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Targeting Federal Farm Programs: Options and Consequences

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The all-time record costs of current federal farm programs and news stories of multi-million dollar payments to a few farm businesses have stirred renewed interest in who is getting the benefits of federal farm programs. An article in *Fortune Magazine*, "How to Cut Farm Spending," proposed that the federal government quit paying crop subsidies and "instead fashion a straightforward welfare program for farmers who can't hack it in the open market" (Smith, pg. 97). A *National Journal* article, "Riding for a Fall", concluded: "Resentment of large federal payments to some farmers, if it spreads and deepens, may undermine support for the farm program, farm-state legislators fear" (Rauch, pg. 2497). These concerns about who is getting the benefits of federal farm programs are really questions about the social consequences or equity impacts and specifically about targeting, the deliberate determination of type and amount of benefits and the intended recipients.

Of course in a general sense targeting farm programs is not new. There has always been a general recognition that the benefits of government programs ought to go to the "deserving." The Homestead Act of 1862, one of the earliest of "farm programs" had an overt distributional objective and targeted the land-poor farmers willing to move West. In this century farm programs have been "targeted" for the general purpose of preserving the family farm structure of the industry. Language to this effect has been included in all major farm bills of the last fifty years. Over the last four decades, attempts to target benefits have included: (1) domestic production allotment "rights to grow" specified acreages for basic commodities like wheat, cotton, corn, rice, and tobacco; (2) marketing quota rights which limit the amounts a farmer could legally sell; (3) formalized procedures for establishing eligibility for farm programs; and (4) limits on direct payments made to individual farmers. To many observers, farm programs are complex, even byzantine, and targeting specific groups of farmers with particular needs has usually been an often articulated but clearly subsidiary objective.

Debate over the impacts of federal price support programs on the structure of agriculture has been around for a long time, and has been the the subject of considerable study. Discussion has frequently centered on the possible linkages between government farm programs and the size and number of farms making up U.S. agriculture. Proponents of farm programs

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have frequently advocated federal intervention in agriculture on the basis that government involvement makes possible the retention of a farm structure largely comprised of family-owned and operated farms. Since the "New Deal" era of the 1930s, and even before, the federal government has been heavily involved in supporting agricultural prices and in other activities thought to be structure-preserving. Yet farm numbers have continued to decline almost every year since then, and each year an ever larger percentage of total agricultural output is produced by "mega" farmers who sell more than $250,000 worth of output, and while many of these are still family owned virtually none of these are operated solely, or even primarily with family labor.

The conventional wisdom among agricultural economists, some politicians, farmers, and the informed public is that the bulk of the benefits of farm program legislation go to large, wealthy farmers who are not truly in need of assistance (See the discussion in Pasour). The classic studies on this are Bonnen, completed in the 1960s, and Schultze's work published in 1971. There is now, however, some research evidence disputing this belief. A USDA survey (conducted by Johnson and Banker) concluded that it was the mid-size, commercial but family farms that reap the greatest share of the benefits. This study concluded that compared to their contribution to production, neither the large "mega" farms producing more than $500,000 of output, nor the part time and subsistence farms individually producing less than $40,000 of output receive revenues from farm programs proportionate with their contribution to output.

That neither the very small nor the very large producers benefited proportionately from government payments is not necessarily bad, if the government desires to provide the greatest assistance through government programs to farmers who truly need help. A large proportion of the middle group of farmers, those producing over $40,000 but less than $500,000 of output were farmers with high debt loads, negative cash flows or both. Those producing more than $500,000 of output were frequently producing commodities ineligible for government price support payments. Those producing less than $40,000 of output usually fall into either of two categories: either part-time farmers who have substantial off-farm income, or elderly and subsistence farmers, who, while perhaps not having high total incomes, can be comparatively debt free and can have comparatively high net worths, at least relative to their incomes.

Despite the rhetoric about preservation of the family farm and insurance of a stable food supply, the major objective of government programs in agriculture is now, and has always been, to increase the incomes. Through the capitalization of increased income into land values, the net worths of landowners may also be increased. Given the amount of money involved in federal farm legislation, the fact that most of the cost of federal farm legislation is due to efforts aimed specifically at increasing farm income, and concerns with respect to the need for a reduction of federal budget deficits, renewed interest in further targeting farmer program payments to those most in need is not surprising.

Targeting: General Considerations

Policymakers at the federal level face a number of options in any effort to more specifically target farm program benefits. All of these

specific options must be analyzed with these three general considerations:

1. **Eligibility and Payment Design**--Federal farm programs have evolved into a system in which most programs are open to producers on a year-to-year elective basis with minimal eligibility criteria. Furthermore, for many of the USDA programs, payments received by farmers come in a variety of different forms. For example, direct payments are made to farmers under the target price/deficiency payment systems for crops like corn and wheat; indirect payments are received through the nonrecourse price support loans when farmers default on the loan and the USDA takes possession of the crop; indirect payments are also made through government purchases of commodities at higher-than-market-prices, such as the dairy support program; and indirect benefits go to farmers whose commodities are subject to allotments or marketing quotas (e.g. tobacco and peanuts) which make resulting crop prices higher than the free market would provide. Any targeting scheme must deal with these kinds of differences across commodities.

2. **Avoidance Behavior**--American farmers are sometimes said to "farm the farm programs" by pursuing production decisions which maximize government payments. This behavior includes reorganizing farm ownership and tenancy to avoid the current $50,000 limitation on deficiency payments and $250,000 limitation on all payments. Targeting schemes may induce farmers into pursuing new avoidance behavior, and, as a result, unintended consequences for policymakers may occur.

3. **Targeting As a Subsidiary Objective**--Targeting must, of course, be the subsidiary rather than the primary objective of any farm program. As such, targeting options must deal with the value-laden, political question of equity and fairness--who should get how much? The primary objective for farm policymakers must center on the efficiency issues in the production of food and fiber for domestic consumption and export. There will be the inevitable questions involving the conflicts and trade-offs necessary when targeting is balanced against the efficiency goals of farm programs.

The degree of success in targeting can and should be measured and analyzed. Weisbrod's suggestions of target efficiency--vertical and horizontal efficiency--are appropriate measures of how well farm programs are doing in the determination of the type and amount of benefits and identification of the ultimate beneficiaries. Vertical efficiency measures the proportion of the benefits received by the intended beneficiaries. Horizontal efficiency measures the degree to which a program reaches all members of the intended target group. While it is admittedly difficult to obtain information on the target efficiency of any public program, this does not diminish the importance of these types of data for farm programs.

Targeting Options for Farm Programs

In the current environment, it would seem that six alternatives or options in targeting farm programs and payments to farmers can be defined:

Option I: Continue with the Current System

The determination of eligibility for and amount of farm program payments is based on an array of different factors, none of which are in any way measures of the farmer's net worth, cash flow situation or taxable

income. With the lone exception of farm credit programs, USDA programs are not need-based. Generally payments are made to farmers who have, in the past, produced commodities covered by the legislation which are in oversupply in world markets and for which the world market price is determined by farm policymakers to be unacceptably low. These include the major commodities of corn, wheat, milk, and cotton plus rice, barley, oats, sugar, honey, and grain sorghum. For eligible commodities, factors influencing payment levels to individual farmers in the current legislation include historical production levels in some base period, historical yield levels, and by the actual market prices relative to support price levels determined in the legislation.

The Johnson and Banker work (USDA) reveals that government payments went to all types of farms, regardless of their cash flow and debt situation. However, nearly 60 percent of the outlays went to farms with a high debt to asset ratio, negative cash flows or both. The remaining 40 percent went to farms which were categorized as low debt and positive cash flow. Pasour indicated that in 1984, one third of all government payments go to farmers who sell more than $250,000 of output. Arguing that farm programs are needed within agriculture and then making government payments to farmers who meet the existing eligibility requirements without reference to a farmers' income or debt situation represents very low target efficiency, especially in a horizontal sense.

Option II: Implement More Severe Payment Limitations

One popular option which is currently under consideration in Congress is further limiting total payments received, perhaps even to a figure as low as $10,000 per farmer. Payment limitations are "caps" on benefits received and not really "targeting" of program benefits. If the federal government wishes to more nearly target payments to those truly in need of assistance, there are several problems with this popular but simplistic payment limitation approach. One characteristic of the current financial crisis is that it is not necessarily limited to any particular size category of farms. The current farm financial crisis is not a problem facing only small producers with low gross incomes. While many small producers are elderly farmers who are comparatively debt-free, or part-time farmers who have other income sources, those who are in severe financial difficulty--with either low net worths or negative cash flows--are often those who expanded most heavily during the 1970s and early 1980s using borrowed funds.

Thus, an individual receiving a $50,000 government payment, when evaluated on the basis of income, cash flow or net worth criteria, may actually be in greater need of government payments than one who receives only $10,000 in payments. Imposing a lower payment limitation without instituting other need-based criteria in the legislation could make it even more difficult for these farmers with high debt loads to survive. Moreover, implementation of more stringent payment limitations would also probably result in increased creativity on the part of farmers in coming up with previously-undiscovered approaches for avoiding the payment limitations.

Finally, more stringent payment limitations generally affect only the payments or benefits received directly. Farmers also receive benefits

indirectly through price-supported or allotment control programs for commodity programs like dairy and tobacco.

Option III: Adopt Cash Flow, Net Worth or Income Criteria Within Farm Legislation

What if the intended beneficiaries of farm programs were more clearly defined in terms of need-based criteria? In this option, payments would be intended for those farmers in greatest financial need by setting up cash flow, net worth or income criteria for eligibility and then build these criteria into existing farm programs. Given the emphasis in the last several years on reducing federal expenditures as a means of reducing the budget deficit, and the amount of public interest in the farm financial crisis, it is somewhat surprising that more questions have not been raised regarding the development of income, cash flow, or net worth criteria for eligibility for government farm payments. Stiff eligibility requirements have the potential of saving the federal government billions of dollars and simultaneously making assistance more generous for those farmers who truly have financial problems.

Yet the public and the Congress has been content to continue to make payments to farmers without regard to need. Imposing maximum income or net worth criteria for eligibility would almost assuredly be politically unpopular with the farm leadership. One of the basic determinants of eligibility under the current wheat and feedgrain programs is the willingness of the farmer to restrict production consistent with the rules that apply within the existing legislation. Local ASCS offices already collect a considerable amount of data about individual farmer's operations on historical acreages, yields and the like in order to determine eligibility under the current legislation, but very little of this is financial data. While the profitability of the farm might be inferred on the basis of some of these data such as yields and acreages, the legislation (and hence ASCS offices) have never required net worth, cash flow or income statements. Such an option would require little additional work for farmers who already prepare and supply these statements to their creditors. It would also improve the data available on the vertical efficiency of targeting.

But there are major difficulties with this approach. If farms with positive cash flows and low debt loads were determined ineligible for government payments, the government may not have any effective means of restricting production on these ineligible farms. This, in turn, might mean greater output from these nonparticipating farmers and lower domestic market prices, resulting in higher government payments to the eligible farmers. Some of the savings generated by not making payments to ineligible farms would thus be offset by higher payment costs to farmers ruled eligible.

If only farmers with net worth or income below predetermined levels were allowed to receive direct payments, the federal government would be, in effect, rewarding many farmers for inefficiency in production or an inability to manage their farms, while making it more difficult for the efficient, well-managed producers to survive. This is counter to free enterprise principles leading to the survival of the well-managed firms and designed to promote efficiency in agricultural production.

Option IV: Merge Income Assistance in the Farm and Non-Farm Sectors

Public welfare programs have stringent eligibility requirements to assure that program dollars go to those who are truly in need of help. These eligibility requirements are generally based on the unavailability of other sources of income, as well as other indicators of need such as family size and net worth. Although federal farm programs, like public welfare programs, are basically income support programs, farmers who receive income support through farm programs are not subject to the stringent eligibility requirements imposed on welfare recipients in the non-farm sector, and program payments go to the poor and the wealthy farmers alike. Of course, farmers who meet eligibility requirements for existing public welfare programs are not automatically excluded from welfare benefits. However, even many farmers with very low annual incomes are precluded from obtaining welfare payments and employment assistance in most states because of their asset situation.

Most farmers do not think of government payments as a form of welfare, despite their effects as an income supplement. As a result, there is very little negative stigma attached to receiving income support in the form of government payments. Many farmers currently are more likely brag to their neighbors about how much government support they receive. If stringent income or net worth rules were adopted, farmers would probably change their behavior in this regard. Farmers sometimes react unfavorably toward the concept of an urban dweller who survives on income support through welfare payments, but farmers generally do not see themselves as part of the same government income-support system. Most farmers would probably find a complete merger of the farm and non-farm income enhancement programs under a shared welfare system even less palatable than the establishment of income or net worth criteria within the farm legislation.

The agrarian myth of the farmer and farm life plays a role. The concept of farmer as entrepreneur in control of his own destiny remains secure in the minds of many urban dwellers. The image of the farmer in the public mind is not the individual who controls millions of dollars of assets and has a six-figure income, but rather as a free-spirited individual who is doing something important for society, producing food, primarily because the way of life is viewed as very enjoyable. Myths surrounding the images of the farmer as an independent entrepreneur, at peace with himself and nature, have probably done much to smooth the way for agricultural legislation through Congress. The negative image of an auction of the assets of a bankrupt farmer is also firmly planted in the mind of the public, and within Congress.

Option V: Transition Loan Programs for Exiting Farmers

Jones and Heffernan have called for a government loan program specifically to meet the needs of exiting farmers. Such a program would make transition loans available to farmers at low interest rates until they could systematically liquidate remaining assets and perhaps obtain off-farm employment. Exiting farmers, having made every effort to save the farm, frequently find themselves in a precarious financial situation with respect to meeting even necessary family living expenses. It may be necessary for the federal government to guarantee loans, given the debt/equity situation

faced by the exiting farmers. Eligibility requirements for loan funds would need to be developed, repayment plans and strategies discussed, and participating credit institutions identified. Ideally, loans should be paid off as the exiting farmers find new employment and the need for the financial assistance is reduced.

The cost of this kind of program could be quite high, particularly if exiting farmers are not successful at finding off-farm work, and as the number of exiting farmers increases. Moreover if the government guaranteed loans are defaulted, costs could also increase quite rapidly.

Option VI: Replace Welfare and Farm Programs with a Negative Income Tax Serving the Needs of Both Groups

In the early 1970s, experiments were conducted with a negative income tax as a replacement for welfare programs. These plans were based on the idea that if income reported to the federal government fell below a certain level, the government would instead make a payment to the individual. Sliding scales were proposed such that the individual would always be better off in terms of income by working than by staying home and accepting the government payment. Other eligibility requirements were drastically simplified or eliminated entirely. The individual was free to use the government payment however he or she wished. Experiments conducted using this approach were at least moderately successful, but no negative income tax was ever adopted.

A form of negative income tax could restore equity in income enhancement programs in the farm and non-farm sectors. The issue of equity in income enhancement between farmers and others who receive government assistance is going to become increasingly important. It is not clear how long the current income support system can survive that singles out farmers as a group for special and more generous treatment. There might be renewed interest in a plan similar to the negative income tax.

Such a plan would mean that prices for agricultural commodities would fall to world market levels, and supply would meet equilibrium market clearing conditions world-wide at the going world price level. Farms that could not survive would go bankrupt, and their assets would be transferred to farms that could produce at a profit given world price levels. True, some commodities might be largely produced cheaper outside the United States. There would be additional downward revaluation of farmland and other assets in agriculture, and in the short run, federal money would be needed to assist the Farm Credit System as well as through the FDIC for commercial bankers in rural areas that would otherwise go under. But in a few years farmland would be valued more nearly at a level consistent with equilibrium prices, making it easier for young farmers to begin farming.

Concluding Comments

The Reagan Administration has called for a withdrawal by the federal government from intervention in agriculture. Without a substantial increase in world market prices for the major agricultural commodities, it is clear that in the absence of existing government price support programs, many more farmers would now be bankrupt. Payments by the federal government to farmers in 1987 approached net farm income. What would happen to these

bankrupt farmers if the federal government reduced substantially the level of farm program benefits? Those unable to continue to farm but with employable skills might find nonfarm employment. Many of these farmers would likely have to move to larger cities where the job opportunities are more readily available. Rural communities and even entire rural states may loose population as a result (Stone). Those whose age and other characteristics make them less likely to be employed in nonfarm jobs would likely enter the unemployment rolls. The future for these exiting farmers does not appear to be very bright.

Thus, expenditures for farm price support programs cannot simply be eliminated without substantial fiscal consequences for the remainder of the federal budget. If such a proposal were implemented, and more farms go bankrupt, additional costs in a number of different budget areas would be incurred by the federal government. These costs include: (1) additional costs for welfare and other public assistance programs serving the needs of low-income ex-farmers; (2) potential additional costs under unemployment insurance programs, although the exact numbers of ex-farmers qualifying for unemployment insurance is uncertain; (3) Additional costs for bailing out the Farm Credit System, as more and more loans are in default; (4) possible public assistance and unemployment payments for individuals whose businesses served commercial farmers, and for dealing with the consequent impacts on rural towns, schools and other public services (Chicoine) and educational and social programs designed to alleviate farm financial stress (Jones and Heffernan); (5) Additional costs and assistance for banks and savings and loan associations serving rural areas through the Federal Deposit Insurance Corporation, and the Federal Savings and Loan Insurance Corporation (Melichar).

The economic problems facing agriculture have also greatly affected employment in the agriculturally-related non-farm sector (Ginder), limiting the most likely non-farm job opportunities within agriculture for displaced farmers. Outside the agricultural sector, manual factory work is becoming increasingly automated, and labor is increasingly being replaced with capital equipment. Some jobs are lost. New jobs are frequently created in conjunction with the new technology, but these new jobs increasingly require sophisticated technical skills which displaced farmers would not necessarily possess. For many of these farmers, it is not entirely clear how smooth the transition would be from farm to non-farm employment. Those who previously had part-time non-farm employment would perhaps be in the best position to make the transition to full-time non-farm employment. However, the full time farmers without significant off-farm income, not the part time farmers who have other income sources, have experienced the greatest degree of financial difficulty under the current economic situation facing agriculture, and would most likely be seeking alternative employment.

Funding for federal farm programs is justified in part on the basis of the need for improving the incomes of farms in financial crisis. Income support goes to those farmers who are in need as well as those who are not in need. Targeting farm programs, though admirable at an intuitive level, may suffer from a fate described best by H. L. Mencken: "For every human problem there is a solution which is simple, neat, and wrong."

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