U.S. Agricultural Programs: Who Pays?

BY E. C. PASOUR, JR.

The Economist labeled the recently enacted 2008 farm bill "A Harvest of Disgrace" (May 24, 2008). The five-year $307 billion bill, through a complicated system of government programs, lavishes cash on upper-income farm households. The major beneficiaries of U.S. agricultural programs, commercial farmers, will have an average income of some $230,000 in 2008, according to the U.S. Department of Agriculture (USDA). The main restriction on these subsidies is a means test that applies to couples making more than $1.5 million per year.

A host of "emergency programs" was enacted as part of President Franklin Roosevelt's New Deal during the Great Depression of the 1930s. Despite huge changes over time in the particulars, the programs affecting the growing and marketing of farm crops remain largely intact.

The focus here is on who bears the cost of farm programs. In addition to a network of programs that affect commodity prices and make direct payments to farmers, there are subsidies for agricultural credit, soil and water conservation, research and education, crop insurance, exports of farm products, and nutrition programs. Consideration of the way the programs work shows that generalizations about the effects of farm subsidies often are wrong.

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It is sometimes said that agricultural subsidies benefit those with above-average incomes at the expense of taxpayers and "everyone who eats." Although agricultural subsidies always hit taxpayers, this generalization about the effect of farm programs on food prices is incorrect. Some agricultural programs, and the associated subsidies, lead to increased output and lower food prices, while some lead to decreased output and higher prices.

Commodity Programs

Field Crops. The early New Deal farm-commodity programs relied mainly on product price supports coupled with production controls in the form of restrictions on land use (acreage controls). Although consumers of products using wheat, cotton, and feed grains bore the major cost of these programs, taxpayers picked up the tab for administering the programs and for funding purchases of surpluses that occurred as farmers responded to higher prices.

For several decades after the programs began, farmers were reluctant to receive government subsidies through direct government payments. They preferred a less-obvious handout in the form of higher product prices achieved through government-imposed restrictions on output!

All this changed in the early 1970s with the "target-price" method of price supports. In this approach farm-

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USDA

ers received government-determined support prices (above free-market levels) for their crops. Farmers could either sell products on the open market or place them in a government-managed storage program. In the simplest case a farmer sold the product (the amount produced at the support price) at the market-clearing price. The government then paid the difference per unit between what the farmer received in the market and the higher support price—a so-called "deficiency payment." The target-price approach led to an increase in output and *lower* consumer prices—with taxpayers footing the bill.

These deficiency payments remained important until passage of the misnamed Freedom to Farm bill in 1996. Under this law price supports were terminated and farmers who participated in farm programs were guaranteed "transition payments" for seven years—after which farm-commodity programs supposedly were to be terminated. Alas, such was not to be. The 1996 farm bill was followed by successive farm bills in 2002 and 2008, which have shown no decrease in government largess.

Moreover, a new wrinkle for farm-commodity subsidies was added in the 1996 law and continued in the 2002 and 2008 farm bills. Most farm-commodity subsidies have been "decoupled" from current production. That is, the amount of payment a farmer receives is determined by the farmer's historical production—not his current production. Indeed, an eligible farmer can receive the payment even if no longer producing commodities! In 2007 these commodity-based direct payments totaled $6.2 billion. In short, since these payments do not restrict output or raise prices, commodity subsidies for major farm crops, including wheat, feed grains, and cotton, now are borne by taxpayers—*not consumers* of products using these commodities.

However, in two major commodity programs—sugar and milk—the programs and associated subsidies impose a burden on both taxpayers *and* consumers.

Sugar. The U.S. sugar cartel raises the domestic price of sugar in the United States above the world price—quite often twice as high. Domestic producers of sugar cane and sugar beets thus profit through import quotas on Brazil and other countries that can produce more cheaply than the United States.

The cost of the sugar program is borne largely by U.S. consumers and manufacturers of sugar products, who must pay much higher prices than if there were no program. The subsidy, in the form of higher retail sugar prices, will force consumers to pay an extra $2 billion per year, *The Economist* reports. It will also drain $1.3 billion over ten years from U.S. taxpayers. As the sugar price increases, so does the demand for, and price of, high-fructose corn syrup and other sugar substitutes. In short, U.S. citizens pay for the sugar program both as taxpayers and as consumers of products using sugar and sugar substitutes.

Dairy. The complexity of the dairy cartel is of Rube Goldberg proportions, involving both federal marketing orders and price supports. A federal marketing order is an institutional arrangement that allows producers in a geographical region to use the police power of government to enforce compliance with restrictions on competition. The system is used to classify and set minimum prices according to the products in which milk is used—fluid milk, cream, cheese, and so on. Under this system, higher prices are charged for milk used for fluid consumption than for manufacturing purposes. And with restrictions on geographical shipments of milk, milk prices vary by region.

In addition to marketing orders, the price of milk is supported through government purchases of butter, cheese, and nonfat dry milk. These products are then disposed of outside conventional market channels: school lunches, military and veterans' hospitals, and other food-subsidy programs.

Cartels typically restrict sales and increase profits—at least in the short run. In most dairy marketing orders, however, there is no limit on the volume of milk a farmer can market or on the entry of new dairy farms. Therefore, as output expands and costs increase, cartel profits tend to be transformed into increased prices (and costs) of specialized resources, including dairy cows, dairy equipment, land, and managerial skills required to produce milk.

The dairy program imposes costs on both consumers and taxpayers. While the program significantly increases the price of milk sold for fluid use, taxpayer cost also is formidable. Payments to dairy farmers, over and above administration costs for the complex system of marketing orders and price supports, have drained some $2.5 billion from federal coffers since 2002.

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Subsidies That Affect Supply of Farm Products

Input Subsidies. Some agricultural programs—including subsidized farm credit, subsidized crop insurance, and subsidized agricultural research and education programs—increase the supply of wheat, corn, and other farm products. An increase in supply places downward pressure on consumer prices for food products. The USDA estimates the taxpayer outlay for these input subsidies in 2008 at $7.5 billion. Since input subsidies reduce product prices, domestic taxpayers—*not* consumers—bear the cost.

Water subsidies, though funded through the Department of Interior rather than the USDA, are no less important to farmers than other input subsidies. Water subsidies in the west—especially in California—are critical to the success of agriculture in that region.

Irrigation districts use artificially low-priced electricity. The electricity is produced by federally funded dams to pump water. These water subsidies increase production of farm products and are quite substantial. It has been estimated that the capitalized value of water subsidies for a 160-acre California farm may exceed $100,000. Without some $2 billion in annual agricultural water subsidies, the huge impact of the West on the production of farm products would be greatly diminished—including the growing of cotton in the Arizona desert, according to a Cato Institute study

("Six Reasons to Kill Farm Subsidies and Trade Barriers," February 1, 2006). The costs are borne by taxpayers, *not* consumers of farm products—and by other users of water, urban and recreational.

Diversion of Cropland. The stated purpose of the Conservation Reserve Program (CRP) is to protect highly erodible cropland and other environmentally sensitive land. Initiated in the 1980s, the CRP induces farmers to take land out of production through annual rental payments for ten to 15 years. High prices for farm commodities this year have brought some 2.5 million acres from the CRP back into production. This program reduces supply and increases prices of farm commodities. The CRP is budgeted at $2.0 billion in 2008—with the cost borne by consumers *and* taxpayers.

Subsidies That Increase Demand for U.S. Farm Products

Nutrition Programs. The largest subsidy in the farm bill is the outlay for subsidized nutrition programs, including food stamps, and school lunches and breakfasts. Subsidized food programs—with an outlay of some $60 billion in 2008—account for about three-fifths of total USDA spending.

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The original purpose of these programs, when begun in the 1930s, was to facilitate the operation of price-support programs for farm commodities. The U.S. government had acquired large stocks of butter, cheese, and other products in operating price supports for farm products, and these products initially were used in food distribution programs to low-income consumers. The subsidized food programs provided a politically acceptable way to dispose of costly surpluses.

Food stamps grew out of dissatisfaction with earlier food-distribution programs, which reduced regular market food purchases (a concern to farmers) and afforded no choice to recipients regarding commodities received. The food-stamp program is now the major subsidized food program, accounting for about two-thirds of all food subsidies.

Food-stamp users largely substitute food stamps for money. In fact the program increases food expenditures less than 2 percent. It is taxpayers rather than grocery shoppers who bear the brunt of the cost.

It should not be surprising that the major constituency for subsidized food programs is no longer commercial agriculture. Instead, it is urban interests benefiting from and advocating "poverty programs." In congressional negotiations on the 2008 farm bill, legislators from farm districts were able to maintain conventional farm-commodity programs and related subsidies in the face of record-high farm product prices by forming an alliance with legislators from urban districts who sought and obtained increased food subsidies.

Export Subsidies. The federal government also subsidizes exports of U.S. farm products, as it has done for more than 50 years. Estimated taxpayer cost of agricultural export subsidies for 2008 is $2.2 billion. These subsidies include export credit guarantees, market-development programs, and foreign food assistance. Export subsidies increase the demand and price of affected commodities—hitting both domestic consumers and taxpayers.

The best-known export-subsidy program, Public Law 480, was first enacted in 1954. Again, the program was begun to reduce stocks of food that the government acquired through agricultural price-support programs. Some current export subsidies also are in-kind—donations of food products in response to devastation caused by floods, earthquakes, famine, and so on.

Other agricultural export subsidies—export credit guarantees and market-development funds—go to private companies and to state and regional trade groups to promote sales of U.S. farm products in foreign countries.

U.S. export subsidies lower food prices to consumers in recipient countries—at least in the short run. But subsidies work against the interests of farmers in those countries—many of whom have very low incomes. Moreover, the ostensible benevolent effect of government-sponsored food aid is undercut by the rule that requires the U.S. government to buy all foreign food aid from U.S. farmers and transport it on U.S. ships.

In short, agricultural export subsidies help to insulate U.S. farmers from world market prices and are inconsistent with free trade. Moreover, these subsidies foster retaliation and increased protectionism by producer interests in recipient countries.

Ethanol Program. Although not funded through the USDA budget, the current ethanol program is having an impact on U.S. consumers and taxpayers no less important than traditional farm programs. President Bush signed an energy bill in December 2007, which mandates an increase in ethanol use from 4.7 billion gallons in 2007 to 36 billion gallons by 2022.

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Ethanol production is dependent on government mandates and subsidies. A 10 percent ethanol content mandate for every gallon of gas produced and ethanol blending subsidies—$5 billion in 2007—now divert one-third of the U.S. corn crop to ethanol. The taxpayer-financed subsidy is strengthened by a 54-cent-per-gallon tariff on ethanol from Brazil to prevent imports of ethanol from undermining the U.S. ethanol program!

U.S. corn prices increased threefold from early 2006 to May 2008, with ethanol production being an important contributing factor. Consumers are now reaping the results—increased prices for bread, milk, beef, chicken, and other food products. In short, the government-mandated ethanol program is imposing huge costs on taxpayers *and* consumers.

Agricultural subsidies transfer wealth from taxpayers, and in some cases consumers, to farmers, suppliers of farm inputs—including machinery, fertilizer, seed, and pesticides—and other businesses involved in the production and marketing of farm commodities. They obviously have no place in a free economy. FEE