

Draft: Comments welcome

Eliminate Farm Programs*
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Background

Economic consequences of terminating farm price and income support programs are predicted to differ sharply for farmers compared to the public at large. Program termination would impose financial hardship on some farms, commodities, and regions especially in the short run. The farming economy could recover in as little as five years, depending on the transition program in place. The nation's economy on the whole is predicted to benefit in both the short and long run from phasing out government farm supports.

The observed lack of broad public purpose in current commodity programs noted herein suggests they seem destined to be phased out sooner or later. A carefully crafted transition program could ease the pain from eliminating programs, whether the phase out takes five years or 30 years.

Some see the Agricultural Act of 1949 as an impediment to terminating farm supports. That Act is permanent, having no expiration date, and is default legislation. That is, if Congress fails to enact new legislation by 2008 when the 2002 farm bill expires, the 1949 bill will govern farm programs. That would mean a return to up to 90 percent of 1910-14 parity prices (through nonrecourse loan rates more than double current prices) for basic commodities if producers approve supply controls in referendum. Because imposition by Congress of such anachronistic farm legislation seems

* Comments of Carl Zulauf and other reviewers are gratefully accepted.

unthinkable, legislators will pass new farm legislation—they will not just let the 2002 farm bill expire without a replacement, even if that replacement is a phase out.

The term “farm programs” in the title refers only to public programs directed at supporting farm prices and incomes above market levels. “Eliminating farm programs” would end such federal farm support programs but not programs for agricultural research, education, extension, information, the environment, food assistance, and food safety.

Impacts of Terminating Farm Supports

This section depicts for farmers and then for the public at large the impact of eliminating farm price and income support. Any economic sector that has been a sizable beneficiary of government economic support for three quarters of a century would experience some hardship with withdrawal of benefits, and agriculture is no exception. This section shows that economic benefits to the public at large from terminating farm programs are substantial and outweigh losses to farmers.

Impact on Farmers of Terminating Supports

Eliminating farm price and income support impacts farm output, commodity prices, income, rate of return, land price, and selected other variables. Most of the outcomes are more painful for farmers in the short run than in the long run.

Based on estimates from several sources, I conclude that eliminating current farm supports would reduce farm output approximately 3 percent (Tweeten 2002, p. 10). The reduced output would raise farm prices 6 percent on average and raise annual farm receipts \$6 billion. The expected net loss in government farm payments of \$16 billion would more than offset the gain in receipts so that gross farm income would fall \$10 billion. Net farm income would not fall as much because of input savings from the

modest reduction in input purchases. Still, lower returns to farming would reduce farm real estate value by an estimated 20 percent (see Goodwin et al., p 99).

The impact of no support programs would vary among farm resources and by type and size of farm. Government payments fairly quickly show up in rents. Up to 60 percent of program monetary benefits or losses are passed from renters to landowners in just one year (see Goodwin et al.). Other estimates (Roberts et al.; Roe et al.) find that farm renters pass much less of reduced farm income to landowners in one year. Because on average operators of large cash grain and cotton farms rent three-fourths of their land, they pass the “cost” of program cuts quite quickly to their landlords. On the other hand, operators of large farms are disadvantaged by payment termination because they are highly leveraged with debt and depend more than do small farms on income from government payments. Small cash grain farmers rent only 25 percent of their land so cannot quickly pass the “cost” of lower payments to landlords. However, small farms have high equity ratios and substantial off-farm income to cushion shocks.

To illustrate, consider the impact on all cost for the average farm with crop and livestock sales of only \$10,000- \$50,000 versus a larger farm with sales of \$250,000- \$500,000 given termination of government payments in 2001 (Tweeten and Hopkins, p.152). The operator cost per dollar of output (“output” includes any payment) would average \$2.55 with full payments, but \$2.69 immediately and \$2.59 in five years on the small farm without payments. On the larger farm, the operator cost per dollar of output would average \$1.00 with full payments, but \$1.09 immediately and \$1.02 in five years without payments. The implication is that the small farm operator is losing money with or without government payments but the larger farm operator is able to break even and

cover all costs—given enough time to reduce rent to landlords. In the very long run after land ownership fully turns over (only 2-3 percent of farmland changes hands annually), lower land costs completely offset loss of government support programs so net income of farm operators is the same with or without programs.

Approximately 40 percent of farm operators receive government payments. Including nonpayment type support programs as for sugar, still only about half of farm production receives price and income support. Income and rates of return on resources are comparable among types of farms whether they specialize in enterprises covered or not covered by government supports. Of course, small and inefficiently operated farms and nonfarm businesses alike earn low returns on assets. Small farms (under 50 acres) are growing in numbers despite perennial financial losses from farming because households freely chose to use their substantial off-farm income to support farm living as a hobby and way of life.

The income and balance sheets of mid-size farms would especially be squeezed with termination of support programs. Competently managed commercial farms (as represented by the top half of farms with crop and livestock sales of over \$250,000 annually) on average have earned returns at least comparable to what their resources would earn elsewhere (see Tweeten 1989, pp. 118-122; 2002, pp. 4-9). In 1997, for example, assets of the top half of farms with sales of over \$250,000 earned rates of return averaging nearly three times the rates earned by the top half of nonfarm businesses (Hopkins and Morehart, p. 79).

A change in government economic support to farms is passed to landowners in five years or more as the wealth of landowners rises or falls in response to the capitalized

value of the program benefits. The farming industry with or without farm supports rather quickly finds economic equilibrium as evident from a real rate of return on farmland averaging near 4 percent annually over time despite major annual and cyclical changes in government supports and in demand and supply of food and fiber. The persistency of this 4 percent real rate over a variety of situations implies that termination of farm programs would not change appreciably the overall current rate of return to farm resources, given time for adjustments. That average will mask the continuing negative return on assets of small farms accounting for most farms and the continuing high returns on assets of large farms accounting for most output.

Annual and cyclical yield and market instability is perhaps the major economic problem of commercial agriculture. Small farms accounting for most farms diversify to handle farm risk through off-farm income that dwarfs their farm income. Many larger farms have sufficient income/wealth to pay without subsidy for useful private risk management tools such as saving, insurance, forward pricing, contracting, storage, flexibility, liquidity, and diversification. Mid-size family farms are frequently least able to cope with risk because they have higher unit production cost than large farms and less time for off-farm work than small farms.

The conclusion is that mid-sized farms with sales of \$50,000 to \$250,000 would be especially disadvantaged by the absence of government support programs. At the same time it is useful to note that, with or without government support programs, many farms in this range will get larger, obtain more off-farm job income, or leave farming in the next decade. The fact that less than one-fifth of farms are in this vulnerable size class also limits the overall loss of farms if programs were terminated.

It is no surprise that dairy, sugarcane, sugarbeet, grain, cotton, and soybean producing farms that have been targets of government supports fare worse without supports than do poultry, livestock, and fruit and vegetable producing farms that have not been targeted for supports (Tweeten and Hopkins, pp. 150-152). The Great Plains, Midwest, and Mississippi Delta regions fare worse than other regions (Drabenstott, pp. 2-4). Much crop production in the Southeast and Plains states lacks international comparative advantage and has relied on sugar, tobacco, peanut, cotton, wheat, and rice supports from government. These regions also have especially benefited from federal cost sharing of crop and revenue insurance programs. Without support programs, up to 25 million acres currently in crops mostly lying in the Southeast and Plains states would be in grass, trees, or other non-crop uses (Skees).

The increase in crop prices in the absence of government supports, though modest, would mean higher prices to poultry and livestock producers. Dairy farmers would especially feel the effects because producers would pay higher prices for feed and would lose the price and income supports unique to them among livestock producers.

Government supports have kept some financially vulnerable farms in business as in the 1981-1986 period, but in the long run may have eroded farm numbers and increased size as the capital and security afforded by supports encouraged farms to leverage equity and consolidate. Thus program termination would lose some farms in the short run but have little effect on farm size in the long run. Continuation of farm supports slows but does not stop farming adjustments. Science and markets are moving agriculture to fewer and larger farms, towards more vertical coordination in the form of production and marketing contracts, and to ever more sophisticated marketing, management, finance, and

technology. In the longer run, having or not having a farm safety net is likely to have little influence on these forces and how they impact agriculture and rural communities.

The conclusion is that the income loss from termination of farm programs would pass to landowners. With nearly half of farm real estate owned by off-farm landowners (including retired farm operators and spouses), farm owner-operators and nonfarmers would share in somewhat equal measure the loss of program supports.

A related final issue is farm poverty. Commercial agriculture, the principal focus of commodity programs, has almost no poverty except among hired workers — a group not served by current commodity programs. Limited resource farm families as defined by the Economic Research Service receive only 1 percent of farm commodity program payments. Absence of commodity programs will not affect farm poverty.

Impact on the Public at Large of Terminating Farm Supports

Whether farm support programs benefit the public at large depends on how they affect economic equity, efficiency, food security, rural development, and resource conservation. This section examines how termination of programs would impact these and other variables.

Termination of farm programs is efficient economically if such termination raises real national income. National income is enhanced by allocating resources and products to their highest and best uses throughout the economy under competitive markets corrected by taxes, subsidies, and the like so that private costs (benefits) are aligned with social costs (benefits) at the margin. Agricultural policies are efficient only if they raise income of agriculture more than they reduce income of other sectors including consumers and taxpayers.

Farm commodity programs lose national income because they distort farm resource-use, raise governmental administrative and lobbying costs, and divert taxes to farm supports from higher value uses. Farm supports cause too little output (supply management) or too much output (insurance subsidies, commodity loan support rates), thereby warping domestic as well as international markets. The overall impact was to reduce real national income by \$6.5 billion annually in the 1998-2000 period (Tweeten 2002, p. 12). The number indicates that taxpayers lose more than producers gain from commodity programs.

Turning next to economic equity, a widely held value judgment is that it is inappropriate to transfer income from lower income/wealth individuals to higher income/wealth individuals. Each year since 1999, income per farm household has averaged 9 to 35 percent above income per nonfarm household (U.S. Department of Agriculture, Table 31). Farmers' wealth averages approximately double nonfarmers' wealth per household. Per household wealth of the 10 percent of farms receiving three-fourths of government payments dwarfs wealth per nonfarm household. It is of more than passing interest that no measure is available of the wealth of farm landowners, although they rather than farm operators are the ultimate beneficiaries of farm programs. These landowners undoubtedly would have substantial wealth even after bearing the full cost of terminating programs. Thus terminating farm programs is consistent with economic equity.

If farm commodity programs do not serve economic equity and economic efficiency, perhaps they do address farm problems of environmental degradation, exploitation by concentrated agribusinesses and predacious foreign governments, family farm loss, rural

community decline, or food insecurity. Evidence indicates that either these are not problems, or that current farm commodity programs address these issues much less cost-effectively than could other means.

Degradation of land, air, and water resources and depletion of natural resources entail externalities not addressed by the market alone. For example, soil erosion brings “downstream” costs or “takings” from farm neighbors and urban people utilizing water-supply reservoirs impaired by soil sediment and chemicals. Such problems are real, but may be dealt with cost-effectively through public purchase of easements for riparian strips or conservation tillage rather than through farm income support programs. Government subsidies for crop and revenue insurance and price supports encourage excessive overall resource use, excessive application of chemicals, and cropping of environmentally marginal land that could be producing environment-saving trees in the Southeast and grass in the Great Plains.

Rural areas, defined here as nonmetropolitan counties (no cities of over 50,000 residents), have been growing in population. On the other hand, farming-dependent rural counties, defined as those with at least 15 percent of earnings or employment derived from farming, are in decline. They accounted for 13 percent of U.S. counties in 2000, down from 20 percent in 1990. Less than one-tenth of the rural (nonmetro) labor force works in production agriculture, and over 90 percent of the rural population resides in non-farming-dependent counties. After analyzing the impact of farm payments by county in the U.S., Drabenstott (p. 3) concluded

In short, farm payments are not yielding robust economic and population gains in the counties where they should have the greatest impact. If anything, the payments appear to be linked with subpar economic and population growth.

The direction of causality in this conclusion is unclear. The Great Plains, where farming-dependent communities are prominent, lost population because of farm mechanization rather than because of generous commodity programs. The important conclusion, however, is that commodity programs are a very cost-ineffective means to preserve and grow rural communities. Extension and general education are more effective federal and state programs than are farm supports to prepare local rural youth for productive employment at home or elsewhere. State and federal help for education could relieve some of the current financial burden of local communities paying for human resource development investments that accrue benefits elsewhere — often in rich metropolitan communities where many former rural residents now live, work, and pay taxes.

Food insecurity is a huge problem in many parts of the world. At issue here is whether American farm commodity support programs are essential to ensure future food security. The answer is no. The world has been blessed with food availability, even abundance, since World War II. Hunger traces to deplorable economic policy, corruption, and violent conflict in poor countries. The United States has vast food production currently used for biofuels and livestock feed that could be utilized directly for human consumption in time of pressing, acute food needs at home or abroad. As the world's most affluent country and large producer of food, the United States will remain food secure with or without farm supports and with or without food self sufficiency.

Developing nations are increasingly using the World Trade Organization rules and procedures to challenge food and fiber export “dumping” and protectionist policies of the United States and other rich countries. Poor countries charge that rich countries are

selling food and fiber abroad at subsidized prices below production cost. The problem of subsidized exports in most cases is a byproduct of rich countries promoting domestic farmers with price and income supports and border protection. The damage to poor countries from dumping is frequently overemphasized: with the exception of a few nations such as Argentina, Brazil, and Thailand, developing countries are net food importers and their consumers gain more than producers lose from cheap imports. Nonetheless, the hurt inflicted on food and fiber producers in poor countries by rich-country farm price and income supports is another reason to phase out commodity programs. Rich countries themselves take offense when countries dump commodities on their markets. International prohibitions against dumping are becoming more binding.

Turning now to a related issue, it is said that American farmers can compete with other farmers at home or abroad, but cannot compete with foreign governments subsidizing competing exports. It is said that America should not end market distortions if other countries will not grant access to their markets. The big losers from market distortions are the countries perpetrating them--international trade studies find that it pays the United States to end market interventions even if other countries do not end theirs. On the other hand, the call by American farm organizations for multilateral trade liberalization makes sense. That is, farm commodity prices would increase 6 percent if only the United States liberalizes markets but would increase 10 percent if the world liberalizes markets.

Similarly, many farmers view government support as essential to countervail the market power of agribusinesses that are growing larger and more concentrated. Several observations are warranted. First, neither economic theory nor empirical evidence

indicates agribusiness firms systematically exploit American farmers (Persaud and Tweeten). To be sure, imperfect competition characterizes many agribusinesses. If they do indeed exercise market power, fewer resources will be used in farming than if agribusinesses were competitive. However, the oligopolistic (few firms) market structure that characterizes much agribusiness is recognized for massive advertising and innovation to expand food and fiber sales. This characteristic expanding demand for farm output, plus the prominence of cooperatives in agribusiness, points to a farming sector that is larger and better paid than it would be in a more competitive agribusiness market. Multilateral and regional trade agreements not only reduce unfair competition from abroad, they encourage American agribusinesses firms to price farm inputs and commodities more competitively.

Conclusions

Farm operators would lose in the short run from termination of farm support programs but ultimately the losses would accrue to landowners. Gains to taxpayers are estimated to be greater than losses to producers and landowners so that the nation as a whole would gain real income. Taxpayers would be major beneficiaries of no price and income support for farmers. Consumers would hardly notice.

A buyout as in the tobacco program could give overall termination of farm supports some political appeal. A buyout recognizes that, with termination of support programs, farm operators and landowners could experience a capital loss of some \$200 billion (20 percent of current land value—the expected lost annual value \$10 billion discounted at 5 percent. A buyout of this magnitude may be unrealistic because the public is reluctant to pay landowners for commodity programs twice: once as a buyin and again as a buyout.

Second, a grand buyout may be impractical because it would immediately add to the large federal budget deficit that presumably motivates an end to commodity programs.

Government is unlikely to withdrawal farm support “cold turkey”; a transition program to ease the adjustment burden has appeal. Given net economic benefits from ending farm supports, gainers could in principle compensate losers and still be better off. Compensation could take the form of adjustment assistance, patterned along the lines of that to workers displaced by freer trade. Assistance could include counseling, job training and information, and mobility assistance loans or payments.

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