



# Cato Handbook for Policymakers

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## 18. Agricultural Policy

### Congress should

- phase down and terminate crop subsidies, a process that was supposed to begin with passage of the 1996 Freedom to Farm Act;
- move farmers toward the use of market-based insurance and other financial instruments to protect against adverse prices and weather events;
- eliminate federal controls that create producer cartels in such markets as dairy and sugar; and
- eliminate trade protections on agricultural goods while working through the World Trade Organization to pursue liberalization in global markets.

The U.S. Department of Agriculture distributes between \$10 billion and \$30 billion in subsidies to farmers and owners of farmland each year. The particular amount depends on the prices of crops, the level of disaster payments, and other factors. More than 90 percent of agricultural subsidies go to farmers of five crops—wheat, corn, soybeans, rice, and cotton. More than a million farmers and landowners receive subsidies, but the payments are heavily tilted toward the largest producers.

In addition to regular cash subsidies, the USDA provides crop insurance, marketing support, and other services for farm businesses. The USDA also performs extensive agricultural research for the industry. These indirect subsidies and services cost taxpayers about \$5 billion each year, putting total farm support at between \$15 billion and \$35 billion annually.

Agriculture has attracted federal government support since the late 19th century, but the subsidies remained modest until the 1930s. New Deal programs included commodity price supports, production controls, marketing orders, import barriers, and crop insurance. The particular structures

of federal farm programs have changed over time, but the central planning philosophy behind them has changed little in seven decades.

Agricultural subsidies make no economic sense, but the farm lobby in Washington is powerful and it strongly resists reforms. One strategy of the farm lobby is to co-opt the support of urban legislators, who seek increased subsidies in farm bills for food assistance programs. Legislators who favor environmental subsidies have also been co-opted as supporters of farm bills.

In 1996, Congress enacted some pro-market reforms under the “Freedom to Farm” law. The law allowed farmers greater flexibility in their planting decisions and moved toward reliance on market supply and demand. But Congress reversed course in the late 1990s and passed a series of large supplemental farm subsidy bills. As a result, subsidies that were expected to cost \$47 billion over the seven years of the 1996 law ended up costing \$121 billion.

In 2002, Congress and the Bush administration passed a farm bill that further reversed the reforms of 1996. The 2002 law increased projected subsidy payments 74 percent over 10 years. It added new crops to the subsidy rolls, and it created a new price guarantee scheme called the “countercyclical” program.

In 2008, Congress overrode a presidential veto to enact farm legislation that continued existing supports and created new subsidy programs. The legislation added an expensive “permanent disaster” program for areas often hit by adverse conditions, and it added a revenue protection program for farm businesses, which is designed to lock in 2008’s record-high commodity prices. This Average Crop Revenue Election program might cost taxpayers billions of dollars if prices fall to more typical levels in coming years.

The 2008 farm bill also added a new sugar-to-ethanol program under which the government buys excess imported sugar that might put downward pressure on inflated U.S. sugar prices. The program supports domestic sugar growers’ protected 85 percent of the U.S. sugar market, and it provides for the government to sell excess sugar, at a loss if need be, to ethanol producers.

Finally, producers of “specialty crops,” including fruits and vegetables, were able to secure new subsidies in the 2008 farm bill, including a marketing support program. Although limited means testing of subsidies was introduced in the 2008 farm bill, a farming household could still earn up to \$1.5 million in adjusted gross income before forgoing any farm subsidies.

The federal welfare system for farm businesses is costly to taxpayers, and it damages the economy. Subsidies induce overproduction and inflate land prices in rural America. The flow of subsidies and regulations from Washington hinders farmers from innovating, diversifying their land use, and taking other actions needed to prosper in a competitive global economy.

## **Eight Types of Federal Farm Subsidies**

**1. Direct payments.** “Direct” payments are cash subsidies for producers of 10 crops: wheat, corn, sorghum, barley, oats, cotton, rice, soybeans, minor oilseeds, and peanuts. Direct payments are based on a historical measure of a farm’s acreage used for production, but some payments go to owners of land that is no longer even used for farming. Established in 1996, direct payments were intended to be transitional, a way to wean farmers off old-fashioned price supports. Unfortunately, direct payments have not been phased down as planned even as price supports are continued. Direct payments cost about \$5 billion annually.

**2. Marketing loans.** The marketing loan program is a price support program that began in the New Deal era. The program encourages overproduction by setting a price floor for crops and by reducing the price variability that would otherwise face producers in the free market. The marketing loan program covers the same crops as the direct subsidy program. In addition, the 2002 farm law expanded it to cover wool, mohair, honey, dry peas, lentils, and chickpeas. In recent years, payments under this program have ranged from about \$1 billion to \$7 billion annually.

**3. Countercyclical payments.** Although the 1996 farm law moved away from traditional price guarantee subsidies, the 2002 farm bill embraced them with the addition of the countercyclical program. This program covers the same 10 commodities as the direct payments program, and the 2008 farm bill added dry peas, lentils, and chickpeas. In recent years, countercyclical payments have ranged from about \$1 billion to \$4 billion annually. Like the marketing loan program, the countercyclical program stimulates excess farm production.

**4. Conservation subsidies.** USDA conservation programs dispense about \$3 billion annually to the nation’s farmers. The Conservation Reserve Program was created in 1985 to idle millions of acres of farmland. Under the CRP, farmers are paid on a per-acre basis not to grow crops. About one-third of land idled under the CRP is owned by retired farmers, so one does not even have to be a working farmer to get these subsidies.

**5. Insurance.** The Risk Management Agency runs the USDA's farm insurance programs, which are available to farmers to protect against adverse weather, pests, and low market prices. The RMA has annual outlays of about \$3 billion. Federal crop insurance policies are sold by 16 private insurance companies, which receive direct federal subsidies. The firms operate like a cartel, earning excess profits from the high premiums they charge. At the same time, the government provides large subsidies for insurance premiums, such that farmers pay only about one-third the full cost of their policies.

**6. Disaster aid.** The government operates various crop insurance and disaster assistance programs for farmers. In addition, Congress frequently jumps in to declare "disasters" whenever the slightest adverse event occurs, and often distributes special payments to farmers regardless of whether they sustained substantial damage. The 2008 farm bill's new permanent disaster program, intended to reduce ad hoc emergency relief bills, is projected to cost \$3.8 billion over the five-year life of the bill.

**7. Export subsidies.** The USDA operates a range of programs to aid farmers and food companies with their foreign sales. The Market Access Program hands out about \$140 million annually to producers in support of activities such as advertising campaigns. Recipients include the Distilled Spirits Council, the Pet Food Institute, the Association of Brewers, the Popcorn Board, and the Wine Institute. Another program, the Foreign Market Development Program, hands out \$35 million annually to groups such as the American Peanut Council and the Mohair Council of America.

**8. Agricultural research and statistics.** Most American industries fund their own research and development programs. The agriculture industry is a notable exception. The USDA spends about \$3 billion annually on agricultural research, statistical information services, and economic studies. The USDA carries out research in 108 different locations and provides subsidies to the 50 states for research and education.

## Six Reasons to Repeal Farm Subsidies

**1. Farm subsidies redistribute wealth.** Farm subsidies transfer the earnings of taxpayers to a small group of fairly well-off farm businesses and landowners. USDA figures show that the average income of farm households has been consistently higher than the average of all U.S. households. The average income of farm households in 2006 was \$77,654, or 17 percent higher than the \$66,570 average for all households.

Although policymakers often discuss the plight of the small farmer, the bulk of federal farm subsidies goes to the largest farms. For example, the largest 10 percent of recipients have received 73 percent of all subsidy payments in recent years. Numerous large corporations and even some wealthy celebrities receive farm subsidies because they are the owners of farmland. It is landowners, not tenant farmers or farm workers, who benefit from subsidies.

**2. Farm subsidies damage the economy.** The extent of federal micro-management of the agriculture industry is unique. In most industries, market prices balance supply and demand, profit levels signal investment opportunities, and entrepreneurs innovate to provide better products at lower prices. Those market mechanisms are blunted in U.S. agricultural markets. Farm programs variously result in overproduction, overuse of marginal farmland, less efficient planting, excess borrowing by farmers, insufficient attention to cost control, and less market innovation.

**3. Farm programs are prone to scandal.** Like most federal subsidy programs, farm programs are subject to bureaucratic inefficiencies, recipient fraud, and pork-barrel politics. A 2004 Government Accountability Office study found that as much as half a billion dollars in farm subsidies are paid improperly each year. Farmers create complex organizational structures to get around legal subsidy limits, and many farmers do not pay back their USDA loans, according to the GAO. At the same time, Congress and the USDA tend to distribute payments for farm emergencies carelessly. Disaster payments often go to farmers who have no need for them.

**4. Farm subsidies damage U.S. trade relations.** Global stability and U.S. security are enhanced when less developed countries achieve stronger economic growth. America can further that end while helping itself by encouraging the expansion of trade by poor nations. However, U.S. and European farm subsidies and import barriers are a serious hurdle to making progress in global trade agreements. U.S. sugar protections, for example, benefit only a very small group of U.S. growers but are blocking broader free trade within the Americas as well as harming U.S. consumers.

The World Trade Organization estimates that even a one-third cut in all tariffs around the world would boost global output by \$686 billion, including \$164 billion for the United States. 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. Farm programs damage the environment.** Federal farm policies are thought to damage the natural environment in numerous ways. Subsidy programs cause overproduction, which draws marginal farmland into active production. Similarly, trade barriers induce agriculture production on land that is naturally less productive. As a result, marginal lands that might otherwise be used for parks or forests are locked into farm use because farm subsidy payments get capitalized into higher prices for land.

Subsidies are also thought to induce excessive use of fertilizers and pesticides. One reason is that producers on marginal lands that have poorer soils and climates tend to use more fertilizers and pesticides than do other producers. An excessive use of chemicals can contaminate water systems, as Florida sugar growers illustrate. Large areas of wetlands have been converted to sugar cane production because of artificially high U.S. sugar prices. Unfortunately, the phosphorous in fertilizers used by sugar farmers has caused substantial damage to the Everglades.

**6. Agriculture would thrive without subsidies.** If U.S. farm subsidies were ended and agricultural markets were deregulated, farming would change—different crops would be planted, land usage would change, and some farms would go bankrupt. But it is very likely that a stronger and more innovative industry would emerge that had greater resilience to shocks and downturns.

Interestingly, producers of most U.S. agricultural commodities do not receive regular subsidies from the federal government. In fact, commodities that are eligible for federal subsidies account for about 36 percent of U.S. farm production, whereas commodities that generally survive without subsidies, such as meats and poultry, account for about 64 percent of production. And, of course, most other U.S. industries prosper without the extensive government coddling that many farm businesses receive.

An interesting example of farmers' prospering without subsidies is New Zealand. In 1984, New Zealand ended its farm subsidies, which was a bold stroke because the country is four times more dependent on farming than is the United States. The changes were initially met with fierce resistance, but New Zealand farm productivity, profitability, and output have soared since the reforms. New Zealand farmers have cut costs, diversified land use, sought nonfarm income, and developed niche markets, such as kiwifruit. The Federated Farmers of New Zealand argues that that nation's experience "thoroughly debunked the myth that the farming sector cannot prosper without government subsidies." That myth needs to be debunked in the United States as well.

### **Suggested Readings**

- Cato Institute. Center for Trade Policy Studies website. “Agriculture.” [www.free-trade.org/issues/agriculture](http://www.free-trade.org/issues/agriculture).
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- Edwards, Chris. “The Sugar Racket.” Cato Institute Tax & Budget Bulletin no. 46, June 2007.
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- Griswold, Daniel, Stephen Slivinski, and Christopher Preble. “Ripe for Reform: Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers.” Cato Institute Trade Policy Analysis no. 30, September 14, 2005.
- James, Sallie, and Daniel Griswold. “Freeing the Farm: A Farm Bill for All Americans.” Cato Institute Trade Policy Analysis no. 34, April 16, 2007.
- Lambie, Thomas. “Miracle Down Under: How New Zealand Farmers Prosper without Subsidies or Protection.” Cato Institute Free Trade Bulletin no. 16, February 7, 2005.

*—Prepared by Chris Edwards and Sallie James*

