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Supporting farm income through direct payments, decoupled from current production, is being implemented to partially replace commodity price supports in the European Community (EC). The motive for this change is to reduce trade distortions and promote efficiency in resource use. Like the EC, the United States initially used price supports to enhance and stabilize farm income. The change to direct subsidy payments as the major means of farm income support has been sporadic and still does not include all commodities. Decoupling payments from production has been partially accomplished. This paper recounts U.S. farm program shifts to direct payments. Insights from the U.S. experience should be helpful to the EC policymaking process.

Direct government payments are made to farmers for several purposes. One is to purchase resource use adjustments, such as idling land or producing lower valued crops, which enhances prices and indirectly raises farm income. Another purpose is to return to farmers a commodity tax usually collected from processors. The tax mostly is passed on to consumers and, therefore, is simply a mechanism to raise the price of the commodity. Neither one of these payments is a direct farm subsidy. Direct farm subsidies are income enhancing payments from general government revenues. Decoupling these payments from current production mitigates the output and trade distorting aspects of a subsidy payment. The direct subsidy component of payments to U.S. farmers is the focus of this paper.

Programs of the 1930s

Farm income supports in the United States have evolved out of New Deal programs enacted in response to the depression of the 1930s. Beginning with the Agricultural Act of 1933,

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*Johnson is professor, Department of Agricultural Economics, North Dakota State University, Fargo. Paper presented at the 28th EAAE Seminar, "EC Agricultural Policy by the End of the Century," Lisbon, Portugal, September 10-12, 1992.

price supports and associated production controls on basic commodities[1] were the major means to stabilize and enhance farm income. The nonrecourse loan[2] initiated for corn and cotton in 1933 continues to provide a price floor for most storable commodities.

Direct payments also were made to farmers under the 1933 law. However, the payments were tied to a requirement that farmers reduce plantings of specific crops (Benedict, page 306). In most cases, the payments were greater than necessary to compensate for the land removed from production. A portion of these payments, therefore, directly enhanced farm income. However, the cost of the programs came from taxes levied at the first domestic processor of the commodity. Processors, to the extent possible, passed the tax to consumers. Direct payments, therefore, were largely financed by higher consumer prices and were not a government-financed farm subsidy.

The processing tax was declared unconstitutional in 1936. Congress funded replacement legislation from the Treasury (Benedict, page 351). Direct payments were made to farmers to shift specified percentages of their land from soil-depleting crops, such as grains and cotton, to soil-conserving grasses and legumes. These payments typically were little more than compensation for the net income lost from the changes. The Agricultural Adjustment Act of 1938 contained a provision for direct compensations called parity[3] payments that depended on funds

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[1]Basic commodities originally were wheat, cotton, corn, hogs, rice, tobacco, and milk. Commodities have been added and deleted over the years. Price and/or income programs exist for all the original basic commodities except hogs. Peanuts, sugar, other feed grains, wool, and oilseeds also have price and/or income support programs.

[2]Nonrecourse means that government loans to farmers based on collateral of a commodity need not be repaid in cash. If the loan price remains above the market price, the farmer can fulfill his obligation by delivering the grain to the government. The term "nonrecourse" refers to the fact that the government has no recourse to collect the difference between the loan price and the market value.

[3]Parity payments were to make up the difference between market prices and parity prices. Parity prices were prices that would give a commodity the same purchasing power for farmers as in the 1910-1914 base period.

available (Benedict, page 378). Parity payments were made for wheat, cotton, corn, rice, and tobacco, beginning with the 1939 crop and continuing through 1943.

As in previous programs, the receipt of the parity payments depended upon participation in the various commodity programs. Participation required limitations on acreages devoted to a crop. Although not a pure subsidy payment, the concept of direct Treasury payments chiefly to enhance income rather than to control supplies had its first use under the 1938 Act.

The Brannon Plan

Parity payments terminated soon after the U.S. entry into World War II. After the war, the emphasis returned to price supports and supply control to support farm income.

Secretary of Agriculture Charles Brannon in 1949 proposed a farm plan based on direct payments to farmers. Under his plan, all perishable commodities would be sold at prices that would clear the market. The difference between the market price and the support price would be made up by compensatory (direct) payments to farmers. All major farm organizations, except the liberal Farmers Union, opposed the proposal--which never passed Congress. A major opposition to the Brannon Plan was that it would obtain farm income through the Treasury rather than through the market (Tweeten, page 331).

National Wool Act

The first use of a direct farm subsidy paid from general tax revenues with no production control aspects was in the National Wool Act of 1954. The United States has been almost continually a net importer of wool. Sheep numbers began declining after World War II, increasing reliance on wool imports, chiefly from Australia and New Zealand.

Wool prices had been supported since 1938 through nonrecourse loans and purchases. By 1954 government-owned wool stocks were over 50 percent of a year's production (Lawler and

Skinner, page 27). The National Wool Act of 1954 authorized direct payments to producers at the end of the season. Payments would be sufficient to make up the difference between average prices received and the support price. The declared purpose of the act was to encourage domestic production at prices fair to both producers and consumers with the least adverse effects on foreign trade. A primary reason for the switch to direct payments according to Benedict and Stine (page 352) was to build economic and security ties with Australia and New Zealand. Wool was so important to the Australian economy that increasing tariffs or even imposing quotas would have disturbed Pacific-area security. A secondary objective was to avoid the further buildup of stocks.

The wool support price has been increased periodically through legislation since 1955. The support price has been above the market price every year except 1973. Government payments from 1955 to 1990 have averaged 66 percent of the average market price. Payments authorized by the wool act are based on a percentage of sales and were not subject to a payment limit until 1991.

U.S. wool production has continued to decline in spite of the wool-incentive payments. Since wool's market value represents only about 15 percent of U.S. sheep producers' income, the government payments only added about 10 percent to total sheep enterprise receipts.

The wool program has operated for nearly 40 years with little publicity. Its obscurity can be attributed to the lack of controversy surrounding the program. Taxpayers like the low cost--less than $100 million per year, exporters take comfort in declining U.S. wool production, and sheep producers appreciate the extra income without production restrictions.

Precursors to Present Direct Payments for Crops

Price supports after World War II were set at levels giving rise to surplus stocks. The surplus problem was dealt with by marginally lowering price supports and instituting new

programs to expand demand and control supply. Demand expansion was led by Public Law 480--passed in 1954. This law provided for concessional sales and donations of farm surpluses to developing nations. Supply control was achieved by combinations of mandatory and voluntary acreage controls. Notable among supply control programs was the Soil Bank of 1956. The program provided for the paid conversion of cropland to conservation uses for periods up to 10 years. In spite of these programs, surplus stocks remained a serious problem.

Direct payments based on production were reintroduced for feed grains in 1963 under the Food and Agricultural Act of 1962 (Cochrane and Ryan, page 81).[4] Price supports for corn, barley, and sorghum were dropped to approximately world levels, and the difference from the previous price support level was made up with a direct payment to participating farmers--unlike later programs, the payment rate was not dependent on the market price. The price support payment was based on planted acres times the farmer's normal yield. To qualify for the program, the participant had to withdraw a portion (typically 20 percent) of his feed grain base acres from production. A small payment also was made for the land diverted from production.

In 1966, the price support payment rate was increased but was limited to 50 percent of base acreage. The diversion payment was eliminated on the first 20 percent diverted. The program operated with only minor changes through the 1970 crop season (Cochrane and Ryan, page 200). The program allowed feed grain to move into international markets without subsidy and gave feed cost relief to livestock producers. The major drawback was budget exposure.

Although the 1963-70 feed grain programs used direct payments, these payments were as much a payment for acreage diversion as a direct farm income subsidy. Evidence for this assertion is the relatively low rate of participation in the program. Participation rates for the 1963-70 period ranged from 37 to 50 percent of farmers' acreage and 55 to 66 percent of base acreage (Cochrane and Ryan, page 188). A large direct income subsidy would have attracted

[4]A similar program was provided for wheat in 1963.

nearly all producers. Like the parity payments of the 1930s, the supply control aspect undoubtedly raised prices and indirectly raised incomes of both participants and nonparticipants.

A direct payment program also was instituted for wheat in 1964. Known as the certificate program, it was partly financed by requiring domestic processors to purchase a 75¢-per-bushel certificate. The program continued until 1973. Total payments to farmers under the wheat certificate program were greater than necessary to encourage participation. From 76 to 96 percent of eligible acres were enrolled in the program from 1964 to 1973. The wheat program during this period involved a substantial subsidy to farm producers, but consumers largely funded the direct subsidy aspect through higher prices for products made from wheat.

An innovative feature introduced in 1971 eliminated planting restrictions on most crops. To qualify for price supports, the farmers had to set aside from production a certain percent of his cropland. The flexible "set-aside" feature was retained until 1982.

Target Prices, Deficiency Payments

The current target price, deficiency payment terminology was introduced in 1973. The program, which initially covered wheat and feed grain, retained short-term land retirement provisions. The goal of target prices was to seperate farm income protection from price supports. Target prices are used to determine deficiency payments when market prices fall below the targets. Deficiency payments are direct transfers to farmers based on the difference between target prices and the higher of seasonal average market prices or loan rates. Payments are made for normal production (base acres times normal yields) reduced by any land retirement requirement (Tweeten, page 338).

Support prices were retained to facilitate orderly marketing through the popular nonrecourse loan feature of previous programs. Also, the support price limits the government's budget exposure since deficiency payments cannot exceed the difference between the target and loan price.

Another feature of the 1973 Act was to drop the parity formula. Cost of production was to become the basis for target prices. Without comprehensive production cost data, Congress set target prices for 1974 and 1975 with adjustments based on prices paid and yield indexes in subsequent years. By 1979, all target prices escalated on the basis of changes in unit production costs excluding land (Tweeten, pages 338-339).

Large foreign demand from 1973 to 1977, triggered by Soviet purchases, resulted in little use of the provisions of the 1973 Act. Neither production controls nor deficiency payments were important during this period.

Four-year farm legislation was enacted in 1977 and again in 1981, which retained the basic structure of the 1973 Act. Cotton was added to the target price-deficiency payment program in 1977, and rice was added in 1981. Soybeans were given a price-supporting nonrecourse loan in 1977, but they were not included in acreage control or deficiency payment programs (Tweeten, pages 339-341).

The 1981 Act abandoned changes in cost of production for adjusting target prices. Congress set target levels with increases during the four-year life of the bill. Congress also set minimum price support--i.e., nonrecourse loan levels. These supports made U.S. commodities noncompetitive in world markets (Tweeten, page 341). High support prices and a worldwide recession caused farm exports to fall and surplus stocks to build. The largest acreage diversion program in U.S. history was inaugurated in 1983. The program was financed by paying farmers with surplus commodities. The payment in kind (PIK) placed government grain on the market, pushed grain prices below the price support level, and helped to make grains more competitive in international markets.

Like previous direct payment programs for grains, the deficiency payments under the 1977 and 1981 Acts were often coupled with acreage diversion requirements. The annual cost of direct payments and annual land retirement requirements are presented in Table 1.

Subtracting an estimated land diversion cost, farmers' opportunity cost, gives the direct income subsidy component of the programs (last column of Table 1). From 1977 through 1984, direct payments were divided 40 percent between compensation for land diversion and 60 percent for farm income subsidy.

TABLE 1. FEED GRAIN, WHEAT, COTTON, AND RICE PROGRAM COSTS, LAND DIVERSION AND ESTIMATED DIRECT SUBSIDIES, 1977-1991

Fiscal Year	Cost of Feed Grain, Wheat, Cotton, and Rice Programs	Annual Cropland Diversion[a]	Estimated Farmers' Cost of Diversion[b]	Estimated Farm Income Subsidy[c]
	(million $)	(million acres)	(million $)	(million $)
1977	2,807	0	0	2,807
1978	3,290	18	1,602	1,688
1979	1,642	13	1,157	485
1980	2,553	0	0	2,553
1981	1,370	0	0	1,370
1982	8,989	11	979	8,010
1983	12,261	78	6,942	5,319
1984	2,355	27	2,403	(48)
1985	12,445	31	2,759	9,686
1986	18,740	46	4,094	14,646
1987	19,495	60	5,340	14,155
1988	10,525	53	4,717	5,808
1989	5,529	31	2,759	2,770
1990	4,115	28	2,492	1,623
1991	6,929	29	2,581	4,348

[a]Does not include long-term land retirement under the 1985 Conservation Reserve Program which currently totals 34 million acres.
[b]Based on weighted average per acre return above variable expenses (1989) for corn, barley, sorghum, wheat, cotton, and rice ($89.00 per acre).
[c]Column one minus column three.

SOURCES: U.S. Department of Agriculture, Economic Research Service, *Agricultural Resources*, various issues; U.S. Department of Agriculture, Economic Research Service, *Agricultural Outlook*, various issues; U.S. Department of Agriculture, Economic Research Service, *Costs of Production--Major Field Crops, 1989.*

Food and Agricultural Acts of 1985 and 1990

The Food Security Act of 1985 made three changes affecting direct payments. First, target prices were frozen for two years and then reduced by 10 percent over the final three years. The 1990 Farm Act froze minimum target prices for another five years.

Second, loan rates were reduced sharply to bring them near or below world market prices. To further reduce market prices, the Secretary of Agriculture paid part of the deficiency payments with generic, negotiable PIK certificates. These certificates were used to release government-owned grain into the market. For cotton and rice, the market loan replaced the nonrecourse loan. The market loan allowed farmers to keep or sell the commodity under loan and repay the government at the current market price. The market loan untied cotton and rice prices from the loan price.

Lower price supports, generic PIK, and market loans kept U.S. market prices competitive, and increased deficiency payments (see Table 1). Beginning fiscal year 1985 through 1989, direct payments exceeded compensation necessary for land set-asides required for program participation. Direct payments in this period became a large part of net farm income and taxpayer costs increased dramatically (Tweeten, pages 343-344).

Third, the 1985 Act attempted to decouple program payments from current yields. Previous programs allowed farmers to submit their production records to prove their yields used to calculate deficiency payments. Under the 1985 Act, the Secretary of Agriculture could freeze program payment yields--which he did. Yields continue to be frozen under the 1990 Farm Act. Since higher yields cannot improve deficiency payment rates, farmers were expected to make production decisions based on the expected market price rather than the target price. However, this expectation is valid only if farmers believe deficiency payment yields have been frozen permanently. Many farmers likely believe program yields eventually will have to be updated, based on recent yields. Their decisions are, therefore, biased toward achieving higher yields than current market prices alone would justify.

Decoupling payments from planted acreage was achieved partially by making it more difficult to expand base acreages. Also, the 50/92 and 0/92 provisions were introduced. These provisions give 92 percent of deficiency payments even if only 50 percent or, in some cases, none of the crop is planted. There are restrictions on the use of the land not planted to a program crop.

Two additional major features of the 1985 law are the Conservation Reserve and Export Enhancement Programs. The Conservation Reserve calls for placing up to 45 million erosion-prone cropland acres into soil conserving uses under 10-year bid contracts. The Export Enhancement Program provides an in-kind commodity bonus for each qualifying commercial purchase. Also known as export PIK, this program in effect lowers the price of U.S. grain exports to selected markets.

The Food, Agriculture, Conservation, and Trade Act of 1990 continued most programs established by the 1985 and previous Acts. The major change was to reduce the cost of deficiency payments and provide farmers with additional planting flexibility. This was accomplished by reducing the acres upon which deficiency payments are calculated by 15 percent. These so-called flex acres could be planted to any commodity except fruits and vegetables (Pollack and Lynch, page 133).

Payment Limitations

The switch to direct payments makes subsidies transparent, and the imposition of payment limits to individual farmers becomes an issue. Payment limits first were established in 1970 at $55,000 per crop for each person (excluding commodity loans) for producers of upland cotton, wheat, and feed grain (Tweeten, page 337). The limits and exemptions have changed with each farm act, but have had minimal impact until deficiency payments became a substantial part of gross income beginning in fiscal year 1985. Even then large farm operators were able to get

around the limitations because the definition of a person included corporations (artificial persons). By forming several corporations, a single farming entity was legally able to circumvent the payment limitation. The most recent legislation limits payment eligibility to persons actively engaged in farming and also limits the producers' ability to create entities that separately qualify for farm program payments (Kelly and Malasky, page 9). Current limits are $50,000 per person for deficiency payments; $75,000 per person for certain other programs, such as market loan gains; and a $250,000 overall limit (Kelly and Malasky, pages 22-23).

Payment limitations or payments graduated down with their size, which has also been proposed, are at the heart of the philosophy of agricultural subsidies. If direct payments are looked upon as a payment in place of price supports and if price supports are justified on the basis of "parity" or cost of production, then payment limits would not be justified. After all, the market does not have an income limit. On the other hand, if direct payments are seen as a social program to keep more farmers on the land, for example, then payments should be so much per person and should not be tied to either current or historical production. Although U.S. farm program history and farm organizations cling to the first view, the rationale for continued subsidies "to save the small family farm" tends to point to the second view. The political farm policymaking process in the United States has not been able to seriously consider completely divorcing subsidy payments from a historical production base. Tightening the payment limit has been the most that has been politically acceptable.

Conclusions

Direct payments have been used in the United States since the inception of current farm programs. Currently, direct payments are made to producers of wool, feed grains, wheat, cotton, and rice. Except for the wool program, direct payments mainly have been for diverting land from production of crops in surplus. The situation changed in 1985 when market prices were

allowed to fall far below target prices. Direct payments then became a major farm income supplement. Decoupling payments from production was partially done in 1985. The latest farm legislation has reduced direct payments by reducing the eligible acreage.

Payment limitations usually have been included in direct payment programs. A politically acceptable criteria to set subsidy levels other than using production history has eluded U.S. policymakers.

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