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## **A Strong Case for Change**

Every five years or so, the U.S. Congress crafts legislation on food and farm policy that is commonly known as the “farm bill.” Through its several titles, the farm bill authorizes billions of dollars for commodity support programs, conservation, agricultural trade and aid, nutrition programs, farm credit and rural development, research, forestry, energy (a new title introduced in 2002), and other areas. The current farm bill, officially known as the Farm Security and Rural Investment Act of 2002, is due to expire on September 30, 2007. As Congress gears up to write a new farm bill, it should consider current and future trends in agricultural markets, taxpayer demands for efficient and responsible use of their money, and the benefits and costs of farm policy that fall on particular groups in the American economy and abroad. Here we offer a market-based alternative to the current system and a clear path toward a farm policy that would serve the interests of the United States as a whole.

A new direction for U.S. farm policy is especially important now because the 2007 Farm Bill will be rewritten at a critical juncture. The Doha round of World Trade Organization negotiations, expiration of trade promotion authority (whereby Congress delegates to the executive branch the power to negotiate trade agreements and submit them to Congress for an up-or-down vote without amendment), record prices for commodities, and budgetary concerns will all influence the debate.

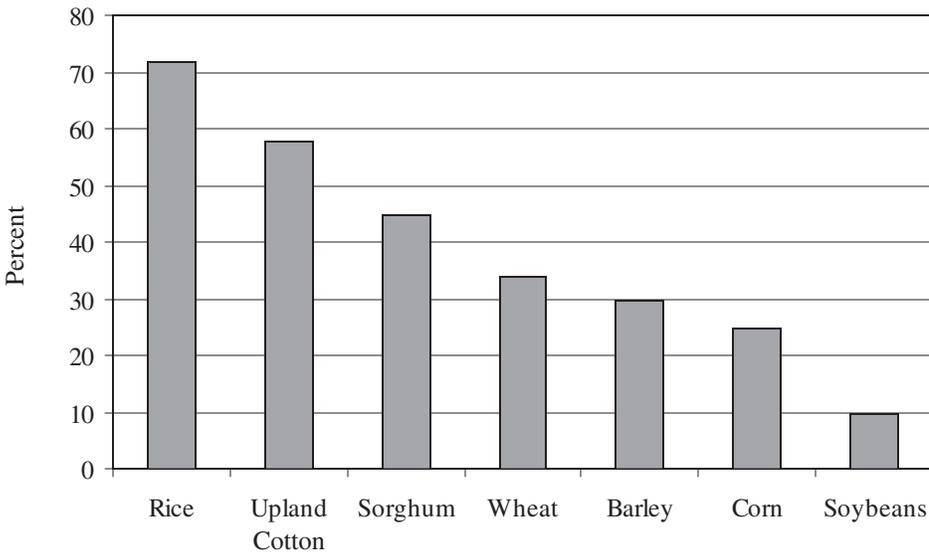
These issues are interrelated, too: Congress may extend trade promotion authority if a successful conclusion to the Doha round is in sight. Current market conditions, with unusually high prices for many commodities, provide an ideal opportunity for the United States to go further on its current offer to the WTO for cuts in domestic support with minimal transition costs for farmers. Making the cuts now will have the added effect of injecting life into the Doha round and therefore extending the benefits of more open trade to other sectors of the American economy.

Government intervention in agricultural markets and rural affairs owes much to history and emotion. The Great Depression and Dust Bowl of the 1930s set a precedent for farm policy that remains today, despite a radically different U.S. economy. Rural life is often romanticized, and the iconic “poor struggling family farm” looms large in American lore, even if it bears little resemblance to the socioeconomic reality of farming today. Some supporters of current policy defend it on national security grounds: being “dependent” on foreigners for our food supply is supposedly a national security risk.

But rising farm incomes and land values and increased awareness about the largesse and unfairness of government farm subsidies have raised questions about the way farm policy is currently structured. As market conditions have changed and the status quo draws wider criticism, new actors in the agricultural debate have come into play. Some farmer groups—such as fruit and vegetable growers, for example—insist that they do not want traditional sorts of subsidies but have asked for government support to the tune of \$1 billion over the course of the next farm bill for conservation programs, marketing efforts, and increased spending on their products in government nutrition programs.<sup>1</sup> Environmental groups are drawing attention to environmental damage caused by distortions in farm markets, while international nongovernmental organizations such as Oxfam International shine a spotlight on the harm U.S. and other rich-country farm programs cause to poor farmers abroad because of artificially depressed global prices. Food processors and other commodity-consuming U.S. producers are raising concerns that artificially high domestic farm prices are jeopardizing exports, sales, investment, and jobs. Taxpayer groups see the farm bill as an opportunity to trim federal spending.

Acknowledging the high costs that current farm programs impose on Americans and U.S. trade partners is an important first step toward bringing agriculture into the 21st century and treating it no more or less favorably than any other industry. A 2005 Cato study, “Ripe for Reform,” outlined the major ways that Americans would benefit from substantial reform of farm policy.<sup>2</sup>

**Figure 1**  
**Subsidy Payments as Share of Cash Receipts, Major Crops, Average FY1996–2005**



Source: Randy Schnepf and Jasper Womach, “Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview,” *CRS Report for Congress*, October 25, 2006.

Removing trade barriers and price supports would benefit hundreds of millions of American consumers of sugar and dairy products. U.S. industries using those commodities in their final products would also benefit from lower costs. The most recent figures from the Organization for Economic Cooperation and Development estimate that high domestic food prices caused by farm policies saw American consumers transfer more than \$8 billion to domestic producers in 2005.<sup>3</sup> That “food tax” is regressive, because poorer families spend a higher proportion of their income on food. Moreover, the median wealth of American farm households is more than five times the estimated median wealth of the overall average American household, with average annual incomes exceeding the overall average household income by 5 to 17 percent every year since 1996.<sup>4</sup> In other words, the relatively poor are subsidizing the relatively rich. As an income redistribution program, it is woefully regressive.

The new Congress would do well to reduce the billions of taxpayer dollars spent on farm subsidies. The Environmental Working Group, a Washington-based nonprofit organization that maintains a database of federal farm subsi-

dies, estimated that the federal government spent more than \$21 billion on farm programs in FY2005 (\$16 billion of that on commodity payments alone), the highest figure since 2001.<sup>5</sup> Doubly unfairly, the farmers who receive this largesse are often the biggest, with more than half of government payments in 2005 going to the 7 percent of farms defined as large family farms (having revenues above \$250,000 per year).<sup>6</sup> Far from helping small, family farms, subsidies often help big farms to consolidate by buying their neighbors’ land. This concentration of payments in the hands of the relatively wealthy few amounts to little more than corporate welfare. Even though they are minimally, if at all, trade distorting, some payments even go to owners of land that has been removed from farming altogether. Members of Congress concerned about fiscal responsibility should support efforts to curb taxpayer transfers to farmers.

A recent Congressional Research Service study shows that, in some periods and for some crops, farming has been kept alive largely by government check. Figure 1 shows the subsidization rates (the ratio of total subsidies to the market value of production) of major U.S. crops, using data from the CRS study.

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**The opportunity cost of agricultural support policies between 1986 and 2006 was an estimated \$1.7 trillion.**

Those average subsidization rates, as damning as they are, hide the extent of subsidization in some years for some commodities. In FY 2000, for example, subsidies for rice and cotton covered 174 percent of market income, and sorghum and wheat saw subsidy rates of more than 100 percent. The CRS concludes, “It is only with the aid of subsidies that a substantial portion of U.S. production is made economically sustainable.”<sup>7</sup>

Farm policy reform would promote much-needed diversification, innovation, and productivity on farms. The current system, by concentrating on a few commodities and encouraging overproduction, leads to overuse of marginal land and water and heavy use of farm chemicals that can damage the environment. Farmers have less incentive to listen to what the market demands and to innovate accordingly. The purported “rural development” benefits of farm subsidies are spurious at best, with a recent study finding a negative correlation between government payments to rural counties and their job and population growth.<sup>8</sup> Despite decades of government support for agriculture, jobs in farming are declining:

Agricultural jobs in rural and small-town America fell from 12.4 percent of nonmetro jobs in 1976 to 6.2 percent of nonmetro jobs in 2004. Along with this drop has been a relative decline in overall employment in areas that depend the most on farming. . . . The manufacturing sector employs far more nonmetro workers than the farm sector does.<sup>9</sup>

U. S. subsidies hurt Third World farmers by encouraging U.S. production and therefore depressing world prices for commodities. Poor farmers in developing countries cannot compete with the U.S. Treasury. The perceived hypocrisy of the United States—which professes a belief in economic opportunity for all—does not help U.S. foreign policy and security. Agricultural policy in developed countries is also a major obstacle to completing the Doha round of trade talks, which would extend benefits of freer trade to U.S. consumers and import-using U.S. pro-

ducers and would open markets abroad for U.S. exporters. For agriculture in particular, opening export markets is the key to growth. The world’s population is forecast to grow by 3 billion by 2050, and as developing countries grow they will spend a higher proportion of their extra income on food. For American farmers, future growth lies abroad.

American consumers and taxpayers have paid a high price for our failed farm programs. Although the discussion in Washington tends to focus on federal budget expenditures for commodity price supports, Americans also pay for farm programs through trade barriers that raise prices for domestic consumers. Since 1986, a few favored farm sectors have received between \$21 billion and \$56 billion a year in government support in the form of direct taxpayer subsidies and higher prices.

Our calculations show that the opportunity cost of agricultural support policies between 1986 and 2006 was an estimated \$1.7 trillion. That cost includes subsidies plus producer support from trade barriers and price floors, assuming discount rates in each year equal to the prevailing average 10-year Treasury note rate. In other words, if American taxpayers and consumers had been spared the cost of farm programs during the past two decades, and had they been able to invest those savings at the market rate of interest, they would be \$1.7 trillion wealthier today (see Table 1).

The cost of the U.S. farm program is a significant drain on the economy. Reforming it unilaterally, by removing import barriers, domestic price supports, and the institutional infrastructure for continuing taxpayer-funded agricultural support, is a policy overwhelmingly in the wider national interest. A new farm bill should guarantee that Americans will not be on the hook for another \$1.7 trillion or more during the next two decades.

## **A Farm Policy for All Americans**

For lasting reform of American agricultural policy to take hold, policy alternatives must be

**Table 1**  
**Total Cost of Farm Support Programs in the United States, 1986–2005 (billions of dollars)**

Year	Product Support Estimate	Average 10-year bond rate	Opportunity cost
1986	38.55	0.0768	169.34
1987	40.08	0.0839	185.22
1988	32.25	0.0885	148.39
1989	39.61	0.0849	158.26
1990	32.11	0.0855	119.31
1991	31.51	0.0786	98.04
1992	31.95	0.0701	82.48
1993	34.12	0.0587	71.61
1994	29.92	0.0709	68.08
1995	21.06	0.0657	42.41
1996	29.76	0.0644	55.55
1997	30.67	0.0635	53.37
1998	47.19	0.0526	71.12
1999	56.21	0.0565	82.58
2000	53.07	0.0603	75.41
2001	51.78	0.0502	66.15
2002	40.34	0.0461	48.31
2003	35.93	0.0401	40.43
2004	42.87	0.0427	46.61
2005	42.67	0.0429	44.50
Total			1,727.15

Sources: OECD, United States: Estimates of Support to Agriculture; Bureau of Economic Analysis Implicit Price Deflators for Gross Domestic Product; and *Economic Report of the President*, February 2006, Table B-73.

crafted and sold to lawmakers in the face of powerful special interest groups. Ideally, decades of bad policy would require no buyout of any kind, and repealing the legislation that enables farm programs could occur overnight with the expiration of the 2002 Farm Bill. Political realities, however, are such that some sort of transition mechanism and payments are likely needed in order to achieve reform. And while the payments may be morally questionable—after all, what moral claim do long-protected special interests have for “compensation”?—the long-term benefits to American taxpayers and consumers of farm products, and to our trade partners and interests more broadly, surely outweigh the short-term cost of a well-designed, limited payout.<sup>10</sup>

This concession to political reality may be the only way to enact reform and to capture the benefits from a more market-oriented farm policy. A

recent study from the Australian Bureau of Agricultural and Resource Economics estimates the medium- to long-term benefits to the U.S. economy from increased competition and exposure to market signals in agriculture. Contrary to some prophets of doom, the ABARE study predicts a largely positive future for farming in America through improvements to agricultural productivity, better allocation of resources, and an improvement in the average efficiency of farmers (as inefficient farmers leave the industry).

Although production of the major program crops and sugar is expected to fall, and milk production to fall marginally, production of fruit and vegetables, beef cattle, and pigs and poultry are all forecast to increase. Although the net present value (discounted at 7 percent and measured in 2005 dollars) of the fall in farm income is projected to be \$65 billion over the 10 year phase-in period, the net present value of the

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budgetary savings over this same period would be \$120 billion.<sup>11</sup> In other words, American taxpayers could fully “compensate” farmers for lost income and still save \$55 billion compared to what would be spent under existing programs.

Because the commodity payments (covered by Title I of the farm bill) and the trade barriers that support domestic prices are the most damaging economically, they are the main focus of our analysis. We leave it to other authors to provide detailed insights into how to reform the other titles, recognizing that reductions in commodity support and market intervention will have effects on other policy areas covered by the farm bill, including conservation and rural development.

## **General Guidelines**

For farm policy to reflect the interests of all Americans, changes to farm policy must satisfy a number of broad principles. First, any changes must be compatible with the U.S. government’s commitments in the WTO. That is, trade-distorting support (subsidies that are linked to production or prices of certain commodities) must not breach the current limit of \$19.1 billion per year. Beyond that, though, changes to agricultural policy that go further than mere compliance with WTO commitments will not only benefit the U.S. economy but will set a positive example for other WTO members to do the same. And far from giving away a bargaining chip, as some lawmakers and farmer groups have claimed, the standing of countries such as Australia and New Zealand, not to mention Hong Kong and Singapore, has improved following their unilateral trade liberalization efforts in the 1980s and 1990s because they come to negotiations with relatively clean hands. Australia in particular enjoys an influence on agricultural negotiations far in excess of what would be expected, given its size. If the United States were to lock in its unilateral reforms by translating the spending and tariff cuts into new limits in its schedule of commitments, that would provide a further guarantee against any political temptation to renege.

Second, changes to U.S. farm policy should significantly decrease market distortions. Payments to farmers should be completely de-linked from production and all price supports removed. Support given to farmers that does not stimulate production and impose injury on competing exporters through price suppression effects is less damaging from an economic point of view than payments that are given without any conditions, fiscally irresponsible though the latter may well be. Although the support provided by import barriers attracts fewer headlines than do budgetary outlays on commodity payments, any reform of farm programs should recognize and eliminate the role of tariffs in distorting agricultural markets.

Third, reforms should challenge the implied compulsion to spend. The United States needs a farm policy that leaves a smaller footprint on the economic landscape and intrudes less into people’s lives and businesses. Lawmakers should make a clear commitment to phasing out farm subsidies once and for all and dismantling the infrastructure that supports them. The next farm bill must confront and defeat the entitlement mentality prevalent in farm lobby groups and include a clear plan for ending farm welfare as we know it.

Fourth, farm policy should benefit the nation as a whole: does it ensure that America is freer, more just, and more prosperous? Any plan for reform of agricultural policy in the United States should ensure that markets are freer, U.S. companies are less vulnerable to litigation, and taxpayers and consumers bear less of a burden for supporting a chosen few. Farmers choosing what to grow based on market conditions rather than a subsidy regime will truly free the farm.

## **A Buyout of Commodity Support: An Investment Worth Making**

Various farm and environmental groups involved in the farm bill debate have released ideas for less trade-distorting alternatives to the current system, such as shifting government money to environmental payments and “rural

**Table 2**  
**The Present Value of Projected Commodity Payments (millions of dollars)**

Year	Subsidies (total)	Cost (2007 value at 4.5%)
2008	13,076	12,513
2009	12,263	11,230
2010	10,909	9,560
2011	10,386	8,709
2012	9,950	7,984
2013	9,440	7,249
2014	9,125	6,705
Total	75,149	63,950

Source: Congressional Budget Office March 2006 baseline.

development” programs. Those alternative plans are certainly an improvement over current commodity-based farm programs and are a move in the right direction. But many of the proposals—which support increased land stewardship payments, increased funding for renewable fuels, and a greater emphasis on “locally-produced” foods—will not address the need for less government involvement in rural America. Taxpayer savings under many proposed alternatives would be minimal.

To address the need for smaller government, freer markets, and open trade in agricultural goods, Congress should consider an up-front buyout program in place of existing subsidies and price supports (including import barriers). This approach would pay current farmers a lump sum with minimal strings attached in exchange for the permanent elimination of all current production subsidies, quotas, and tariffs. The reforms should also include a “cutout” (i.e., elimination without explicit compensation) of “rural development” outlays and disaster payments. The buyout payments could be made all in one year, or spread out over a period of five to seven years to lessen the immediate budget impact.

The lump-sum payments should certainly not be more than the present discounted value of future support under existing law. In fact, the payments should be less because we are brokering a compromise: a politically necessary short-term gain for farmers together with the longer term gain of better policy and consumer/tax-

payer benefits. For sectors currently receiving commodity payments, payments over the next seven fiscal years are expected to decline gradually from \$13 billion in the current fiscal year to \$9 billion in FY2014, according to the March 2006 CBO baseline figures shown in Table 2. A seven-year time horizon would be slightly longer than the life of a typical farm bill, offering farmers “compensation” not only for payments that would likely be extended through a the 2007 farm bill but also a share of the less certain but still likely farm payments from the farm bill Congress would consider five years from now. When adjusted at a discount rate of 4.5 percent, those seven years of payments represent a present discounted value of \$64 billion.

Congress could offer an up-front, total buyout of commodity programs of \$45 billion (70 percent of the present discounted value of the next seven years of farm payments) or allocate total payments of \$15 billion a year for the next three years or \$9 billion a year for the next five years and still save money for taxpayers compared to what would have been spent under current law. Although the lump-sum payments would be something less than expected payments codified in current legislation, they would be fixed, accelerated, and decoupled from production decisions or price fluctuations.

The distribution of payouts among commodities would be as shown in Table 3, which shows the average projected spending on each commodity type as a percentage of total com-

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**Table 3**  
**Amount and Proportion of Buyout Payments to Each Commodity Group**

Commodity	Share of total projected spending, % <sup>1</sup>	Total amount, \$billion <sup>2</sup>
Feedgrains (corn)	44.1	19.8
Wheat	15.0	6.8
Rice	6.1	2.8
Upland Cotton	14.5	6.5
Soybeans	11.1	5.0
Peanuts	2.6	1.2
Sugar	2.3	1.0
Dairy	1.9	0.9
Other	2.5	1.1

<sup>1</sup> Total projected spending on each commodity according to the CBO March 2006 Baseline estimate, averaged 2007–2016, as percentage of total projected spending on commodity programs. Numbers may not add to 100 due to rounding.

<sup>2</sup> Numbers may not add to \$45 billion due to rounding.

modity spending, according to figures from the CBO March 2006 baseline (authors’ calculations). Multiplying this share by the \$45 billion total payout will give the total amount due to each commodity group. In other words, and in the absence of more detailed figures, farmers of a given commodity will get roughly 70 percent of the present value of what they would have received were the 2002 farm bill continued for seven years. Payments to individual farmers should be based on fixed historical production acreage (often called “base acreage”) and yields, as set in the 2002 farm bill, for direct payments and countercyclical payments (those that are based on fixed historical production but vary with market price). Buyout amounts for loan deficiency payments (based on actual production and market prices) should be based on actual payments paid over the life of the 2002 farm bill.

Buyout payments to individual farmers would be paid into a special Rural Seed Account in a lump sum. On receipt of the payments, the land would become “nonbase”; that is, ineligible to receive any further price or income support payments. The payments would be tax-deferred, so farmers would pay tax only on the amount actually withdrawn from the account. Unlike individual retirement

accounts or health savings accounts, there would be no restrictions on what the money could be used for. Farmers could spend the money for farm operations, education, home improvements, a business start-up, or a vacation and widescreen TV.

The account could act as a kind of self-insurance program, a rainy day fund that farmers could draw on to ease their transition to a fully liberalized market for farm products, to smooth their income during years when prices or yields fall, and to purchase insurance in the event of disaster. Taxpayers and consumers would no longer have to pay for future commodity subsidies, “rural development” outlays, and disaster payments.

Since the buyout payments would be completely decoupled from production, they could fit fully into the “green box” of WTO agriculture payments (i.e., those that only minimally distort trade, if at all, and are therefore not subject to caps under WTO rules). Some U.S. price support payments are currently classified as “blue box” subsidies, which are payments that are partially decoupled. In other words, although blue box policies are linked to market prices and may encourage production of a certain commodity, payments are subject to limits on land or production quantities. The United

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States has tried to redefine blue box subsidies during the current Doha round negotiations, so as to provide protection for more farm payments. As agricultural economist David Orden notes, buying out countercyclical payments “will enable the United States to abandon the WTO blue box . . . potentially allowing simplification and improved transparency of the WTO rules for agriculture.”<sup>12</sup> The buyout plan would also insulate the United States from any future challenges by other WTO members.

Some precedents exist for buyout programs. Tobacco farmers’ quota rights were bought out in 2004, and the 2002 Farm Bill saw the end of the domestic production quota system for peanuts (although peanut producers were from then on eligible for direct and price-linked subsidies). The rents that accrued to peanut growers from the production quotas were bought out at a cost equivalent to 24 years of rents discounted at 5 percent.<sup>13</sup> That payment schedule seems excessively generous, and we would advocate a buyout of the remaining support to peanuts along the lines of the other program crops: 70 percent of the present value of seven years worth of projected payments for peanuts is \$1.2 billion, using CBO figures.

## Consumer-Supported Commodities: Special Arrangements for Sugar and Dairy

U.S. farm policy provides special programs for sugar and dairy products. The domestic markets for these products are highly protected by import barriers known as tariff-rate quotas that keep domestic prices above world prices. A small amount of imported product is allowed with low applied tariffs (called the in-quota tariff rate), with any imports above that amount being subject to higher, essentially prohibitive tariffs (the out-of-quota tariff rate).

Behind that tariff wall, the domestic programs vary. Milk prices are supported through government purchases when prices are sufficiently low, and complex government-mandat-

ed price formulae according to the different uses of milk. Dairy products also enjoy export subsidies.<sup>14</sup> The sugar program relies on import barriers to limit foreign supply, and, when needed to support high domestic prices, on domestic marketing allotments to control the amount of sugar that American farmers are allowed to sell.

By limiting imports of cheaper product from abroad, the government minimizes the purchases of dairy and sugar it must make to hold the prices up. The budgetary impact of these programs is thus often small, although they contribute disproportionately to the total support given to farmers as measured by the WTO, called the Aggregate Measure of Support, which takes account of the “wedge” between domestic and world prices as well as budgetary outlays. Chip Conley, Democratic economist to the House Agriculture Committee, recently estimated (using the latest official U.S. data on agricultural support provided to the WTO) that the sugar program, though contributing just 1 percent of the budgetary cost of commodity programs on average from 1999 to 2001, contributed around 7 percent to the AMS over the same period. The dairy program made up 6 percent of budgetary outlays and 30 percent of the AMS.<sup>15</sup> The burden for supporting farmers of these products thus falls mainly on consumers rather than taxpayers, so the figures in Table 3 capture a relatively small proportion of the value of government interventions to dairy and sugar farmers.

Daniel Sumner, in a 2005 Cato Institute study, reclassified certain farm subsidies according to WTO legal rulings on the U.S. farm program and calculated that the market price support provided for sugar, dairy, and peanuts (the latter have had no price supports since 2004) accounted for a range between 21 percent (in 2006) and 79 percent (2004) of total agricultural support since 2001.<sup>16</sup> So, even though they are not prime targets for budget cuts, and the sugar lobby in particular has relied on the low budgetary cost of the program in their efforts to shield it from reform,<sup>17</sup> removing the price supports on sugar and dairy products would go a long way to reducing trade-distorting (“amber-box”) support, and to meeting the current and

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future WTO commitments of the United States. Liberating these markets would bring consumers of these products, including downstream industries, much-deserved relief.

Consumers, no less than taxpayers, deserve to be relieved from the perpetual burden of supporting noncompetitive farmers. A buyout of the protected commodities would not be cheap, reflecting the high costs consumers are paying currently because of existing policy. Economist David Orden, in a 2005 working paper, calculated that the cost of a total buyout of the benefits expected to accrue to sugar farmers over 25 years would range between \$16 billion and \$25 billion, or annual installments of \$2 billion to \$3 billion for 10 years.<sup>18</sup> The total cost of the buyout would depend on the decline in U.S. prices following free trade in sugar, with lower prices translating into a more expensive buyout.

A similar proposal was made in a 2006 Cato Institute study on dairy reform, although that study proposed that a buyout of the dairy program be financed by a producer levy rather than the consumer tax that Orden proposed for the sugar program. A milk buyout, if it were proportional to past benefits as the other buyouts proposed above, would be more costly than a sugar buyout. Although the present discounted value of seven years of projected dairy support payments (CBO figures) is approximately \$1 billion, that amount covers only the budgetary outlays and not the income supporting effects of inflated domestic prices. The latest figures available from the OECD estimate that the total support from taxpayers and consumers to milk producers in 2004 was \$11.3 billion,<sup>19</sup> approximately one quarter of the total farmer support for that year as calculated by OECD. However, the strength of dairy prices since 2004 would make the value of the price support components of U.S. dairy policy (which measures the difference between domestic and international prices) lower than in the past.<sup>20</sup>

Buying out sugar and dairy farmers would shift the public cost of supporting those farmers from consumers to taxpayers, provoking complaints that it is too costly for the federal government. Although such buyouts would

temporarily increase federal expenditures, they would not increase the overall size and cost of government. Americans would pay more as taxpayers but would be more than compensated by the savings they would realize as consumers. The costs of supporting a small group of farmers would also be more transparent because it would be reflected in a specific line in the federal budget rather than hidden in higher daily prices at the grocery store. It would expose the myth that these programs are “no cost” by showing their real cost to the public. Most importantly, the buyout would bring these unjust burdens to an end at a certain date rather than allowing them to continue their permanent, shadowy existence.

Congress is under no moral or legal obligation to “compensate” farmers fully for losing benefits that they arguably should not have been receiving in the first place. The purpose of lump-sum payments would be primarily political—to offer enough incentive to certain farmers to overcome their political resistance to reforms that are in the national interest.

## **Removing Trade Barriers**

Implementing a farm program buyout will require both expenditures through the federal budget and changes in the U.S. tariff code. Trade barriers are a major source of protection and income support, particularly for farmers of certain agricultural products. Typically, those barriers have formed an important part of the supply limits that have maintained artificially high domestic prices and, by limiting the flow of imports, have avoided even more costly government purchases. With price support programs removed and an end to taxpayers’ obligations to support farmers, there are no budgetary reasons for tariffs and tariff-rate quotas on agricultural products to continue. Free from the burden of having to support prices above world prices, the government could unilaterally cut tariffs on farm goods without fear of burdening taxpayers with product purchases and stockpiles.

In addition to reform through the 2007 farm bill, other congressional committees with

responsibility for U.S. trade policy should play their part in freeing agricultural markets from government intervention and distortions by reducing America's trade barriers. A phased-out reduction in all agricultural import barriers and export subsidies—with no “compensating” buyout payments beyond the Title I payout, except for those for dairy and sugar—would need to be coordinated with the reform of domestic farm policy so as to minimize any negative effects on taxpayers. For example, removing import barriers while continuing to support domestic prices would require enormous, if not prohibitive, government purchases of commodities.

Consumers and food processors have borne the burden of artificially high prices for some agricultural commodities for decades. Far from jealously defending trade barriers and domestic farm supports as a bargaining chip in trade negotiations, Congress should abandon those interventions without waiting for the Doha round to conclude. Allowing the free market to flourish is a favor the United States can bestow upon itself.

## Agricultural Trade and Aid

Title III of the farm bill covers programs that are “designed to develop and expand commercial outlets for U.S. commodities and to provide international food assistance,” including export credit guarantees, market development programs, and food aid. They are relatively inexpensive, with the current baseline suggesting a total of \$2 billion from 2008 to 2017.

Programs to address and remove technical barriers to trade such as animal and plant health and food safety standards are relatively inexpensive and minimally trade distorting. In fact, they often help trade to flow. These sorts of programs were allocated \$6 million per year in the 2002 Farm Bill, which we would advocate continuing.

The requirement that the secretary of agriculture be given discretion to adjust expenditures to avoid violating current and future WTO limits on trade-distorting subsidies should likewise

be retained, at least until support to farmers has ended altogether. Export subsidies, specifically for dairy products, are one of the most trade-distorting payments. Short- and long-term export credit guarantees, and the export enhancement program (which ostensibly aims to help U.S. exporters compete against subsidized exports from other countries) fall into the category of export subsidies that Congress should abolish immediately. Many of those schemes, in addition to being highly market distorting, probably violate WTO obligations.

WTO members are discussing rules and possible restrictions on international food aid as part of the Doha round negotiations. The United States, in particular, has come under attack from some WTO members for using food aid programs to dispose of surplus stocks of food—potentially “flooding” local markets with U.S. product and harming domestic producers—and of using food aid programs to develop potential future commercial markets for food. Reform that releases the U.S. government from stockpiling food will also release it from the need to dispose of that food on world markets. Humanitarian assistance, if the U.S. government can and should play a role, should be the responsibility of the U.S. Agency for International Development.

## Some Thoughts on Other Titles

### Nutrition Programs and the Farm Bill—the Ultimate Decoupling

Administered by the USDA's Food, Nutrition, and Consumer Services, federal nutrition assistance programs account for more than half of USDA's budget and are covered under Title IV of the farm bill. The School Meals Program, food stamps, and the Women, Infants, and Children program are perhaps the best known examples of government food assistance. The USDA estimates that more than 25 million Americans received food stamp benefits in 2005.<sup>21</sup> However, the USDA has recently acknowledged that food programs as currently structured are not aligned with nutritional guidelines and often favor the

**Allowing the free market to flourish is a favor the United States can bestow upon itself.**

## The buyout of Title I payments could aid a transition to fully self-funded farm insurance.

products of politically powerful commodity groups.<sup>22</sup> One powerful interest group, milk producers, was strongly opposed to updating the food packages because it would involve less spending on their products.<sup>23</sup>

The administration of any federal food programs, including block grants to state governments, properly belongs with the Department of Health and Human Services. Nutrition programs and commodity payments are entirely different policies. The historical reason for including nutrition programs in the farm bill—that they were the “demand side” of the equation in the centrally managed agricultural policy of the past—is no longer relevant. Legislation to administer and fund the programs, where they continue, should be decoupled from the farm bill completely. That will decrease the temptation for nutrition programs to be used as another form of support to farmers. Separating the legislation would also mean that members of Congress will not be compelled to vote in favor of programs that they do not support, simply because it is tied to legislation that they do support.

### Farm Credit and Rural Development

After reform, with tax-deferred savings accounts on which they can draw, farmers with a viable business plan will presumably have little trouble attracting credit. It is not the role of the government, using taxpayer funds, to ensure that rural areas are sufficiently “developed” to provide a mandated quality of life for rural residents.

As noted above, the benefits provided to rural communities by farm subsidies have been oversold. An oft-cited concern, though, is what will happen to rural land prices when government subsidies are reduced. For corn-producing areas, at least, the ethanol boom (see next section) may mitigate land value depreciations. Agricultural economist Luther Tweeten expects the new biofuels market will add at least 20 percent to land prices and incomes, which is approximately the value that economists have

estimated is added to farmers’ incomes from subsidies. Tweeten has asserted that no net change in land values would come about from removing subsidies to corn.<sup>24</sup> The adverse rural development implications of a fall in farm subsidies may therefore be overstated, at least in corn-producing areas.

Crop land prices have increased even through low-price years (the late 1990s and early 2000s), further illustrating the way that government actions have interfered in market processes. A recent study estimated that farm values would fall the most in the Great Plains and some southern states, where agriculture is most important in determining land values.<sup>25</sup> High implied land rents, reflecting the value of land that includes the capitalized value of government payments, may even be inhibiting the competitiveness of U.S. farms.<sup>26</sup> The funds available to farmers, both through their own savings and from transition payments in the buyout scheme, could be invested in rural communities where viable investment opportunities exist. Without the incentives provided by subsidies to concentrate efforts and resources in a few subsidy-attracting commodities, rural communities may flourish.

Crop insurance and disaster assistance, hidden away in Title X (Miscellaneous), provides for federal subsidies for insurance premiums. Crop insurance has become a lucrative subsidy for insurance firms but a very inefficient way of providing risk coverage for farmers. Agricultural economists at Iowa State University’s Center for Agricultural and Rural Development estimate that the first five years of the crop insurance program transferred a net \$8.8 billion to farmers, but at a taxpayer cost of \$15.5 billion.<sup>27</sup> And despite that high net cost, crop insurance has apparently had little impact on politicians’ tendency to award disaster and emergency assistance. The buyout of Title I payments could aid a transition to fully self-funded farm insurance in two ways: first, by providing initial funds for farmers to buy private insurance and, second, by forming a kind of self-insurance account on which farmers can draw in low-yield years. If private crop insurance is not available in certain areas or conditions, it is a good indication that

farming is not economical and should not continue.

## Energy

No analysis of agricultural policy in the United States today would be complete without at least a brief discussion of the ethanol boom, especially since congressional agriculture committee members—notably, Tom Harkin (D-IA), chairman of the Senate Agriculture Committee—have emphasized the role of alternative energy in their farm bill plans.

Bio-ethanol is an alternative to petroleum-derived gasoline and is produced in the United States mainly from corn. In 2005, the United States produced more than four billion gallons of ethanol, with production increasing more than 120 percent between 2001 and 2005.<sup>28</sup> Although the energy title, first included in the 2002 Farm Bill as a way of developing alternative fuels, established programs and grants for bio-energy research and development, much of the growth in production of ethanol can be attributed to other government decisions: tax relief and rebates (e.g., a 51-cent-per-gallon tax rebate on ethanol), a mandate through the Energy Policy Act of 2005 to use 7.5 billion gallons of renewable fuels a year by 2012, and import barriers (e.g., a 54-cent-per-gallon tariff on imported ethanol). President Bush, in his January 2007 State of the Union address, added to the ethanol frenzy by calling for an almost five-fold increase in the alternative fuels mandate by 2017.

The effect of this policy-driven demand for ethanol has led to almost unprecedented conditions in the corn market: record production coupled with high prices. The National Agricultural Statistics Service forecasted corn production at 10.7 billion bushels in 2006,<sup>29</sup> the second highest yield on record. And yet, average prices for corn in 2007 are predicted to reach \$3.50 a bushel, topping the previous record average price of \$3.24 in 1996.<sup>30</sup> That has flow-on-effects to other crops, as more farm land is diverted to growing corn. Soybeans, for example, are also forecast to fetch record prices in 2007.

Although beyond the scope of this paper, a thorough analysis of the costs and benefits of ethanol would likely reveal that the current enthusiasm for ethanol is misplaced. Jerry Taylor and Peter Van Doren, in a recent article, assert that “absent government favoritism, it’s unlikely that investment [in ethanol] would be more than a tiny fraction of its present level.”<sup>31</sup> The Global Subsidies Initiative, a project of the Canada-based International Institute for Sustainable Development, estimated in 2006 that federal and state government support for ethanol cost more than \$5 billion in 2006 and will increase to more than \$6 billion if current policy continues.<sup>32</sup> Taylor and Van Doren argue that ethanol will not necessarily provide a more reliable source of energy than gasoline and cast doubt on ethanol’s environmental credentials. Furthermore, the amount of ethanol needed to make a dent in America’s energy needs is far beyond the bounds of what the United States could sensibly produce. Diversion of corn to ethanol production will also impose costs on livestock producers, who use corn to feed their animals. A bidding war for corn will mean higher food prices for consumers.

Promoting and subsidizing commercially unviable energy is really just another taxpayer-funded welfare program for farmers, and for the investors in ethanol plants. Any provisions for government support for research into biofuels should be included in energy policy, not farm policy, in order to prevent it from becoming just a new and ingenuous way of responding to politically powerful farm lobby groups and marketing that response as an exercise in energy independence or environmental responsibility.

## Enforcing Reform

A past attempt at introducing reforms in the 1996 Farm Bill (called the Federal Agricultural Improvement and Reform, or FAIR, Act) gave greater planting flexibility to farmers and eliminated links between support payments and market prices. Direct payments, initially legislated for a period of seven years, replaced price-linked payments. However, low commodity prices in the

**Promoting and subsidizing commercially unviable energy is really just another taxpayer-funded welfare program for farmers, and for the investors in ethanol plants.**

**The government must take specific, positive steps to lock in any reforms undertaken.**

late 1990s and early 2000s saw an increase in emergency payments to farmers: outlays by the government on commodity payments, ad hoc and emergency assistance, and trade and conservation payments peaked at \$32.6 billion in FY2000.<sup>33</sup> Many of the ad-hoc market loss payments were then integrated into the 2002 Farm Bill because they formed part of the new baseline—budgetary and political. Similarly, the 2002 Farm Bill reestablished target prices for some commodities, thus moving away from the more market-friendly direction of the 1996 farm bill. Farmers also had a trump card: permanent, decades-old enabling legislation for supply and price controls that would automatically take effect should Congress fail to write a new farm bill.

The record of the reversed reforms of the 1996 Farm Bill and subsequent increases in spending demonstrates that the government must take specific, positive steps to lock in any reforms undertaken. The temptation to backslide on reforms is apparently too strong to resist without some kind of enforcement mechanism. Legislators should, first and foremost, remove from the books the permanent law (the Agricultural Act of 1949 and the Agricultural Adjustment Act of 1938) that mandates commodity price and farm income support. Completely disbanding programs and repealing the enabling legislation as a precondition to any disbursement to the RSAs, rather than simply cutting program budgets or relying on continuing high prices to deliver taxpayer “savings,” will remove the infrastructure necessary for the program to be ramped up again in future. It is true that future Congresses may seek to reintroduce farm programs, but that will be a more difficult task if rebuilding from scratch. As Orden, Paarlberg, and Roe put it in their 1999 book on U.S. agricultural policy reform, “The political resources needed to perpetuate existing programs are . . . less than the resources needed to create new ones.”<sup>34</sup>

Translating new U.S. subsidy limits and tariff levels into the United States’ schedule of WTO commitments will provide a useful further brace against backtracking on reform. Securing an agreement on the Doha round of trade negotiations should be a major priority

for the U.S. government, and the United States can play an important role in achieving that (while pursuing a policy that is in the interests of the United States) by offering these cuts in trade barriers and subsidies. Cutting tariff levels unilaterally would of course require the cooperation of other congressional committees (Ways and Means in the House and Finance in the Senate).

David Orden offers a further, stronger step to ensure that the buyout of commodity programs is permanent. According to Orden, state governments that buy development rights from farmers have devised legally binding criteria and contracts that could be adapted for enforcing a buyout of commodity payments. A farmer’s contract for buyout payments could include, for example, provisions that make the bought out land/output ineligible for future payments.<sup>35</sup>

The 1996 Farm Bill reforms basically amounted to an unenforceable promise by Congress to restrain itself in the future—a promise that proved to be all too easy to break. Unlike the FAIR Act of 1996, the reforms proposed here include mechanisms designed to prevent backsliding: First, repeal of the underlying enabling legislation that maintains a sense of entitlement to farm support payments. Second, a system of enforceable contracts preventing farmers from returning to the federal trough. And finally, making the reforms part of our international obligations at the WTO.

## Conclusion

Once existing farm programs are bought out, farmers would be able to grow whatever they wanted on their own land. Free from government interference and skewed incentives, farmers would be better able to respond to genuine market demand from consumers rather than the government. Taxpayers would no longer be saddled with an expensive welfare program that benefits mainly corporations and large-scale agribusinesses. For consumers it could mean higher prices for some food products, but goods currently subject to price floors or protected from global competition may become cheaper. In any case, it is fair and prop-

er that consumers pay the full market value of the food they consume. It is true that a buyout of farm programs would impose significant short-term costs on taxpayers. However, a large upfront payment that is legislatively time-limited and ensures that farm subsidies are a thing of the past is, we believe, an investment worth making.

A permanent end to farm programs, and an end to the prospect of another 70 years of taxpayer and consumer transfers to politically powerful special interests, damage to our trading interests, and government interference in markets, is within reach.

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