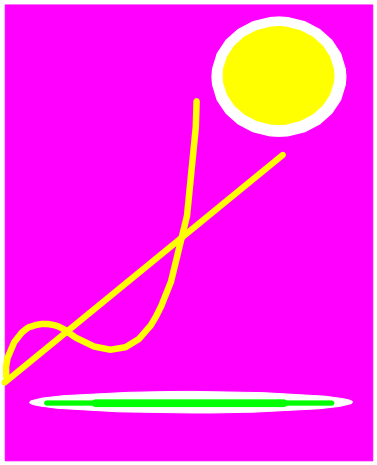

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Eye on Economics:
A Conceptual Analysis of Farm Subsidies

by

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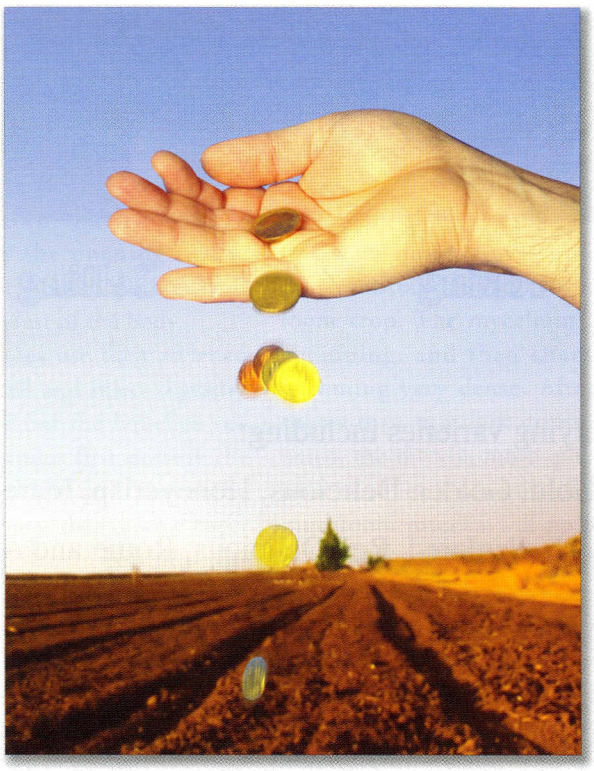
Eye on Economics: A Conceptual Analysis of Farm Subsidies

By Charles Rhodes

How history sowed the seeds for today's regulations, and the resulting effects on the produce industry

INDUSTRY METRICS



To the layman, U.S. farm policy may seem ironic. Why write lengthy and complex farm bills and offer billions in financial support to help put seeds in the ground and tend them through harvest? There seems to be little memory of the harsh, cyclical waves of boom and bust that preceded the first Agricultural Adjustment Acts of the Great Depression. Further, the public's demand for a safe, continuous, and cheap food supply can be difficult to meet when harvests are annual, and when yields vary dramatically due to unforeseeable environmental changes including heat, rainfall, and pests.

Still, it is no accident that every developed country in the world supports its agricultural producers to some degree. Domestic food production is generally more secure, if not always cheaper, and unregulated food markets are too disruptive for reliable economic planning.

The History of Farm Subsidies

New Deal farm policies supported farmgate prices above the cost of production through a system of nonrecourse loans secured by program crops. Crops could be forfeited to the government in full payment of the loan plus interest if prices stayed low. From 1933 to 1953, loan rates were maintained high enough that farms mostly sold commodity crops on the market, farm communities prospered, and the program earned money for the government. Supply management structures protected against overproduction. Perishable crops were ill-suited to this approach, and spent decades on the farm policy sidelines. Corn, soybeans, wheat, rice, and cotton became the backbone of the evolving system, with peanuts, tobacco, and sugar in a second tier. Larger, mechanized farms were rewarded under the yield-based, then acreage-based, payment system, and maintaining stable stocks of staple goods provided the feed and food-manufacturing industries with consistently low-cost inputs.

When loan rates were severely lowered in a 1954 bid to "get government out of agriculture," prices fell and stayed too low for many farmers to consistently recover costs. Traders and food manufacturers profited and grew as over one-third of U.S. farmers were lost between 1950 and 1970. More mechanization, industrialization, and farm debt characterized most survivors, and direct income support became necessary. As the program shifted from price to income support, cheap commodities seemingly overtook rural economic health as the primary policy objective.

Key Elements

Farm subsidies do not directly apply to the produce industry, but indirect effects can be felt. Therefore, it's good to know how these subsidies work:

- U.S. farm policy has evolved in the decades since the Depression in an attempt to balance farmer, consumer, agribusiness, balance-of-payments, and environmental needs.
- Most agricultural policy considerations are subsumed to the goal of maintaining a cheap, safe, and continuous food and fiber supply for the majority outside of the agricultural sector.
- The majority of direct agricultural support continues to favor crops used as food manufacturing inputs rather than crops that are more directly consumable with little or no processing.
- To the extent that subsidies for staple grains lower the prices for grain-based foods and the meat from animals fed those grains/oilseeds, the farm program has consistently increased demand for these relative to produce.

To learn more about each key element, look for the throughout the article.

Payments "coupled" to individual farmer production and commodity market prices were formulaically determined. In the early 1970s, a "fair" price (or "target price") system was enacted that triggered "deficiency payments" to make up the difference between the target price and the best price farmers could get on the market. This raised program farmer income somewhat, but as with other farm payments, much of the value was capitalized into land. The bursting of the land-value balloon in the early 1980s brought the worst farm crisis since the Great Depression.

U.S. farm policy has evolved in the decades since the Depression in an attempt to balance farmer, consumer, agribusiness, balance-of-payments, and environmental needs amidst parochial, regional, national, and global political agendas. Some interests coincide while others conflict, resulting in an ongoing battle with complicated results—the 2008 Farm Bill tops out at over 650 pages.

"Freedom to Farm"

Over time, different interests have attempted to overhaul an agricultural support system that in its broad outline has developed significant inertia. In 1994, Congress put through a "Freedom to Farm" bill intended to turn the whole system over to the free market. Restrictions on program acreage and crop choice (that had implicitly helped manage supply) were to be removed, while producers received transition payments "de-coupled" from production as a subsidy program buyout.

In spite of the buyout, when program commodity prices turned down sharply in 1998 Congress was pressed into tens of billions in emergency aid, and the free-market ideals associated with the 1996 Bill were quietly ignored. The intended result of the overhaul—a smaller, more flexible program—instead became a new era of payments "de-coupled" from production decisions and prices (but still based on program crop participation), paid in addition to "countercyclical" payments designed to engage as a safety net with minimal market distortion.

Federally-subsidized private-company-issued crop insurance exists, but never supplanted federal disaster payments as the

A Conceptual Analysis of Farm Subsidies

1996 Freedom to Farm Act intended. Crop insurance, like many other aspects of agricultural economics, does not meet academic ideals of the market. Losses are random, regional, and large, and premiums are therefore unattractive to producers at actuarially sound premium prices. The 2002 Farm Bill included de-coupled payments, countercyclical payments, and crop insurance support.

Farm Policy Formation

Decades of attempted change have not altered the fundamentals of U.S. farm policy formation. Most agricultural policy considerations are subsumed to the goal of maintaining a cheap, safe, and continuous food and fiber supply for the majority outside of the agricultural sector. Americans pay a smaller portion of their incomes on food than anyone else in the world. Large, capital-intensive program crop farms and animal operations make this possible, and so economically dominate both agricultural production and the most direct program benefits.

All farm subsidies encourage more production, so supply management of some form is necessary to avoid price-crushing overproduction or expensive storage. This occurs through indirect "voluntary" policy mechanisms, including the Soil Bank Program, Acreage Reduction Program, and later the Conservation Reserve Program; and through direct mechanisms, such as acreage allotments required for some program crop participation.

As producers' numbers and relative percentage of the population have decreased, the large, highly-capitalized, higher-debt operations that result are implicitly less stable financially, creating a greater incentive to either move toward dependency on subsidies, or directly away from them to survive. "Insulating producer support from market price impacts" has become the rule for farm program designers and participants. Non-program options include diversification (to an extent prohibited by program participation) and attempts to move up the value-added chain (into processing, direct marketing, and/or transitioning into organic).

Industries or organizations successful in securing program advantages in the past are likely to maintain some form of those advantages in any next stage of policy development. Entrenched interests benefit from policy inertia and the ease of organizing a small number of profit-motivated agents relative to the general welfare interests of the broader public. Those without a strong comparative advantage will attempt to leverage one through policy.

International considerations and treaties are growing in their ability to restrict domestic policy options. Any doubt of this was removed when U.S. program support for cotton was ruled illegal in a recent challenge before the World Trade Organization (WTO). Major bilateral trade partners weigh in on U.S. policy debates whenever they can.

The farm program has never subsidized all agricultural producers, or offered general income payments to preserve the rural economic, environmental, and scenic roles that farms perform. The majority of direct agricultural support continues to favor crops used as food manufacturing

inputs rather than crops that are more directly consumable with little or no processing (except for regional fluid milk price supports).

The staying power of dominant economic interests in agricultural policy tends to dampen the effects of any single election or mood to shift policy, and situations can become very political. The full assortment of political tools used in Capitol policy-making have been applied to agricultural policy, including attaching riders onto unrelated bills and scheduling votes before interested parties have time to read legislation. Not all farm bill provisions carry mandatory funding, so many can be undermined in later political rounds by defunding or underfunding in annual appropriations processes. Competing national funding priorities can collapse authorized funding quickly.

Effects on the Produce Industry and the 2008 Farm Bill

The imbalance of subsidies for some crops and not for others (i.e., fruit and vegetables) does cause some indirect effects on the produce industry. Supported crops are overproduced, often for export, and unsupported crops may be underproduced. For example, corn has been pushed to hyperabundance for use as feedstock, and then fuelstock, a push the traditionally unsubsidized fruit and vegetable industry does not receive. If the money lies elsewhere, some farmers may be tempted to switch their fields over to the more profitable crops.

To the extent that subsidies for staple grains lower the prices for grain-based foods and the meat from animals fed those grains/oilseeds, the farm program has consistently increased demand for these relative to produce. Fruit and vegetable production is much more labor-intensive than program crops, and more vulnerable both to changes in labor practice standards and to sudden environmental changes that may affect more delicate crops. So produce production remains a structurally more expensive category, despite recent extremely high program crop prices.

While subsidies for produce are not on the political radar, fruit and vegetables did finally make it into the 2008 Farm Bill. The Food, Conservation, and Energy Act of 2008 was signed into law on June 18, 2008, replacing the 2002 Farm Bill. According to the House Committee on Agriculture, the Bill increases nutrition program funding, better enforces payment limitations, adds $8 billion in conservation spending, redirects some renewable energy support from corn ethanol toward cellulosic ethanol, and strengthens international food aid.

While the Bill continues direct payments, countercyclical payments, and marketing assistance loans, it also offers a new option, paid for by reductions in both the marketing loan rates and direct payments. Farmers may enter the Average Crop Revenue Election (ACRE) program to disengage from the current system. ACRE allows farmers to focus on market prices rather than government-set target prices, and only offers assistance when there is a demonstrable loss of revenue, rather than making automatic payments. Farmers absorb the first 10 percent of revenue loss before benefits kick in. Enrollment is optional, but once entered, a farmer must remain in the ACRE program for the life of the 2008 Farm Bill.

In a major victory for the produce industry, the Bill also includes the first title for fruit and vegetable production. An array of regulations and policies already strongly impact the fruit and vegetable industry, but the explicit title and increase in funding add a level of official legitimacy to a sector responsible for one-third of U.S. cash crop receipts and one-fifth of U.S. agricultural export value.

Congressional Web sites summarize the following authorizations:

- $33 million to expand direct marketing and farmers' market promotion programs
- $22 million for cost-sharing in organic certification
- $377 million over ten years for pest and disease protection and control
- $23 million for research on food safety hazards
- $10 million annually for high-priority research on honeybee colony collapse disorder
- $466 million over ten years to expand the specialty crop block grant program to support states' projects promoting specialty crop development, marketing, and pest protection ($224 million of this is fully funded in a schedule through 2012)

Planting flexibility into fruit and vegetables on crop program base acres remains prohibited under the 2008 Bill, except for 84,000 acres apportioned among Midwestern corn-soy states in pilot programs, wherein program payments are reduced acre by acre against the produce-planted acres, and wherein fruit and vegetable harvests are contracted in advance with processors (i.e., no portion of which may be sold unprocessed in any market). This planting restriction survived despite a 2005 challenge before the WTO, and subsequent Administration support for lifting the restriction.

While the continued focus of subsidies and the majority of the Farm Bill remain on existing beneficiaries, the produce industry is indirectly affected by such programs. The more the industry knows about such programs, the better prepared it will be if future changes (such as those made to the 2008 Farm Bill) are made that directly impact fruit and vegetables.

Charles Rhodes was a researcher and agricultural policy analyst for nine years before beginning his current pursuit of a Ph.D. in agricultural and resource economics at the University of Connecticut. He specializes in industrial organization and teaches a food policy course.