The Twelve Best Reasons For Commodity Programs:

Why None Stands Scrutiny

by Luther Tweeten

Traditional justifications for farm commodity programs no longer stand scrutiny. Programs either fail to meet the needs of agriculture and society or they meet them cost-ineffectively. Programs are an anachronism of 1930s circumstances that no longer exist.

Justifying programs

Here, I scrutinize twelve reasons for farm programs: (1) equity and fairness, (2) economic efficiency, (3) chronic low returns on resources, (4) food security, (5) risk, (6) countervailing foreign subsidies, (7) preserving family farms, (8) preserving rural communities, (9) protecting the environment, (10) maintaining a fair share of federal government benefits, (11) sustaining farmland values, and (12) the "commodity programs work" principal.

1. Equity and fairness

Measured by income and wealth, American farmers are no longer "have nots."

- Income per farm household equals or exceeds that per nonfarm household. Income parity is the culmination of long-term structural change to larger farms, more off-farm employment, and increased productivity. A phaseout of farm programs would be only a transitory setback in this trend.
- Wealth of farmers (over $300,000 per household) averages several times that of consumers (less than $100,000 per household) and taxpayers (some $150,000 per household). Net worth of commercial farms, defined as those with annual sales of over $100,000, averages nearly $1 million per farm; these farms receive 70 percent of commodity program payments.

Monetary benefits of commodity programs have been capitalized into land values and show up in higher rent, thereby passing program benefits to landlords. Based on ownership of farm real estate in 1992, 37 percent of commodity program benefits (over $5 billion annually) go to *nonfarm* landlords.

Some contend that transfers to agriculture are justified to alleviate farm poverty. The poor do not survive long in commercial agriculture to which commodity programs are aimed. The poor mainly operate small farms or are hired farm workers who have few commodities to sell and little to gain from commodity programs. Human resource development programs are more effective means to alleviate poverty.

2. Economic efficiency

Some contend that our agriculture is efficient because commodity programs raise productivity. Our consumers spend a smaller share of their income on food than do consumers in any other nation, and that low ratio has been achieved during the six decades under commodity programs.

The falling share comes from rising farming productivity and rising consumer real income and not because of commodity programs. Evidence that commodity programs retarded rather than advanced efficiency and productivity is compelling.

- Removing a valuable resource, land, from production reduces productivity and international competitiveness.
- Empirical evidence reveals that productivity gains in agriculture are the product of public and private investments in research, education, extension, and infrastructure rather than of commodity programs.
- Commodity programs typically reduce the nation's net income by $5 billion annually due to resources used unproductively for political lobbying, program administration, cropland set-asides, and other market interventions. Because producers gain $5 billion less than consumers and taxpayers lose, the nation's income and federal budget deficit would improve by phasing out commodity programs.

Returning idled acres to production would initially expand food output and reduce food prices.

With time, some food prices might rise in balancing supply and demand. Total consumer food expenses would not change much because lower prices for sugar and peanuts would offset any higher prices for grains. However, the overall cost of food and fiber (including taxpayer outlays for farm programs) would drop at least $10 billion annually.

- Grains, peanuts, sugar, fiber, and dairy commodities are not public goods, such as national defense, warranting government interventions for economic efficiency. Farm commodities are market goods, because they possess characteristics (rival, exclusionary, transparent) required for markets to function well.

The half of U.S. agriculture that does not receive support (livestock, forages, fruits, vegetables, etc.) is at least as efficient as the half covered by programs. American farm commodity markets work, in part because strong science and efficient agribusiness support them. However, interventions in agriculture sometimes are warranted to provide public goods such as basic research, education, and infrastructure.

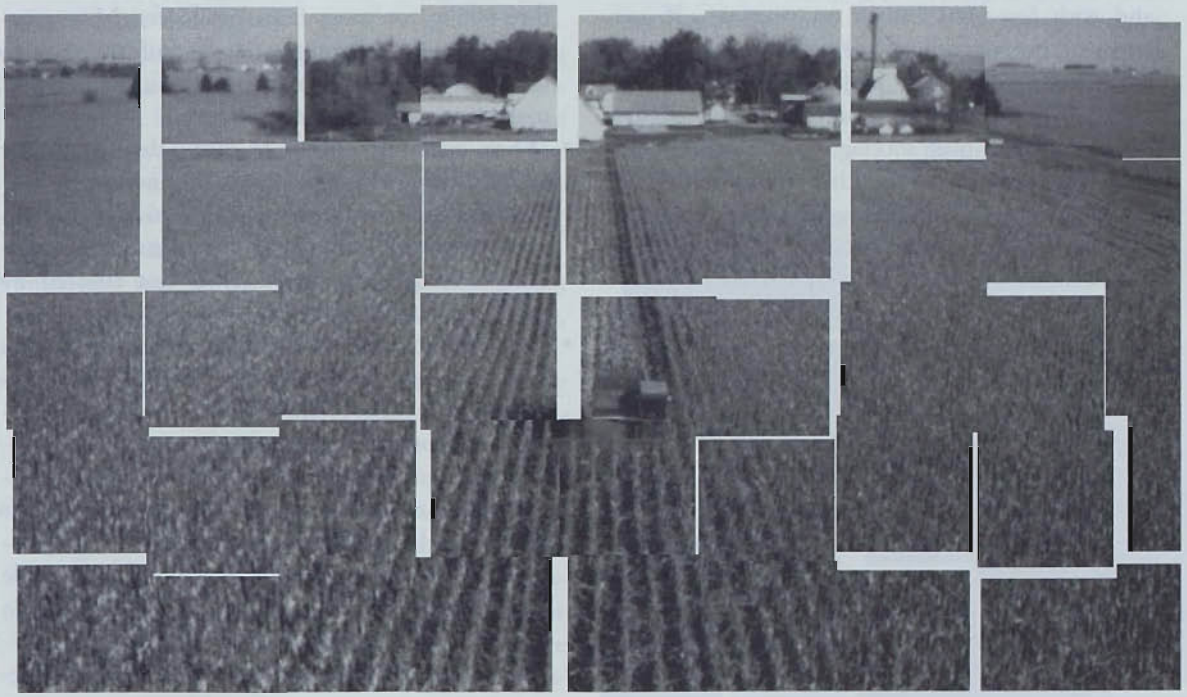
3. Farm resources are predestined to earn low returns in the absence of commodity programs

This argument for continuing farm programs takes many forms. One is that farmers are unique: they are price takers, unlike other sectors that are price makers, able to control their economic destiny. Another assertion is that a competitive farming sector sandwiched between a "monopolistic" input supply sector and a "monopsonistic" marketing sector can never earn a fair return on resources. Farmers, it is said, are exploited by an agribusiness sector reaping profits that should go to farmers.

These and related conjectures are myths.

- Most American firms are price takers. Even General Motors and IBM are price takers, unable to arbitrarily raise their prices without sacrificing profits.
- The American agribusiness sector has an exemplary record of high performance. American farm products are delivered abroad, for example, for less cost per ton mile than products of any other nation.
- Farmers are served by an extensive system of agribusiness cooperatives that acts as a yardstick and as an alternative source of inputs and markets to private agribusiness.
- Even if input supply and product marketing firms were imperfectly competitive and earning high profits, the farming sector would not earn low returns if resources are mobile. And farming resources now are mobile.
- Most importantly, resources on reasonably well-managed commercial farms do not earn low returns. On average, assets on such farms earn returns of 10 percent and more on investment—comparable to what these resources would earn elsewhere in the economy. That outcome is precisely what one would expect from equilibrium in an efficient market.

The current rate of return on farm assets has averaged about 4 percent for several decades, well below typical returns elsewhere in the economy. For various reasons, aggregate farm rates of return appear to be low when they are not, and appear to provide evidence of resource disequilibrium when they do not. Published rates of return combine well-managed commercial



farms earning returns comparable to those elsewhere with small and poorly managed farms earning low and even negative rates. As indicated earlier, returns on the well-managed commercial farms that set land prices average more than double the 4 percent rate. For many small farms, amenities of rural living, tax advantages, and prospects for capital gains offset low monetary returns.

The price system will not provide parity returns on small, poorly managed farms any more than it will on small, poorly managed nonfarm businesses. Unless commodity programs are carefully targeted, they also will not provide uneconomic size farms with a "fair" return. Direct payments targeting such farms may appear to be an attractive alternative to current programs, but they have drawbacks. One is that attempts to target have failed in the past and will be prone to fail again. And the public is wary of subsidizing inefficiency on small units.

4. Food security for the United States

The preamble to the 1990 farm bill says its purpose is "to ensure consumers an abundant supply of food and fiber at reasonable prices." For several reasons, food supplies would not be threatened by terminating commodity programs.

- Short-term food security is assured by massive capacity to reduce our large food exports, raise imports, draw on buffer stocks, and slaughter livestock to supply meat while freeing grain supplies for consumption. Longer-term food security is assured by a scientifically based, technologically advanced, environmentally sound, market-driven agriculture.
- The half of crops and livestock not covered by commodity programs is provided in abundance and with favorable returns on resources. If government interventions were terminated, after an adjustment period the performance for covered commodities would be as favorable. Consumers do not anguish over shortages of tomatoes, potatoes, eggs, broilers, and other commodities not under government control. However, programs indirectly affect such noncovered commodities, for example, by raising costs of feeding animals.
- Tobacco and cotton programs can hardly be justified on food security grounds.
- American consumers spend only 2.5 percent of their income for farm food ingredients. Even the unprecedented 42 percent farm price jump in 1972–73, if repeated today, would add only one percentage point to the share of income consumers spend on food. Studies of risk preferences reveal that most consumers prefer the market-oriented policy of low food prices most of the time (but an occasional food price spike) to high food prices all the time with price supports.
- Governments in the United States and elsewhere have had a disappointing record of managing food supplies. A global movement is underway toward greater reliance on markets.
- A shift away from acreage reduction programs (ARPs) and toward direct payments (marketing loans and deficiency payments) has reduced government buffer stocks. Meanwhile, the continued government presence in agriculture discourages private buffer stocks and forward markets that enhance food security. Thus commodity programs no longer provide buffer reserves they once did, and may increase food insecurity by driving out private holders of buffer stocks. If the government maintains its presence in farming but no longer idles cropland nor holds buffer stocks, its contribution to food security will be negligible if not negative.
- A strong private sector will provide buffer stocks and other food security and risk-shifting functions if the government does not crowd it out. If intervention is deemed necessary, a simple and relatively unobtrusive means would be to expand the 4 million ton emergency wheat reserve to be used in times of special need as judged by the president.

5. High risk

Risk, intensified by biological processes and weather, is the premier economic problem faced by commercial agriculture, but the presence of risk does not justify commodity programs.

- Risk is not a *prima facia* case for subsidies; Las Vegas and lotto gamblers, Wall Street plungers, and futures market speculators are more often taxed than subsidized.
- Risk is a serious irritant but not business-life threatening for most farm producers. Many successfully pursue strategies of diversification (e.g., off-farm earnings), flexibility, liquidity, forward marketing, and private insurance.
- When operators choose to farm, they surely are aware of the risks endemic to the industry.
- Risk-shifting measures such as vertical coordination have been successfully implemented, especially among farm commodities not covered by government supports.
- New instruments such as state crop yield futures contracts and cooperatives to pool risks of small producers would bloom in the absence of government commodity programs.
- Government programs have discouraged innovation of private risk-shifting instruments and their use by producers. Research at Ohio State University and elsewhere indicates that the private trade would come as close as would government to holding socially optimal buffer stocks.
- Risk is not unique to farming. Other major ele-

ments of the economy also face severe risk, and, in fact, small businesses have higher failure rates than farms. Yet, despite or because of minimal government intervention, small nonfarm business has been a vital, dynamic, and growing sector.

- Government risk management often fails. Provision of disaster payments and federal all-risk crop insurance has been an administrative nightmare and subject to abuse by farmers. Few farmers voluntarily buy federal crop insurance despite heavy subsidies. Nowhere in the world are farmers sufficiently risk averse to pay the full cost of all-risk crop insurance. Government payment of insurance premiums encourages farmers to raise output variation to maximize subsidies and encourages cropping in marginal farming areas with fragile, erosion-prone soils.

6. Countervailing foreign subsidies

This justification for programs is stated as, We must subsidize if other countries subsidize, or, We can compete with foreign producers but not with foreign governments. Such statements do not stand scrutiny.

- Other countries, including New Zealand, Canada, Australia, and the European Union (EU), are cutting back agricultural subsidies unilaterally.
- The completed Uruguay Round of multilateral trade negotiations requires countries to cut their agricultural export quantity subsidized by 21 percent and their export subsidy value by 36 percent by year 2000. Our Export Enhancement Program of subsidies may have helped us to get a better deal out of the Uruguay Round, but future U.S. export subsidies are unlikely to influence EU behavior, the chief villain in subsidized trade. Meanwhile, continued U.S. export subsidies alienate our friends.
- Studies summarized by the General Accounting Office indicate that the Export Enhancement Program had a low payoff even before completion of the Uruguay Round. It is less cost-effective than direct payments in raising farm income. It raises domestic prices relative to world prices, inviting imports of durum wheat from Canada.
- Importers such as the Former Soviet Union gain from our food export subsidies while our nation, especially the taxpayer, loses.
- Continuing farm subsidies detract from funding of high-payoff agricultural research for agricultural productivity gains that are the core of our international competitiveness.
- International trade models indicate that consumers, agribusiness firms, and taxpayers gain more than producers lose from terminating trade distortions. Models of the economy typically show U.S. national income losses of $4 billion or more annually from trade distortions induced by commodity programs. These results show as large or larger gains in national income when the United States alone liberalizes trade as when all countries simultaneously liberalize trade. The fact that the U.S., EU, and other major traders liberalized their policies before rather than after the Uruguay Round agreement strongly suggests each country gained from opening markets, whether or not other countries opened their markets. However, because multilateral liberalization lifts world prices, producers are better off from multilateral liberalization than from unilateral liberalization.
- American production of peanuts, tobacco, sugar, cotton, and rice faces competition mainly from countries too poor to provide effective subsidies or government competition warranting countermeasures by the United States. Many would end their subsidies if we would end ours.

7. Preserve the family farm

Commodity programs have not saved the family farm from technological change and industrialization. Empirical models provide some insights.

- According to my empirical analysis, commodity programs have no major impact on farm size and number, but may modestly increase size and decrease numbers in the long term. Programs provide security and capital, encouraging farmers to leverage equity to buy and consolidate a neighboring farm and purchase additional machinery to cut labor needs and expand operations.
- In the 1980s, the rate of decline in farm numbers was twice as fast in Japan as in the United States. Yet, Japan was supporting prices at four times U.S. price levels. The European Union, with very high supports, also has had a higher rate of farm outmovement than the U.S. in recent decades. The major reason for the slower U.S. rate was because we made our adjustment earlier—in the 1950s and 1960s. Commodity programs could

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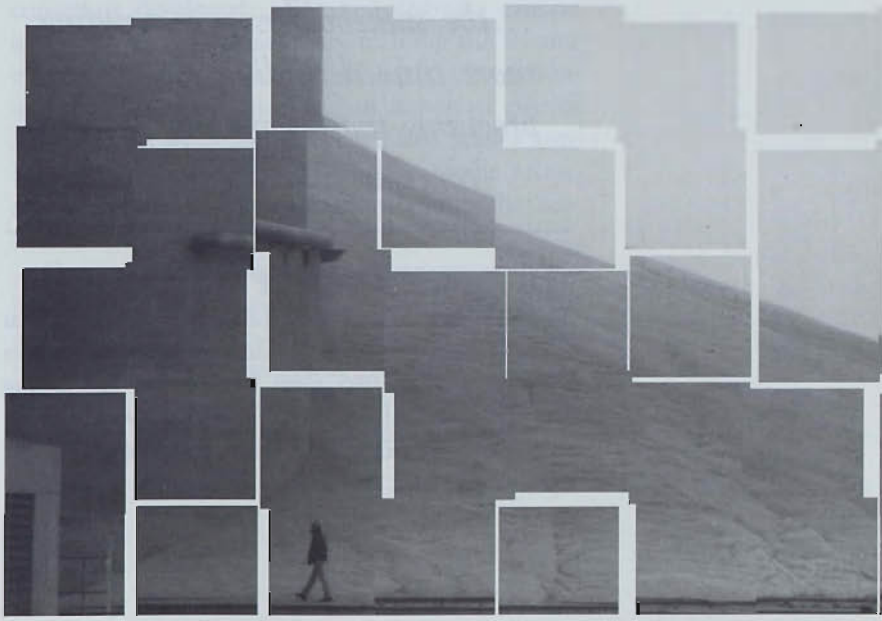

(Commodity Programs, cont. from page 7)
do more to preserve farms of choice, but a major restructuring would be required to target small and mid-size family farms.

- Farm size and numbers are determined primarily by technology. Commodity programs can temporarily run against the tide, but eventually markets and technology prevail.
- Any farm people displaced by ending commodity programs are not necessarily worse off. An Oklahoma study of former farm operators who exited in mid-career found that the number who said they were better off outnumbered those who said they were worse off by a four-to-one ratio.

8. Preserve rural communities

After experiencing net in-migration in the 1970s and net out-migration in the 1980s, rural areas have again returned to net in-migration in the 1990s. Many feel that generous commodity programs are a useful way to further stimulate the rural economy. Several considerations argue against that conclusion.

- Fewer than one-third of the nation's 2,400 rural counties are farm-dependent, that is, receiving over 20 percent of their income from farm-related earnings. These counties, most of which are in the Great Plains, contain only 7 percent of the nation's population. The economic base of most rural communities is service industries and manufacturing rather than farming.
- Less than 10 percent of the 60 million rural residents live on farms. Only one-third of farm households are full-time farmers, and 87 percent of farm household income came from off-farm sources in 1993. Thus, farming is the direct economic base for less than 5 percent of rural workers (full-time equivalent), and for less than 10 percent if multipliers are considered for local nonfarm jobs created by farm jobs.
- Farm-dependent rural communities are more affluent than rural communities dependent on other occupations. And my research with David Henderson indicates that increasing farm income can hasten the shift of shopping from nearby small towns to more distant urban areas offering more variety at lower prices.
- Other, more cost-effective state and federal strategies, such as investment in more hours of schooling per day and per year, will serve the people in rural communities better than will commodity programs.

In summary, neither efficiency, equity, nor cost-effectiveness are valid arguments that commodity programs are a wise route to rural development.

9. Protect the environment

Although the market alone will not protect the environment, current commodity programs are an inadequate delivery system for several reasons.

- Conservation Compliance (CC) is a success story, but omits half of all land in farms and one quarter of all cropland—that being farms not participating in government crop programs. Surveys indicate that CC is generally well received by producers, but cannot be comprehensive if tied to commodity programs.
- Commodity programs discourage rotations and encourage excessive application of pesticides and synthetic fertilizers per acre on crops.
- The Conservation Reserve Program is not cost-effective to protect the environment. Many acres in it have no environmental hazards. Much land classified as "highly erodible" can be farmed with modern conservation tillage and other "best practices" without harm to the environment. I have proposed a twenty-year or permanent Cropland Easement Program (CEP) to remove approximately 25 million acres of cropland from production that cannot be farmed with conservation tillage at acceptable erosion rates or that pose water quality problems. CEP would include 5 million acres for filter strips and 20 million acres of the most highly erodible cropland. CEP would allow haying, grazing, forest, wildlife, or recreation use.

Conservation Compliance (CC) needs to cover all cropland having environmental hazards. Some current commodity program funds would be reallocated to pay for environmental structures such as fences protecting grass filter strips. The public is not necessarily obligated to compensate farmers for extending Conservation Compliance because (*a*) modern conservation tillage practices now permit CC with no loss of profit or output on most land; (*b*) producers in most instances are being asked only to do what is reasonable, such as saving their own soil or stopping "downstream" damage that they are causing other farmers or nonfarmers; (*c*) costs to individual producers of CC are very difficult to estimate and, hence, to compensate; and (*d*) CEP needs to attend CC in removing cropland from production that cannot be cropped at acceptable soil erosion tolerance or water quality levels using best practices. CEP would compensate farmers and avoid "takings."

10. Maintain a fair share of government benefits for farmers

Those who contend that commodity programs are justified to ensure that farmers receive a fair share of federal benefits emphasize the declining farm portion of the federal budget. That share has fallen from 4 percent in 1950 to 1 percent in recent years. In contrast, farming accounts for nearly 2 percent of the nation's population and gross domestic product (GDP).

Several considerations argue against the principle that farmers should receive the same share of the federal budget as their share of population and GDP.

- The vast majority of federal spending is for services rendered, such as defense and interest on the debt, or for insurance, such as social security and medical care. These alone constitute two-thirds of federal outlays. Most other outlays are not subsidies to specific sectors. If we consider only federal budget subsidies to industries and arbitrarily allocate 2 percent of that to agriculture, the industry will receive far less than the annual $10–$15 billion for farm subsidies received in recent years.

- The proper way to cut the federal budget is to prune spending that is inequitable, inefficient, and not effective in addressing the nation's needs. In contrast, spending that has a high payoff in meeting the nation's needs that the private sector will not supply warrants expansion, even as overall spending is cut. By that standard, commodity programs need to be pruned while basic research to raise food resource productivity needs to be expanded. Viewpoints reflected in statements such as, Agriculture will accept cuts proportional to those in the rest of the budget, or, Agriculture has already taken its share of cuts, may be good politics, but they are not evidence of sound economics.

11. Sustain farmland values

Expectations of continuing farm commodity programs have caused some $100 billion of such benefits to be capitalized into land prices, or up to 15 percent of total farmland value. The percentages are higher in cotton, rice, and wheat areas where benefits have been especially generous.

Maintaining these capitalized benefits is not a case for continuing farm programs for several reasons.

- Preserving programs without merit just to avoid capital losses makes no more sense than maintaining unneeded military bases and personnel to avoid adjustments.
- Commodity programs are of little value to new owners, renters, operators, and farm laborers. Benefits have gone mainly to those who owned land when programs were initiated. However, termination of programs will be painful to the new owner-operators because they will experience decapitalization of real estate assets. The impact is dampened somewhat because many land market participants anticipated that programs could not be sustained, and they have restrained their land bids accordingly in recent years.
- Adjustments to the market need not be traumatic. Program support parameters have been reduced 50 percent since 1985, but real income per capita on farms has risen. Phasing programs out over ten years, as I propose, would not avoid some front-loading of capital losses, but the land depreciation would average about 1.5 percent annually for ten years, other things being equal. Over the long term, land prices have kept pace with inflation and are expected to do so in the future. If inflation averages 4 percent annually over the next decade, land price gains may average 2.5 percent per year (4 – 1.5) with program phaseout, a disappointing but not devastating adjustment compared to the 6 percent average annual drop between 1982 and 1987.

12. Commodity programs work

Politicians and commodity groups frequently defend programs by saying "they work" or "If it ain't broke, don't fix it." The meaning of "they work" is unclear, but probably means programs meet the needs of their advocates.

- Even the egregiously worst agricultural policies the world over have avid defenders. That is because someone gains from policies that fail the most elementary tests of equity and efficiency. The programs work to serve special interests, but not the public interest.
- Failure of the previous eleven justifications to stand critical scrutiny is evidence programs do not work to meet the needs of the public at large.

Conclusions and recommendations

Commodity programs have lost their economic, social, and environmental rationale and now must rely for sustenance on political power. The conclusion that farmers have achieved income/wealth parity with nonfarmers has profound policy implications. With farming no longer a welfare case, producers can afford to pay for means to cope with risk and other "unique" problems of agriculture. The nation can no longer afford upper middle class welfare.

To avoid severe adjustment strains, programs need to be gradually phased out over a ten-year period. Announcing the phaseout in advance alerts investors to stop capitalizing benefits into land and to begin adjusting to a market economy. The government could afford to be generous in providing training, job information, relocation assistance, and counseling for any who leave farming, rather than continue the far more costly commodity programs to maintain land price.

The case for ending "no federal cost" programs for sugar, tobacco, peanuts, and marketing orders for milk is at least as strong as for ending grain and cotton programs. "No federal cost" programs "taxing" consumers are more regressive than programs taxing taxpayers. That is because taxpayers on average are more wealthy than consumers. Also, programs providing decoupled deficiency payments from taxpayers distort markets and reduce national income less than programs distorting markets with mandated high prices. ■

■ For more information

Documentation for this paper comes from sources too numerous to list, but most are given here.

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