and trade flows, leading to world market prices that are more volatile and vulnerable to shocks than they would be if trade flowed more freely.

If global barriers to farm trade were removed, the World Bank estimates that global farm exports would be 74 percent higher by 2015 than they would be under current policies. For American farmers, comprehensive global and agricultural trade reform would mean an additional $88 billion in annual farm exports by 2015 and an additional $28 billion in farm imports, for a net $60 billion surplus.[44] American farmers would be among the big winners if global agricultural barriers and subsidies, including our own, were eliminated.

Protection has not served the long-term interests of even the most protected farm sectors. Barriers to commodity imports discourage diversification of production into higher value-added items and retard development of food-processing capacity. Protection slows adoption of more efficient production methods and cost-saving innovations. It can discourage domestic consumption and encourage the use of lower-priced substitutes, undermining the food-processing industries' own domestic market share.

America's protected sugar industry appears to be suffering that very fate. Artificially high domestic prices have contributed to a long-term decline in domestic sugar consumption. Today Americans consume about 40 percent less sugar per capita than they did when consumption was at its peak in 1972.[45] Domestic sugar has been replaced on the menu, not by imports, but by homemade substitutes such as high-fructose corn syrup and low-calorie sweeteners. As substitutes have grown more popular, sugar's share of the domestic sweetener market has been cut in half since 1967.[46]

For the farm sector as a whole, government payments and protection have failed to deliver the "rural development" supporters of farm bills routinely promise. Farm programs may even be contributing to the relative decline of jobs and population in rural areas by concentrating payments on a narrow range of "program commodities," such as corn, cotton, rice, wheat, and dairy products, rather than more diversified production of so-called specialty crops. Producers of program commodities must realize ever-higher economies of scale to stay competitive, which reduces economic diversity, employment, and business opportunities in rural communities.

A recent study by the Federal Reserve Bank of Kansas City found a negative correlation between the amount of farm payments rural counties receive and job and population growth. The bank's Center for the Study of Rural America concluded:

> Farm payments are not providing a strong boost to the rural economy in those counties that most depend on them. Job gains are weak and population growth is actually negative in most of the counties where farm payments are the biggest share of farm income. . . . In short, farm payments are not yielding robust economic and population gains in the counties where they should have the greatest impact. If anything, payments appear to be linked with subpar economic and population growth. To be sure, this quick comparison cannot answer whether growth would have been even weaker in the absence of payments. Still, farm payments appear to create dependency on even more payments, not new engines of growth.[47]

Real-world experience shows that farmers can thrive in free and open markets. Most U.S. agricultural production occurs without government price supports or trade protection. American farmers profitably produce lettuce, celery, cauliflower, potatoes, almonds, pistachios, apples, pears, cherries, melons, blueberries, grapes, and hundreds of other specialty crops without guaranteed prices and protected markets. The fact that a few U.S. crops receive massive government support complicates the task of lowering barriers abroad to the export of specialty products and raises the cost of land and other inputs used to produce them.

The experience of New Zealand and Australia demonstrates that farmers can survive and thrive without significant government support. Both of those countries enacted sweeping unilateral reforms that included elimination of import barriers and domestic price support subsidies. As expected, some farms have gone out of business, and many others have changed their operations to meet the market demand of consumers. The result has not been a massive downsizing of the agriculture sector but instead a surge of innovation, productivity, and output.

Beginning in the mid-1980s, the government of New Zealand repealed its extensive system of protection and price supports in favor of free and open markets. Critics and some farm groups predicted that 10 percent of farms would go out of business, but in fact only about 1 percent exited the market.[48] The farms that remained became more productive by controlling costs and shifting production to crops and livestock for which market demand was greatest. Annual productivity growth in the agricultural sector quadrupled after the reforms, and agriculture's share of the country's total gross domestic product actually increased—a rare development for an advanced economy.[49] Given its own natural endowments, the United States would continue as one of the world's leading agricultural producers without a protected domestic market.

Through artificially high domestic prices, government farm programs send out misleading signals that encourage production that would not be justified in a free and competitive market. At the same time, those higher prices undermine long-term domestic demand and competitiveness, leaving the supposedly favored sectors even more vulnerable to foreign competition if and when markets are opened. Every year that reform is delayed adds to the eventual pain of adjustment.

## Reason no. 6: A More Hospitable World for American Values and Foreign Policy

A sixth reason for fundamental reform of farm policy lies beyond our borders. The elimination of U.S. agriculture tariffs, quotas, and subsidies would create a more hospitable climate abroad for U.S. foreign policy and would improve and enhance U.S. security. Equally important, the repeal of those policies would be consistent with the long-standing American belief in the value of economic opportunity for all. By eliminating policies that are widely resented around the globe, the United States would set the example for other developed countries, which exercise an even greater influence over their agricultural sectors.

Although advocates of the current market-distorting agricultural policies do not seek to cause harm to others, the collective effect of U.S. farm policies is to lower the price of agricultural products worldwide. Those policies might provide modest short-term benefits for farmers in developed countries, but at the cost of depressed global prices for agricultural products that exacerbate poverty in those areas around the globe, such as Sub-Saharan Africa and Central Asia, where people are heavily dependent on agriculture.

The frustration and despair caused by those policies in turn undermine American security. Most people who are dependent on agriculture for their survival, both as a source of nourishment and also as a means for acquiring wealth, have limited access to information. Unfamiliar with the historical and economic rationale for particular agricultural policies, those individuals perceive that U.S. farm policies fit neatly within a competing narrative crafted by the hatemongers who claim that the United States seeks to keep the rest of the world locked in poverty. Protestations to the contrary from U.S. government officials typically fall on deaf ears, and terrorist ringleaders find fertile ground for their message of violence.

**The experience of New Zealand and Australia demonstrates that farmers can survive and thrive without significant government support.**

**The continuation of U.S. market-distorting agricultural policies lowers the price of agricultural products worldwide, undermining the efforts of farmers and others employed in the agricultural sector to climb out of poverty.**

The September 11 Commission and the Pentagon's Defense Science Board both warned of the effect of rising anti-American sentiments, particularly within the Muslim world. Zogby International has conducted a series of polls in the Middle East over the past few years and has discovered a disturbing downward trend in attitudes toward the United States. As the *Washington Post* reported in July 2004: "In Zogby's 2002 survey, 76 percent of Egyptians had a negative attitude toward the United States, compared with 98 percent this year. In Morocco, 61 percent viewed the country unfavorably in 2002, but in two years, that number has jumped to 88 percent. In Saudi Arabia, such responses rose from 87 percent in 2002 to 94 percent in June."[50]

Respondents said their opinions were shaped by U.S. policies. When asked, "What is the first thought when you hear 'America'?" those polled overwhelmingly said, "Unfair foreign policy."[51] The Pew Research Center similarly found that anti-American sentiments flowed from opposition to U.S. policies and did not apply to our political values (for example, tolerance of dissent, fair elections, and press freedom). Pew polls also found widespread enthusiasm for American popular culture and respect for American technology.[52]

Against that backdrop, the anti-poor bias of U.S. agricultural policy plays into the hands of our nation's enemies. Although it is impossible to determine which particular policies stir the greatest anger and resentment around the world, poll respondents appear to differentiate between policies that are helpful to them and those that are harmful. Also, to the extent that U.S. policies harm the economic well-being of hundreds of millions of poor farmers in the developing world—not just in the Middle East or predominantly Muslim countries—those policies must also be considered within the mix that is, collectively, giving rise to such virulent anti-Americanism. Indeed, in a lengthy survey of anti-American sentiments around the world, Pew researchers found that a majority of poll respondents in more than a dozen countries were convinced that U.S. policies increased the so-called poverty gap worldwide. Those sentiments transcended geographic, ethnic, and religious boundaries.

Many liberal-minded Western economists agree that U.S. policies contribute to poverty in the developing world. Johan Norberg of the Swedish think tank Timbro notes that "world trade in agriculture is growing far more slowly than trade in other commodities," and that is attributable in large part to the "startling protectionism" practiced by the affluent countries. For the developing world, Norberg explains, agricultural quotas and subsidies constitute a "deliberate and systematic means of undermining the very type of industry in which the developing countries do have comparative advantages."[53]

Nicholas Stern, former chief economist of the World Bank, is even more blunt. "It is hypocritical to preach the advantages of free trade and free markets," Stern complained, "and then erect obstacles in precisely those markets in which developing countries have a comparative advantage."[54]

Stern and Norberg are hardly alone in criticizing the inherent hypocrisy of agricultural subsidies and quotas. While there are some instances in which agricultural policies have a direct and detrimental impact on U.S. security, for example by undermining the fight against radical Islamism in Central Asia, the broader effects of those policies are often more subtle and relate to perceptions of U.S. intentions. The belief that Americans speak out of both sides of their mouths with respect to the needs of people in impoverished countries is unfortunately quite widespread. On the one hand, the United States sends hundreds of millions of dollars abroad, much of it to less-developed nations that are most heavily dependent on agriculture. On the other hand, the continuation of market-distorting agricultural policies lowers the price of agricultural products worldwide, undermining the efforts of farmers and others employed in the agricultural sector to climb out of poverty.

Cotton subsidies have become a key cause of organizations such as the British charity Oxfam and have also spurred complaints from other members of the WTO. The United

States is the second-largest cotton grower after China and the biggest cotton exporter, accounting for 41 percent of global exports.[55] According to Oxfam, "In crop year 2002, the U.S. government provided $3.4 billion in total subsidies to the cotton sector," including about 25,000 growers. "To put this figure into perspective, it is nearly twice the total amount of U.S. foreign aid given to Sub-Saharan Africa. It is also more than the GDP of Benin, Burkina Faso, or Chad, the main cotton-producing countries in the region."[56]

Market-distorting policies have driven down world cotton prices, which in turn have cost developing countries hundreds of millions of dollars in lost export earnings. That has had a horrible effect on rural communities. A recent report by the International Food Policy Research Institute focused on Benin and determined that a 40 percent reduction in farm-level cotton prices leads to a 21 percent reduction in income for cotton farmers, which, in turn, increases rural poverty by 6 to 7 percent.[57]

The losses associated with cotton subsidies exceed the value of U.S. aid programs. Consider a few of the effects of those subsidies in Sub-Saharan Africa. Oxfam charges that U.S. subsidies directly led to losses of more than $300 million in potential revenue in Sub-Saharan Africa during the 2001–02 season.[58] Other studies have estimated that U.S. cotton subsidies alone impose an annual cost of between $250 million and $400 million on farmers in the main West African and Central African cotton-producing countries of Benin, Mali, Burkina Faso, and Chad. More than 12 million people in that region depend directly on the crop, with a typical small-scale producer making less than $400 on an annual cotton harvest.[59] In short, agricultural policies have the effect of taking away with the right hand what the left hand gives in aid and development assistance.

Some people would attempt to correct that problem by increasing foreign aid, but state-to-state aid programs are known to be extremely inefficient, in large part because the provision of aid is heavily influenced by political considerations. But there is yet another practical problem with the subsidies-combined-with-aid approach: it amounts to asking taxpayers to pay twice—once to sustain the inefficient subsidies and then again to pay for aid programs to countries harmed by those policies.

William R. Cline, senior fellow at the Institute for International Economics and the Center for Global Development, estimated that half or more of the annual gains from trade would come from the removal of protectionist barriers against developing-country exports. By removing such barriers, industrial countries could convey economic benefits to developing countries worth about twice the amount of their yearly development aid.[60]

The United States is hardly the worst violator among the developed countries when it comes to unfair trading policies, particularly with respect

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**Table 2**
**Aggregate Measure of Protection (AMP) against Developing Countries (tariff equivalent)**

| | United States | European Union | Japan |
|---|---|---|---|
| Agriculture | 19.9% | 46.4% | 82.0% |
| Textiles, Apparel | 10.9% | 11.6% | 9.2% |
| Other Manufacturers | 2.1% | 3.2% | 1.5% |
| Oil and other* | 0.9% | 0.6% | 0.3% |
| All (AMP) | 4.0% | 9.5% | 16.6% |

Source: William R. Cline, "Effective Economic Growth for People: The Role of the United States," Center for Global Development, December 2004, p. 4; and Cline, *Trade Policy and Global Poverty*.
*Other = nonagricultural raw materials.

America's agricultural polices are relics of a bygone era, a drag on our 21st-century economy, and a blemish on America's image in the world.

to agriculture. Cline calculated aggregate measures of protection (AMP) in four different sectors and then compared U.S. protectionism with that practiced by Japan and the countries in the European Union. Although the United States is marginally more "protectionist" than Japan in three of four broad sectors (manufacturing, textiles and apparel, and oil and other nonagricultural raw materials), Japan's aggregated agricultural policies were four times more protective than those of the United States. The agricultural sector in EU countries, meanwhile, was over twice as protected as that in the United States.[61] (See Table 2.) But the fact that other advanced economies tilt their agricultural policies against developing countries does not excuse the same mistake by the U.S. government.

Poor countries don't want our pity; they want our respect. To the extent that U.S. security depends on the expansion of liberal democratic institutions and free-market economics, U.S. policymakers must be particularly sensitive to policies that exacerbate poverty in the developing world. The United States should lead by example and eliminate its market-distorting agricultural policies. Those policies serve no useful purpose for the vast majority of American consumers and taxpayers, and they seriously undermine the effectiveness of many of the nation's most urgent foreign policy initiatives.

## An Opportunity for Real Reform

America's agricultural polices are relics of a bygone era, a drag on our 21st-century economy, and a blemish on America's image in the world. For the sake of our broader national interest, Congress and the president should reduce, with the ultimate goal of eliminating, all agricultural trade barriers and production subsides. The long-term interests of Americans as consumers, producers, taxpayers, and citizens of the world should not be continually sacrificed to the short-term interests of a small minority of agricultural producers.

The confluence of American interests surveyed in this study makes the case for reform compelling; a confluence of events on the horizon makes the goal of reform a real possibility.

The Doha Development Round of negotiations in the WTO will approach a hard deadline in 2007. That is when the U.S. president's authority to negotiate trade agreements and present them to Congress for an up-or-down vote will expire under the terms of the Bipartisan Trade Promotion Authority Act of 2002. Without such authority, it will be virtually impossible for the Bush administration to conclude a complex multilateral agreement with the other 147 members of the WTO. Aggressive proposals by the U.S. government to reduce its farm subsidies and trade barriers, and the willingness of Congress to make those proposals a reality, will be necessary for the successful conclusion of the Doha Round negotiations by the 2007 deadline.

Meanwhile, the U.S. cotton program and the European Union's sugar program have been found in separate WTO cases to be in violation of rules established in the Uruguay Round governing trade-distorting subsides. Both of those cases, if fully implemented, will cast doubt on the legality of similar rich-country farm programs. The U.S. government's demands that other WTO members, such as China and the European Union, conform to the letter of their WTO commitments will ring hollow if the United States itself maintains trade-distorting agricultural programs that manifestly violate the same WTO rules.

On the domestic front, the farm bill will be coming up for reauthorization at about the same time that the Doha Round negotiations enter their final stages. A new farm bill offers Congress an obvious opportunity to fundamentally reshape U.S. agricultural policy in a more market-friendly direction. A farm bill with deep cuts in subsidies and trade barriers would save U.S. taxpayers and consumers tens of billions of dollars during the next decade and potentially open the door for a comprehensive agreement in the WTO that would open markets abroad for tens of billions of dollars more in exports of U.S. services, manufactured goods, and farm products. Repeal of subsidies and trade barriers would free rural communities from dependence on payments that concentrate production in less-competitive commodities that do not provide a foundation for real prosperity.

Congress and the president should seize the opportunity to turn away from decades of failed policies and at last bring America's agricultural sector into the nurturing sunlight of a free and open global market.

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Scholars at the Cato trade policy center recognize that open markets mean wider choices and lower prices for businesses and consumers, as well as more vigorous competition that encourages greater productivity and innovation. Those benefits are available to any country that adopts free-trade policies; they are not contingent upon "fair trade" or a "level playing field" in other countries. Moreover, the case for free trade goes beyond economic efficiency. The freedom to trade is a basic human liberty, and its exercise across political borders unites people in peaceful cooperation and mutual prosperity.

The center is part of the Cato Institute, an independent policy research organization in Washington, D.C. The Cato Institute pursues a broad-based research program rooted in the traditional American principles of individual liberty and limited government.

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