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Reforming Federal Farm Policies

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The federal government spends more than $20 billion a year on subsidies for farm businesses. About 39 percent of the nation's 2.1 million farms receive direct subsidies, with the lion's share of the handouts going to the largest producers of corn, soybeans, wheat, cotton, and rice.[1]

The current farm law—enacted in 2014—added new crop programs that have turned out to be more costly than promised. The law expires this year, and subsidy proponents are eager for Congress to pass another expensive bill. But farm subsidies impose a burden on federal taxpayers, and they harm the economy. President Donald Trump proposed cuts to farm programs in the 2019 federal budget, but the longer-term goal should be to fully repeal all farm subsidies.

This report provides background for the upcoming farm bill debate. It suggests that agriculture is no riskier than other industries and that it does not need an array of federal subsidies. The government protects farmers against fluctuations in prices, revenues, and yields. It subsidizes their conservation efforts, insurance coverage, marketing, export sales, research, and other activities. Federal coddling of the agriculture industry is deep and comprehensive.

Farm subsidies are costly to taxpayers, but they also harm the economy and the environment. Subsidies distort the decisions made by farm businesses. They encourage overproduction, which pushes down prices and creates political demands for more subsidies. Subsidies discourage farmers from innovating, cutting costs, diversifying their land use, and taking other actions needed to prosper in the competitive economy.

A BRIEF HISTORY OF FARM POLICY

Agriculture has long attracted federal support. The Morrill Act of 1862 established the land-grant colleges to teach agriculture and other subjects. The Hatch Act of 1887 funded agricultural research, and the Smith-Lever Act of 1914 funded agricultural education. The Federal Farm Loan Act of 1916 created cooperative banks to provide loans to farmers. That developed into today's Farm Credit System, which is a government-sponsored financial system with more than $280 billion in assets.

The Agricultural Marketing Act of 1929 created the Federal Farm Board, which tried to raise crop prices by buying up and stockpiling production.[2] That did not work, and after spending $500 million this early agricultural boondoggle was abolished in 1933.

Congress enacted many farm programs during the 1930s, including commodity price supports, supply regulations, import barriers, and crop insurance. These programs have been expanded, modified, and added to over the decades, but the central planning philosophy behind farm programs has not changed. U.S. farm policies remain stuck in the past, despite the ongoing economic harm and taxpayer costs.

Between the 1940s and the 1980s, Congress considered farm policy reforms occasionally, usually when commodity prices were high, but then reverted to subsidy expansions when prices were lower.[3] In the 1980s the Reagan administration proposed cuts to farm subsidies, but farm finances took a bad turn, and that prompted Congress to increase farm aid, not reduce it.

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Farm subsidies have never made economic sense, but farm interests have held sway in Congress. While farmers are a small share of the U.S. population today, the farm lobby is still strong. One reason is that farm-state legislators have co-opted the support of urban legislators by including food-stamp subsidies in farm bills. Other legislators support farm bills because of the inclusion of conservation subsidies.

In 1996 Congress enacted reforms under the "Freedom to Farm" law, which allowed farmers greater flexibility in planting and increased reliance on market supply and demand. But Congress reversed course in the late 1990s, and it passed a series of supplemental farm subsidy bills. As a result, subsidies over the seven years of the 1996 farm bill ended up costing more than double what had been promised.[4]

In 2002 Congress enacted a farm bill that further reversed the 1996 reforms. The law increased projected subsidy payments, added new crops to the subsidy rolls, and created a new price guarantee scheme called the countercyclical program. The 2002 law increased projected farm subsidy payments by 74 percent over 10 years.[5]

In 2008 Congress overrode a presidential veto to enact farm legislation that added further subsidies. The law created a permanent disaster aid program and added a revenue protection program for farmers to lock in profits from high commodity prices. It added a sugar-to-ethanol program to keep sugar prices artificially high, and it added new subsidies for "specialty crops" such as fruits and vegetables.

In 2014 Congress passed another huge farm bill. The bill changed the structure of subsidies, but it did not cut the overall level of benefits. The law ended the direct payment program, the countercyclical program, and a couple of other smaller programs. But it expanded the largest farm subsidy program—crop insurance—and it added two new subsidy programs, the Agriculture Risk Coverage (ARC) program and the Price Loss Coverage (PLC) program.

When the 2014 farm bill was passed, supporters claimed that it would save money, but the opposite has happened. The ARC and PLC programs have cost almost double what the Congressional Budget Office originally estimated.[6] Meanwhile, the cost of crop insurance has soared over the past 15 years.

All of these subsidies ensure that farm incomes are much higher than the incomes of most Americans. Farm programs are welfare for the well-to-do, and they induce overproduction, inflate land prices, and harm the environment. They should be repealed, and farmers should support themselves in the marketplace.

EIGHT TYPES OF FARM SUBSIDY

The U.S. Department of Agriculture (USDA) runs more than 60 direct and indirect aid programs for farmers. This section summarizes the major ones.

Most of the direct aid goes to producers of a handful of field crops, not to livestock producers or fruit and vegetable growers. In the three largest farm subsidy programs—insurance, ARC, and PLC—more than 70 percent of the handouts go to farmers of just three crops—corn, soybeans, and wheat.[7]

1. **Insurance.** The largest farm subsidy program is crop insurance run by the USDA's Risk Management Agency. Spending on the program has averaged more than $8 billion a year over the past five years, up from around $3 billion in the early 2000s.[8]

   The program subsidizes both the insurance premiums of farmers and the administrative costs of the 16 private insurance companies that offer the policies. Over the past five years, spending has averaged $6.7 billion a year in premium subsidies, $1.5 billion for insurance company subsidies, $0.3 billion for underwriting losses, and $0.2 billion for federal administrative costs.[9]

   Subsidized insurance is available for more than 100 crops, but corn, cotton, soybeans, and wheat are the main ones. About 80 percent of current policies in force protect against revenue shortfalls, while the other 20 percent protect against yield shortfalls.[10]

   The insurance companies receive direct subsidies for administration, but they also earn inflated profits from the high premiums they charge. The Government Accountability Office has found that crop insurance firms earn high rates of return.[11] Agricultural economist Bruce Babcock has found that commissions made by crop insurance agents have increased substantially over the years.[12]

   As for farmers, the USDA pays 62 percent of their premiums, on average.[13] Most farmers actually make money on this so-called insurance, receiving more in claims than they pay in premiums. The Congressional Budget Office found that farmers have received $65 billion more in claims than they have paid in premiums since 2000.[14] As Babcock noted, this program is not "insurance" at all, but a lottery that is a sure bet.[15]

   Congress has expanded crop insurance to become the largest farm program for a reason. For other farm programs, the identities of the wealthy subsidy recipients are public information, which can be politically embarrassing for farm program supporters. But with insurance subsidies, Congress essentially launders the cash through the insurance firms, which hides the identities of the recipients.

Also, unlike other farm programs, there are no income limits on insurance, so millionaires and billionaires receive subsidies. There are about 20 farm businesses that receive more than $1 million a year from the program.[16]

2. **Agriculture Risk Coverage (ARC).** This program pays subsidies to farmers if their revenue per acre, or alternately their county's revenue per acre, falls below a benchmark or guaranteed level. Generally, the lower the prices and revenues, the larger the subsidies. The program covers more than 20 crops, from wheat and corn to chickpeas and mustard seed. ARC subsidies fluctuate, but they were $3.7 billion in 2017.[17]
3. **Price Loss Coverage (PLC).** This program pays subsidies to farmers on the basis of the national average price of a crop compared to the crop's reference price set by Congress. The larger the fall in a crop's national price below its reference price, the larger the payout to farmers. Since reference prices are set high, payouts are likely. The program covers more than 20 crops, and payments were $3.2 billion in 2017.[18]

   Farmers choose to participate in either ARC or PLC. At the same time, they can enroll in crop insurance, which has the same general function of keeping farm incomes high. So farmers can double dip from at least two subsidy programs should their crop revenues come up short.[19]
4. **Conservation Programs.** The USDA runs numerous farm conservation programs, which cost taxpayers more than $5 billion a year. Some of the programs pay farmers to improve lands that are in production, such as the Conservation Stewardship Program. Other programs pay farmers to take land out of production, such as the Conservation Reserve Program. Like other farm programs, these subsidies are tilted upward, providing the great bulk of benefits to the largest farms.[20]

   Rather than handing out taxpayer cash to farmers, a better way to conserve marginal lands would be to repeal farm subsidies, which encourage excessive cultivation.
5. **Marketing Loans.** This is a price-guarantee program that began during the New Deal. The original idea was to give farmers a loan at harvest time so that they could hold their crops to sell at a higher price later. But today the program is just another unneeded subsidy that boosts farm incomes. The cost of this program dropped to near zero in 2017, but it was about $160 million in each of the previous two years.[21]
6. **Disaster Aid.** The government operates disaster aid programs for various types of farmers, from wheat growers, to livestock producers, to orchard operators. In addition to disaster programs already in law, Congress often distributes more aid after adverse events. Disaster aid amounts fluctuate, but such aid has averaged $1.9 billion a year since 2010.[22]
7. **Marketing and Export Promotion.** The Agricultural Marketing Service spends $1.2 billion a year on farm and food promotion activities. The Foreign Agricultural Service spends about $300 million a year on marketing activities for U.S. farm and food products, including operating more than 90 foreign offices.
8. **Research and Other Support.** Most American industries fund their own research and development, but the government employs thousands of scientists and other experts to aid the agriculture industry. The USDA spends about $3 billion a year on agriculture and food research at more than 100 locations. The department also provides an array of other support services to farmers, such as statistical data and economic studies.

REASONS TO REPEAL FARM SUBSIDIES

The Trump administration's budget for 2019 proposes to cut farm subsidies by tightening limits on the maximum payments to each farmer and ending subsidies for farmers with incomes above $500,000 a year.[23] The budget would also cut insurance subsidies and conservation subsidies. The reforms would save about $6 billion a year when phased in.

Studies from various think tanks have also proposed reforms. Heritage Foundation experts propose repealing the ARC and PLC programs and trimming crop insurance.[24] American Enterprise Institute (AEI) experts have found that modest limits on payments to large farms would produce major savings.[25] For example, a cap on insurance subsidies of $40,000 per farm would affect only 5 percent of farmers but save $2 billion a year.

Ultimately, Congress should end all farm subsidies. Businesses in other industries face many risks and market fluctuations, yet they prosper or fail depending on their own skill and planning without a federal subsidy cushion. Farm businesses face some unique risks, but so do other businesses. Consider, for example, the fast pace of change in technology industries, or the large price fluctuations in the mining and energy industries.

The following sections discuss why farm subsidies make little sense.

1. **Subsidies Redistribute Wealth Upward.** Farm subsidies go mainly to high-earning households. The average

income of all farm households was $117,918 in 2016, which was 42 percent higher than the $83,143 average of all U.S. households.[26] The same year, the median income of farm households was $76,250, which was 29 percent higher than the U.S. median of $59,039.

Farming incomes are down somewhat in recent years as crop prices have dipped from unusually high levels between 2011 and 2013. But the ratio of average farm household income to the average income of all U.S. households has been trending upward since at least 1960.[27]

Those income measures are for all farm households, but Congress delivers the bulk of subsidies to the largest and wealthiest farm households. A recent analysis by AEI scholars found that 60 percent of subsidies from the three largest programs (insurance, ARC, and PLC) go to the largest 10 percent (by sales) of farms.[28]

The AEI scholars found that the largest farms were more intensely subsidized than smaller farms. Looking at the crop insurance program, for example, they found that the top 10 percent of farms received subsidies of $29 per acre, compared to an average of $12 per acre for all crop farmers.

The high-end concentration of farm payments has increased over time. A recent USDA study found that "in 1991, half of commodity program payments went to farms operated by households with incomes over $60,717 (in constant 2015 dollars); however, in 2015, half went to households with incomes over $146,126."[29] The study found similar increases in the high-end concentration of crop insurance subsidies and conservation subsidies.

Politicians often claim that farm aid helps alleviate rural poverty. But farm aid goes to farm owners, and they have relatively high incomes. Just 2 percent of farm households fall below the poverty line, compared to 14 percent of all U.S. households.[30] Also, USDA data show that while less than one-third of farms with revenues of less than $100,000 received federal subsidies, three-quarters of farms above that threshold did.[31]

At the top end, many billionaires have received farm subsidies over the years. Looking at the period from 1995 to 2014, the Environmental Working Group (EWG) found that 50 people on the Forbes 400 list of the wealthiest Americans received farm subsidies.[32] Today, the largest pot of subsidies is channeled through insurance companies, which hides the identities of recipients, as noted.[33] However, the Government Accountability Office found that at least four recipients of crop insurance subsidies have a net worth of more than $1.5 billion.[34]

2. **Subsidies Harm the Economy.** In most industries, market signals steer investment, businesses balance risks and rewards, and entrepreneurs innovate to reduce costs. Federal programs blunt those market mechanisms in agriculture, causing a range of economic harms, including overproduction, distorted land use, distorted choice of crops, and inadequate cost control.

   Subsidized crop insurance, for example, creates "moral hazard" for farmers, meaning it induces them to make decisions that maximize their subsidies, not market efficiencies. Subsidies induce farmers to take unwise risks since taxpayers pick up the tab upon failure.[35]

   Agricultural economist Vincent Smith notes: "When farmers buy subsidized crop insurance coverage based on their farms' crop yields, they use fewer inputs that reduce the risk of crop losses. In plain language, farmers change their production practices—and on average produce less output—when they have crop insurance coverage."[36] Thus, he says, "by subsidizing crop insurance, taxpayers are encouraging farmers to work less efficiently, produce fewer crops, and make smaller contributions to the overall productivity of the U.S. economy."[37]

   Farm subsidies inflate land prices and land rental costs because—to an extent—the expected future stream of subsidies is capitalized. As a result, subsidies probably benefit landowners more than farmers, and those are often different people because more than half (54 percent) of U.S. cropland is rented.[38] As subsidies have pushed up sales prices and rental costs for land, it has become harder for young farmers to break into the business.

   Farm program supporters claim that an economic benefit of aid is that it helps consumers. But crop subsidies do not reduce food prices much, if at all. One reason is that commodity costs make up just 10 percent of the retail prices of domestic food, on average.[39] Also, some farm programs raise consumer prices. Dairy and sugar market restrictions raise prices for those products, for example, and the federal ethanol mandate raises corn prices.[40]

   Some policymakers claim that subsidies support rural workers. But the vast majority of aid goes to the capital-intensive production of field crops such as corn, soybeans, and wheat.[41] By contrast, the agricultural industries that are more dependent on low-skill labor—such as fruits and vegetables—receive virtually no federal subsidies.

3. **Subsidies Are Prone to Scandal.** Like most federal subsidy programs, farm programs are subject to bureaucratic waste and recipient fraud. One problem is that the government distributes disaster payments in a careless

manner, with payments often going to farmers who do not need them.

Another problem is that some farmers claim excess benefits—for example, by creating business structures to get around legal subsidy limits. The inspector general of the USDA recently found that more than 30 percent of the applicants for the Conservation Stewardship Program were either ineligible or receiving excess payments.[42]

Another ongoing boondoggle is the "prevented planting" program, which covers farmers for losses if conditions during a season prevent them from planting some areas. EWG found that billions of dollars have been paid to farmers who probably would not have planted the areas they received subsidies for.[43] AEI scholars concurred, noting that payments under the program "may significantly exceed the actual losses" experienced by farmers.[44] The losses claimed by farmers under the program are difficult to verify, which has encouraged cheating.

Perhaps the biggest scandal with regard to farm subsidies is that agricultural committees in Congress include members who are active farmers and farmland owners. Those members have an obvious conflict of interest whenever there is a vote on subsidies. There are 32 current members of Congress who have received federal farm subsidies.[45]

4. **Subsidies Undermine U.S. Trade Relations.** When countries subsidize farm production and doing so boosts commodity exports, it undermines foreign producers and distorts global trade patterns. Most high-income nations subsidize their farmers, yet those nations often complain about subsidies in other countries undermining their own farmers. The solution is for all nations to slash farm subsidies, which would save taxpayers money and allow the most efficient producers to supply global markets.

One particular concern is that farm subsidies and trade protections in high-income countries—such as the United States—harm lower-income countries and undermine their efforts at economic reform. Global stability is enhanced when poor countries adopt markets and achieve growth through trading. But U.S. and European farm subsidies and agricultural import barriers undermine progress on free trade. U.S. sugar protections, for example, block freer trade within the Americas, while harming U.S. consumers and food companies.

The Congressional Budget Office reviewed studies examining the repeal of U.S. and foreign farm subsidies and trade barriers.[46] It concluded that all major studies found that the U.S. and the global economy would gain from such reforms. Trade liberalization would boost the exports of U.S. goods that are competitive on world markets, including many agricultural products, but U.S. farm subsidies and protections stand in the way of that goal.

5. **Subsidies Harm the Environment.** Federal farm policies damage the natural environment in a number of ways. Subsidies cause overproduction, which draws lower-quality farmlands into active production. Areas that might have been used for parks, forests, grasslands, and wetlands get locked into agricultural use. AEI scholars note that subsidizing crop insurance encourages farmers "to expand crop production on highly erodible land."[47] Lands that would have been used for pasture or grazing have been shifted into crop production.

Subsidies may induce excessive use of fertilizers and pesticides. Producers on marginal lands that have poorer soils and climates tend to use more fertilizers and pesticides, which can cause water contamination problems. Sugar cane production has expanded in Florida because of the federal sugar program, for example, and the phosphorous in fertilizers used by the growers causes damage to the Everglades.

Finally, subsidies may discourage crop rotation in favor of planting only a subsidized crop, which in turn can lead to increased use of fertilizers. The boom in corn production driven by subsidies and the ethanol mandate is apparently generating pollution problems in the Mississippi River and Gulf of Mexico.[48]

6. **Subsidies Are in Addition to Favorable Taxation.** If farmers were large payers of federal income tax, they might argue that they were covering the costs of the spending subsidies they are receiving. But that is often not the case. Income tax data over recent decades show that, in general, farm businesses are lightly taxed.

About 87 percent of farms are structured as sole proprietorships and file under the individual income tax with a Schedule F.[49] These farms account for half of U.S. agricultural sales. Farms structured as partnerships and S corporations also pass through their business income to their individual returns. A small share of farms are structured as C corporations and pay the corporate income tax. Overall, farm entities taxed under the individual income tax account for 97 percent of farms and 85 percent of agricultural production.[50]

The USDA examined farm taxation in 2001 and found that "in general, income from farming is taxed more favorably than income from many other businesses."[51] The USDA also noted: "This favorable tax treatment is reflected in the size of farm profits and losses reported for income tax purposes. Since 1980, aggregate farm losses have exceeded farm profits and are used to offset taxes on off-farm income."[52]

More recent USDA studies show that farm tax returns continue to show net losses overall.[53] Only about one third of Schedule Fs report farm profits in a typical year. Losses on tax returns do not necessarily mean that farms are losing money, but rather that tax rules for farms are very favorable.[54]

Internal Revenue Service (IRS) data show that aggregate farm losses reported on Schedule Fs are often roughly twice the size of aggregate farm income.[55] Those net losses can be used almost without limit to offset nonfarm income.[56]

Larger farms may have substantial capital gains and rental income from the farm, which can move their farm-related income into positive territory. But even including that income, about half of farms report an overall loss from farm activities on their tax returns.[57]

IRS data for 2015 show 1.26 million Schedule F farms with net losses of $26 billion, and 0.54 million farm returns with net income of $15 billion.[58] Farm households use the net losses to reduce taxes on their nonfarm incomes.

The USDA reports that "about half of all farm partnerships and small business corporations also report losses" on their tax returns in a typical year.[59] Recent IRS data show that farm S corporations do report aggregate net income on their tax returns, but the ratio of net income to revenues for farms is a bit less than that for all S corporations.[60] C corporations in agriculture have a similar burden of taxes to that of all C corporations.[61]

Larger farms are more likely to pay income taxes than smaller farms.[62] The USDA found that "while many commercial-size farmers pay taxes on their farm income, farm sole proprietors in the aggregate pay little in federal income tax on farm income."[63]

Why is that? In testimony to the House Committee on Agriculture last year, accountant Christopher Hesse, who specializes in farm taxation, described more than a dozen tax provisions that provide favorable treatment to farms.[64] Many provisions allow farmers flexibility over the timing of income and deductions, allowing them to push income forward and prepay expenses, which reduces taxable income.

The 2017 Tax Cuts and Jobs Act provided a new tax benefit for farmers who sell their crops to cooperatives. The *Wall Street Journal* said it would allow "more farmers to lower their taxable income to zero and cost the U.S. government significant revenue."[65] The inclusion of the break illustrated the power of the farm lobby, but in this case Congress realized it went too far and subsequently repealed the break in the omnibus spending bill passed in March 2018.

In sum, farmers have done well for themselves in Washington, not just on the spending side of the federal budget but also on the tax side. It is true, however, that the largest farms that receive the bulk of subsidies are also more likely to be payers of income tax.

7. **Farmers Can Provide Their Own Safety Nets.** The Trump administration's 2019 budget proposes cuts to farm subsidies, but it also promises to "maintain a strong safety-net for farmers." But why can't farmers create their own safety nets?

Farmers deal with fluctuations in crop prices and yields, which causes variations in their incomes. But those risks are well known, and farmers can plan for them. For one thing, they can save. When corn prices are high, the corn farmer can save the excess profits, and when corn prices fall he or she can withdraw from savings.

Borrowing is another way to smooth finances over time. In good times, farmers can pay down debt so that they have more room to borrow during leaner times. Farm program supporters claim that farmers would not be able to access bank credit without the federal aid they currently receive. But Vincent Smith notes that banks routinely lend to unsubsidized farm businesses. Banks "are happy to make loans to ranchers who raise cattle (not crops) and hog and poultry producers, without a guaranteed government backstop. All those businesses manage farm operations with highly volatile incomes and costs."[66]

Saving and borrowing are basic financial tools available to all businesses. There are other market-based tools that farmers can use, including insurance and various price hedging products such as futures and options. The existence of farm subsidy programs has replaced, or crowded out, greater use of such market-based financial tools.[67]

Diversification is another strategy farmers can use to reduce risks. They can diversify their crop plantings to reduce risks from fluctuating yields and prices. They can diversify their planting locations to reduce risks from adverse weather.

Farm households can diversify their sources of income to include both farm and off-farm income. Indeed, USDA data show that about three-quarters of farm household income today comes from off-farm sources.[68] Back in 1960, farm households had roughly equal amounts of farm and off-farm income, but since then the latter has soared.[69]

Farm households have greater financial stability today than in the past. Farm debt levels have been low in recent decades.[70] And the bankruptcy rate in agriculture has been consistently lower than that in other industries. With the exception of the mid-1980s, the annual rate has been 2 to 3 per 10,000 farms since the 1950s, and it was 2.4 in 2017.[71] By contrast, the bankruptcy rate for all U.S. businesses has been about 8 per 10,000 in recent years.[72] So the farm bankruptcy rate is one-third the rate of U.S. businesses overall.

8. **Farmers Would Thrive without Subsidies.** If U.S. farm subsidies were ended and agricultural markets deregulated, farming would change. Different crops might be planted, land use might change, and some farm businesses might contract while others expanded. Farm businesses would rely on market-based risk-reduction methods, such as saving and diversification. A stronger and more innovative industry would emerge that had greater resilience to market fluctuations.

An interesting example of farmers prospering without subsidies is New Zealand. In 1984 that nation ended its farm subsidies, which was a bold stroke because New Zealand is four times more dependent on farming than is the United States. The changes were initially met with resistance, but New Zealand farm productivity, earnings, and output rose in the years after reform. New Zealand farmers cut costs, diversified land use, sought nonfarm income, and developed niche markets such as kiwi fruit.

The Federated Farmers of New Zealand argues that New Zealand's experience "thoroughly debunked the myth that the farming sector cannot prosper without government subsidies."[73] That myth needs to be debunked in the United States as well.

CONCLUSIONS

A number of major farm programs expire at the end of September 2018, which provides Congress a chance to rethink its costly farm policies. Policymakers should look to the Trump administration's 2019 budget, which includes a number of sensible reforms to farm programs.

For Republicans in Congress, farm subsidy cuts would signal that the party is concerned about fiscal responsibility at a time of rising budget deficits. The GOP has sought cuts to low-income welfare programs, and it makes sense to combine those with cuts to farm subsidies, which are welfare for the well-to-do.

As the Heritage Foundation has argued, Congress this year should at least repeal the crop subsidy programs added in the last farm bill, ARC and PLC.[74] Over the longer term, all farm subsidies should be ended. American farmers should stand on their own two feet in the marketplace, as do businesses in nearly all other industries.

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