doing what works

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Bad Seeds

A Plan to Phase out the $5 Billion in 'Direct Payment' Agricultural Subsidies

Jake Caldwell May 2011

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Introduction and summary

Agriculture and the family farm are the foundation of strong and healthy rural communities, and a critical engine of U.S. economic growth. Regrettably, a key aspect of U.S. agricultural policy does not meaningfully contribute to the success of U.S. farmers: Most federal farm subsidies are outdated, expensive, and inequitable.

In an era of fiscal constraint and more immediate budget priorities, many of these ineffective subsidies can no longer be justified. The federal government each year pays owners of historical croplands $4.9 billion in "direct payment" subsidies regardless of whether the people receiving the payments farm their lands. And these payments are automatically made every year despite rising fiscal deficits and a relatively healthy farm economy that saw net farm income grow by 27 percent in 2010.[1]

An exclusive set of commodities—corn, sorghum, barley, oats, cotton, wheat, rice, soybeans, and peanuts—have received 72 percent, or $160 billion, of all U.S. farm payments since 1996.[2] Even among this small group of commodities there are widespread disparities. Upland cotton and rice growers, for example, receive a disproportionately high level of farm program payments relative to the other crops.[3] Meanwhile, fruit and vegetable growers, and the majority of other agricultural producers in the United States, receive minimal direct subsidies despite contributing more than 50 percent of the total farm gate value in the United States.[4]

Because direct payments are linked to historical lands and amount of acres, the benefits of the payments tend to accrue to larger farm operations with more acreage. The Department of Agriculture found that 62 percent of farm payments, including direct payments, went to the largest 12 percent of farms in 2008.[5] The Government Accountability Office found that 305 farm operations that same year each received $200,000 or more in direct payments.[6]

Direct payments also tend to flow to people with high incomes. The GAO found that recipients of direct payments and other farm program payments in 2008 were more than "twice as likely to have higher incomes as other tax filers."[7]

Several members of Congress receive direct payments and other farm program payments. According to a recent analysis by the Environmental Working Group, 23 federal lawmakers currently in Congress—six Democrats and 17 Republicans—received agricultural subsidies between 1995 and 2009. Republicans took home $5.3 million in taxpayer-funded subsidies during this period while Democrats received just less than $500,000.

Other agricultural subsidies are doled out based on production, making prices more volatile for farmers in the United States and overseas, and often undermining U.S. development and antipoverty programs. As commodity prices fluctuate, agricultural subsidy programs in general could eventually cost taxpayers between $7 billion and $24 billion a year.

Bottom line: Poorly designed and ineffective agricultural subsidy programs weaken the competitiveness of our nation's farmers and rural communities, drain taxpayer resources, and should be reformed. Among the recommendations we make in this paper:

- The United States should reduce and phase out the $4.9 billion per year in automatic direct payments to individuals and apply the savings to deficit reduction.
- As direct payments are phased out, the maximum individual direct payment should be capped at an appropriate level and the overall income eligibility amounts should be reduced.
- $650 million saved from direct-payment reduction should be reinvested into existing rural-based programs to provide incentives for renewable clean energy, energy efficiency, and advanced dedicated biomass energy crops on the farm.
- A portion of these savings should also be dedicated to enhancing U.S. agricultural exports in a manner that promotes small business and is consistent with international trade obligations.
- All government spending on agricultural subsidies should be disclosed in an open and transparent manner.

If these recommendations are implemented, the federal government can save more than $35 billion by 2020 and apply most of these savings to deficit reduction while also investing in a clean energy future in our rural communities.

Background: Agricultural commodity subsidies and the 2008 farm bill

Most federal agriculture and food policies are today authorized by the Food, Conservation, and Energy Act of 2008.[8] The farm bill, as it's known, is an omnibus multiyear piece of legislation that establishes the types and levels of federal benefits provided to agricultural producers and landowners under mandatory commodity price supports. It also sets government funding of discretionary conservation programs.

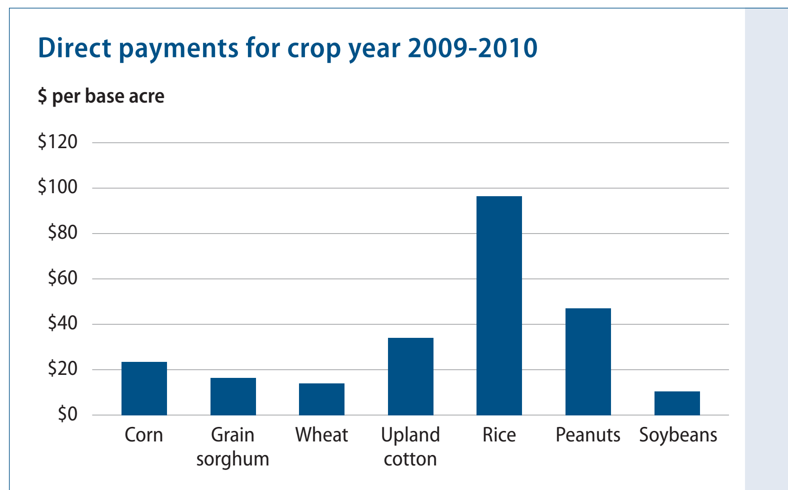
The farm bill also authorizes many other USDA activities, including export assistance, food aid, agricultural research, energy initiatives, rural development, and domestic nutrition programs, such as the Supplemental Nutrition Assistance Program, or food stamps.[9] The act is generally renewed every five years and the 2008 farm bill is set to expire in late 2012.

The three types of subsidies and how they work

Agricultural subsidies for the production of commodities are a substantial component of the farm bill. Also known as "income support," these subsidies come in three types of mandatory payments: direct payments, "counter-cyclical payments," and "marketing loan benefits" available to producers of a distinct set of crops. Under current policy, two-thirds of U.S. farmers receive no subsidies and the largest 10 percent of farms receive nearly 70 percent of the total farm payments.[10] The majority of subsidies are reserved for major crops including wheat, corn, cotton, rice, and soybeans.

Direct payments are not affected by how much a farmer produces and are available to people who own or rent land that has historically grown a select set of the major commodities. Direct payments are "fixed annual payments based on historical production [and] do not vary with current market prices or yields," according to the Congressional Research Service.[11] The government will spend $49 billion on direct payments from fiscal years 2012 through 2020, according to nonpartisan congressional estimates.[12]

Counter-cyclical payments are designed as payments to farmers when market prices fall below a target price established by the government. Marketing loan benefits give farmers access to short-term government financing when prices fall below a certain price. They are designed to give producers of the major commodity crops a guaranteed floor price and the opportunity to use their crops as collateral to secure an improved price on the market at a later date. Marketing loan benefits have a tendency to encourage production, and in some instances overproduction, of commodities when prices are low, since they guarantee the producer a minimum price.



Source: Compiled by USDA Economic Research Service from USDA Farm Service Agency and USDA National Agricultural Statistics Service data.

In the first two years of the 2008 farm bill, commodity prices have remained high. Demand for counter-cyclical payments and marketing loan benefits has therefore been relatively low, costing the government just $2.6 billion since 2008. Direct payments continue to be paid out at a steady $4.9 billion per year despite high market prices.[13]

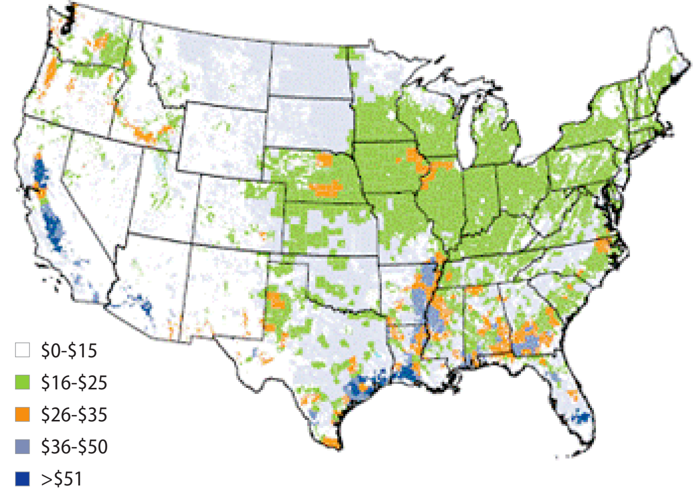
The problem with direct payments

One of the policy goals of U.S. agricultural subsidies is to give farmers, who engage in a critical and risky profession, income stability and protection against volatile commodity prices. Subsidies can improve the international competitiveness of U.S. agricultural products. They also have been justified as a way to enhance national security by ensuring the United States has consistent access to a domestic, plentiful, and affordable food supply.

The roughly $4.9 billion in federal direct payments paid out each year are fixed, automatic disbursements to landowners or renters based on the historical use of the land. Farmers may plant any crop they choose or they may leave the land fallow and still receive a direct payment. The market price of commodities has no effect. Indeed, no commodity production on the land is required to receive the payment so there is little incentive to overproduce commodities.

Direct payments first appeared in the 1996 farm bill as a "trade-friendly" alternative to subsidies that encourage production (such as marketing loan benefits) and thereby distort trade. Direct payments were intended to be temporary. The idea was that eventually incentives like direct payments that didn't encourage overproduction would also be phased out and the overall amount of agricultural subsidies reduced.

Under the direct payment system, farmers on historical cropland were exempted from traditional restrictive government limits on planting and given the flexibility to grow any choice of crop, or nothing at all, and still receive a payment. Direct payments lost their temporary status in the 2002 farm bill and were made a permanent feature of U.S. agricultural policy.



Source: Compiled by USDA Economic Research Service from USDA Farm Service Agency data.

Proponents of direct payments say they help farmers secure bank credit and help contribute to a farm's operating expenses.[14] Since direct payments represent much of Congress's annual agricultural spending and authorized funding in the farm bill, many lawmakers from farm states see them as a way to maintain and boost overall federal spending on agriculture.

Supporters also say direct payments are the least trade-distorting way to support farmers' income because the subsidies do not influence production decisions and are generally considered to be compatible with U.S. obligations to the World Trade Organization.[15] WTO member nations are in general most concerned about agricultural subsidies that encourage overproduction and result in the dumping of commodities on global markets at low prices. An agricultural subsidy that is "decoupled" from production incentives is also less likely to drive global prices downward and undermine local production and agricultural markets in developing countries.

The Department of Agriculture has noted that the "primary economic impacts of direct payments are increases in farm income and land values."[16]

Some critics of direct payments paint the subsidies as little more than income transfers from taxpayers to landowners of historically farmed land.[17] Others note that the annual automatic payments inflate land values and raise rents in rural

Direct payment rates

Commodity	Unit	Direct payment rate	Direct payment rate if enrolled in ACRE
Wheat	Bushel	$0.52	$0.42
Corn	Bushel	$0.28	$0.22
Grain sorghum	Bushel	$0.35	$0.28
Barley	Bushel	$0.24	$0.19
Oats	Bushel	$0.024	$0.017
Upland cotton	Pound	$0.0667	$0.0534
Medium-grain rice	Hundredweight	$2.35	$1.88
Long-grain rice	Hundredweight	$2.35	$1.88
Soybeans	Bushel	$0.44	$0.35
Other oilseeds	Hundredweight	$0.80	$0.64
Peanuts	Ton	$36.00	$28.80

communities. While direct payments are available to both owners and renters of historical lands, renters are frequently disadvantaged because the landholder takes a cut. Moreover, owners tend to use direct-payment income as justification for higher rent on historical land.[18]

Higher land prices in turn present new farmers with additional barriers to entry. Higher land prices and low interest rates are giving rise to concerns about speculative land bubbles emerging in rural communities.[19]

Direct payments may also discourage the planting of crops because the subsidies are doled out whether land is worked or not worked. For example, several areas in Texas that have historically grown rice have now become "cowboy starter kits"—large housing developments and properties with a large house and small acreage for retiring urban residents—that no longer grow rice but continue to receive a direct payment.[20] As these housing developments have grown, rice acreage in Texas has been reduced.

The compatibility of direct payments with WTO obligations is, in all likelihood, overstated. As a condition of receiving the direct payment, farmers are restricted from planting fruits and vegetables on historical cropland. This prohibition influences the production levels of fruits and vegetables in U.S. agriculture and is potentially trade distorting. Indeed, a WTO dispute settlement panel noted that direct payments are in this way linked to production and influence international trade.[21]

Outlook: The 2012 farm bill

The $284 billion 2008 farm bill is set to expire in the fall of 2012.[22] External factors including federal budget constraints, the relative health of the U.S. agricultural economy, and the scope of changes sought by policymakers will be influential in shaping debate on the 2012 farm bill.

The federal deficit is projected to reach $1.5 trillion in fiscal year 2011 with federal debt topping out at more than $10.4 trillion. Mounting fiscal deficits will probably mean a leaner overall farm bill with less funding available for all programs in the omnibus act.

Under the current bill, a person can't get more than $40,000 in direct payments in a single year. People with more than $500,000 in nonfarm income or $750,000 in farm income are ineligible for direct payments.

The current budget

On April 14, 2011, Congress passed a spending bill for the remainder of the current fiscal year that reduces funding for overall agriculture programs by $3 billion, or 14 percent, less than the 2010 levels—with minimal cuts to commodity subsidies.[23] The House Agriculture Committee recently proposed that appropriators in 2012 seek funding cuts for food stamps rather than pursue reductions in commodity subsidies.[24]

The president's proposal

President Barack Obama's fiscal year 2012 budget and deficit-reduction plan proposes to cut direct payment subsidies by $2.5 billion over 10 years. He accomplishes this by lowering the $40,000 cap on direct payments to $30,000. The presi-

dent would also reduce income eligibility limits by $250,000 over three years in a phased reduction. The Agriculture Department estimates these changes would impact 30,000 farmers, or 2 percent of farmers now receiving direct payments.[25]

The House Republicans' 2012 budget resolution

On April 15, 2011, House Republicans voted to adopt a fiscal year 2012 spending blueprint authored by Rep. Paul Ryan (R-WI), the budget committee chairman.[26] This plan proposes to cut $127 billion from food stamp programs, $30 billion from direct payments and crop insurance programs, and $20 billion from conservation and other initiatives over the next decade.

The GOP plan would therefore shrink direct payment subsidies by as much as $3.3 billion a year, or 66 percent, from the current $4.9 billion-a-year level.[27]

Factors contributing to the 2012 bill

The state of the domestic general and agricultural economy will influence the scope and direction of the next farm bill when it is written later this year and early in 2012. Net farm income in 2010 was $81.6 billion, up 31 percent from 2009, and 26 percent more than the 10-year average.[28] In 2011 net farm income is forecast to be $94.7 billion, up $15.7 billion (19.8 percent) from the 2010 forecast.[29] Corn, wheat, and soybean prices are currently high but stocks are low and prices are likely to remain volatile because of rising global demand and high oil prices, which increase farming inputs and costs.

Political priorities will also influence the scope of any final legislation. Given fiscal priorities and other factors, Congress may try to substantially reform farm bill programs, or it may prefer a less ambitious extension of the 2008 bill that reduces funding for certain programs and makes only modest overall changes to agricultural policy.

A way forward

Policymakers shaping the next farm bill will do so in an economic landscape that features both strong farm incomes and the need for fiscal restraint. Such a climate argues forcefully for a reduction in the $4.9 billion a year in inequitable direct-payment subsidies. The 2012 farm bill is also an opportunity to craft a farm policy that rewards more of our farmers while contributing to efforts to promote rural-based clean energy, energy efficiency, and U.S. agricultural exports.

We believe savings from reduced direct payments should be dedicated primarily to deficit reduction. But reinvesting some of the savings to the development of renewable clean energy on farms and in rural communities will provide new revenue streams and long-term cost savings to rural communities.

The upside of such a policy approach is more than deficit reduction. In contrast to current commodity-based direct payments, *all* farmers could be eligible for the renewable clean energy programs. The inflationary pressure currently being applied to land values as a result of commodity-based direct payments will be moderated. And the practice of automatically paying nonfarming landowners will end.

As direct payments are phased out, a transitional adjustment period should be established for current recipients. Direct payments should be gradually reduced to a cap of $10,000 per individual in a single year, with eligibility restricted to individuals earning less than $150,000 in nonfarm income and $250,000 in farm income.

Farm policy should promote energy cost savings and rural-based clean energy in wind, solar, geothermal, bioenergy, and other renewables. While the majority of savings from a curtailed direct-payment program should go to deficit reduction, Congress can and should redirect $650 million of the money in the following ways.

Grants to farmers for clean energy projects: $300 million

Congress should dedicate $300 million to farm-based clean energy through the existing Rural Energy for America Program by providing grants and loan guarantees directly to farmers, ranchers, and rural small businesses seeking to design and construct their own clean energy projects. Projects and technologies might include bioenergy facilities, manure digesters, energy efficiency projects, and wind, solar, and geothermal power, and should prioritize small farmers.

Home repair loan and grant program for rural areas: $40 million

Energy efficiency retrofitting is the most cost-effective way to reduce household energy costs while providing manufacturing and construction jobs in local rural communities. Low-income families who own homes in need of repair under the current program are eligible to receive loans and grants to undertake home renovations, including replacing heating and water systems. The program's priorities should be expanded to include energy efficiency improvements and modernization of homes.

Encourage farmers to grow advanced biofuel crops: $300 million

Farm policy must bring advanced biofuels to commercial scale as rapidly as possible. Advanced biofuels are made from agricultural and other wastes, wood chips, algae, or dedicated energy crops such as switchgrass. Biomass growers are primarily located in rural areas and the costs of collecting and transporting biomass means many production facilities are in rural communities and will provide rural jobs.

USDA's existing Biomass Crop Assistance Program provides funding to producers and farmers of renewable energy crops of up to 75 percent of the cost of establishing the energy crop and annual payments for up to 15 years for crop production, and deserves additional support. The program funding should be increased by $50 million from FY 2010 appropriations. Funding priority should be given to farmers who establish and plant dedicated energy crops.

Support U.S. agricultural exports: $10 million

Farm legislation should strengthen agriculture's role in meeting the president's National Export Initiative goal of doubling U.S. exports by 2015. We should boost infrastructure and technical assistance funding by $10 million. In addition, the United States should redouble its efforts in a variety of international trade forums and agreements that provide market access for U.S. agricultural products, including the World Trade Organization Doha round of negotiations; bilateral free trade agreements with Korea, Panama, and Colombia; and the evolving Trans-Pacific Partnership.

Conclusion

Current direct-payment agricultural subsidies are outdated and are shortchanging the vast majority of hardworking U.S. farmers. These subsidies cost taxpayers $4.9 billion a year, artificially inflate land values, create barriers for beginning farmers, provide minimal protection against risk, and are not made available to most farmers throughout the United States. Direct payment subsidies were never designed to endure for 16 years.

The 2012 farm bill provides an opportunity to reform direct payments, save taxpayer money, reduce the deficit, and bring more farmers and rural communities into the safety net of U.S. agricultural policy. By phasing out and reducing the annual direct payments, and applying the majority of savings to deficit reduction, we can save more than $35 billion by 2020.

At the same time, a portion of these savings should be reinvested in farmers and rural communities. A modest investment in farm-based renewable energy, energy efficiency, and advanced biofuels will generate new revenue, reduce energy costs, and lessen our nation's dependence on fossil fuels. Investing in agricultural exports will open markets to U.S. products and make our agricultural sector even more competitive than it is today.

Our nation's farmers deliver an affordable and abundant food and fiber supply every day. They deserve an agricultural policy that benefits more farmers and works for, and not against, their needs. Congress can simultaneously reduce the deficit and invest in economic competitiveness by phasing out direct payment subsidies and revitalizing our historically strong commitment to farmers and rural communities. The time for reform is now.

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About the author

Jake Caldwell is the Director of Policy for Agriculture, Trade & Energy at American Progress. Mr. Caldwell is an adjunct professor of law at the University of Maryland School of Law where he teaches a seminar course on the environment and world trade. Mr. Caldwell received his B.A. from McGill University and a J.D. from the University of Maryland School of Law, where he served as Editor-in-Chief of the Maryland Journal of International Law and Trade.

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