Moving to A Free Market Agriculture Policy

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1 FOREWARD

There is no question that market-oriented policies promote economic efficiency by allowing market forces to determine supply and demand, and consequently a competitive market price, with little or no government controls. Such forces are absolutely beneficial for the U.S. farming sector. However, given the importance of agricultural production to a country's security, a free market in agriculture has proven particularly difficult to accomplish.

The following report offers a brief analysis of U.S. and world agricultural markets and policy. Section 2 offers a background on U.S. agricultural markets and policy. More specifically, we discuss price supports, trade negotiations, and other programs that affect the U.S. agricultural industry. Section 3 discusses how government intervention distorts competitive market outcomes and reduces economic welfare. Further, we outline specific governmental policies that affect the competitiveness of U.S. farms by increasing the costs of production. Section 4 concludes the report by offering policy reform suggestions for U.S. and world agricultural markets that will lead to a freer, more efficient domestic agriculture system.

In short, this paper outlines an agricultural agenda built upon the philosophies that:

- The regulatory strains, and consequent tax burdens, driving up U.S. agricultural production costs should be eased to improve U.S. competitiveness and make it easier to reform U.S. farm subsidies.
- The rapid increase of foreign agricultural subsidies and market distorting policies should be addressed to improve free-market conditions and create an environment more conducive to U.S. reform.
- Future U.S. policy reforms should continue transitioning from taxpayer-backed subsidies to more market-oriented programs.

2 BACKGROUND

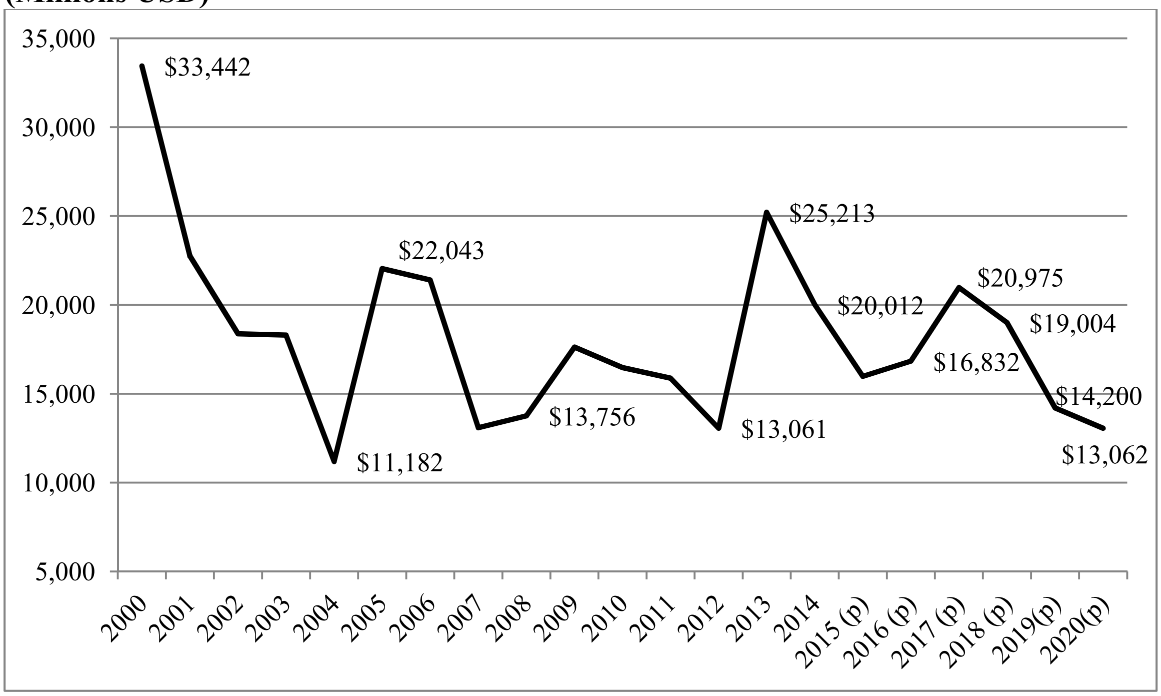
The United States has had some form of farm policy since the country was founded. Over time, this policy has taken different approaches. During the 1930s, this policy was built around the idea of balancing prices and supply with acreage controls and production quotas. Reforms were made in 1996 to eliminate planting restrictions and supply controls to enable farmers to participate more freely in the global marketplace. 1996 also began direct subsidy payments to farmers buffeted with periodic ad hoc disaster aid packages from the government to deal with inevitable weather disasters. In 2002, the high cost and unpredictability associated with the intermittent nature of disasters led to a new farm bill that created a countercyclical program, which made payments to farmers when there were significant price movements. The 2002 Farm Bill also included significant investments in a growing crop insurance program.

After one of the longest Congressional debates over agricultural policy, the Agricultural Act (Farm Bill) of 2014 was signed into law on February 7, 2014 (U.S. Government Publishing Office, January 3, 2014). This bill ended direct payments but left two key features. First, an expanded crop insurance system that is delivered by the private sector and enables farmers to purchase protection against crop failure and market swings. Second, new countercyclical mechanisms designed to provide assistance when prices dip below production costs.

The Congressional Budget Office (CBO) estimates that the Bill will cost the federal government nearly $1 trillion over a ten-year period, and of that total, approximately $800 billion will go to nutrition programs (U.S. Congressional Budget Office, January 28, 2014).

While the projected $200 billion that CBO projects will be spent on agriculture programs over the next decade is a considerable taxpayer expense, farm spending has trended downward in recent years due to free-market oriented policy reforms. As demonstrated in Figure 1 below, federal spending on agricultural programs dropped by 40 percent between 2000-2014, and spending is projected to continue trending downward through 2020.

Figure 1. Historical Expenditures on U.S. Agricultural Programs, 2000-2020 (Millions USD)



Source: U.S. Office of Management and Budget (2015), Historical Table 3.2, Function 351. The expenditures associated with years labeled with *(p)* are based on projections.

Despite conventional wisdom, approximately 96 percent of U.S. farms with crop production are family owned, and these family farms originate 87 percent of the value of crop production (MacDonald et al., 2013). However, the modern family farm is not necessarily the same as that depicted in "American Gothic" or "Little House on the Prairie," as generally held by the popular imagination (DePillis, August 11, 2013). Many U.S. farms, including family-owned farms, are now very large. The U.S. Department of Agriculture (2014) considers 98 percent of U.S. farms to have "high wealth," which is defined as household wealth greater than the median level of the economy as a whole.

Therefore, the domestic agricultural industry is comprised of family farms whose makeup consists of households that are far wealthier than the average household in the non-farm economy. This classification is somewhat explained by an internal redefinition of what is considered to be a farm, which is defined as any place from which $1,000 or more of agricultural products were produced and sold (Economic Research Service, 2015).

The growth of the modern farm business is a natural consequence of globalization and industrialized agribusiness. The average family-owned farm today is approximately 235 acres (MacDonald et al., 2013). The growth of the modern day family-farm is driven by the development of high-tech farm equipment, seeds, and pesticides that have made farming far less labor intensive today than it was fifty years ago (DePillis, August 11, 2013). Large farms, those with annual sales exceeding $250 thousand, constitute 12 percent of family farms, and account for approximately 84 percent of production volume (Hoppe and Banker, 2010). This evolution in size of farm operation is the natural result of vertical integration (similar to other industries), which allows for increased productivity and fewer labor hours.

The transformation of farm policy since 2002 has created a more market-based system forcing the agriculture industry away from the federal command-and-control system, which dictated that certain crops be planted to certain fields, to one where farmers have a much greater freedom to make these determinations for themselves.

2.1 Smart Domestic Agricultural Policies

As discussed further in the next section, government intervention into competitive markets, such as markets for agricultural commodities, reduces economic welfare and distorts competitive market outcomes. In order to ensure smart domestic policies, U.S. policymakers must promote an economic environment where full subsidy elimination is possible. That is, an environment that minimizes taxpayer costs and embraces free-market operational efficiency. Government policies that cushion agricultural producers invite risk-taking behavior – otherwise known as moral hazard – by shifting the burden of costs to taxpayers.

The 2014 Farm Bill that passed into law made strides in moving these agriculture subsidies toward a more market based environment. Under the Bill, a large number of reforms were enacted including an elimination of the direct payment program, which formerly included a complicated system of payments to agricultural producers of certain commodities.[1] Under the former legislation, producers of these commodities were scheduled to receive payments each year regardless of the market price for the crops (Congressional Budget Office, November 13, 2013).

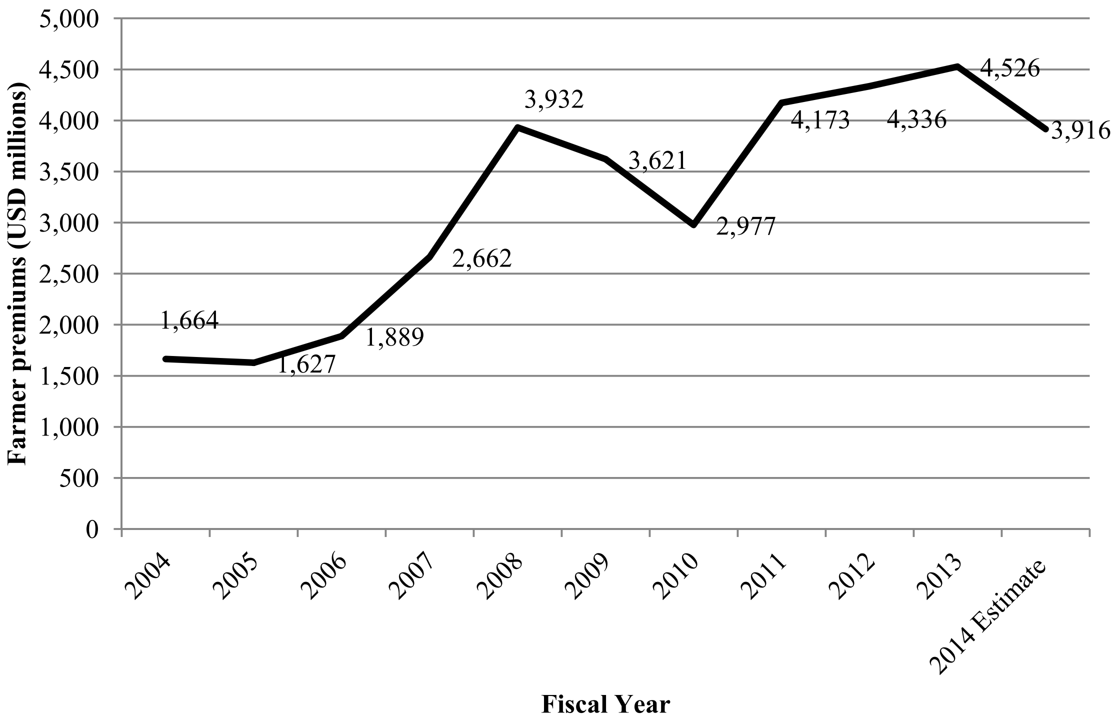
As the 2014 Farm Bill moved away from direct payments, it created an evolution in agricultural policy reforms by shifting the traditional farm price and income support programs to risk management, and the Bill has solidified crop insurance as the primary tool for farmers dealing with production and price risk (Crop Insurance in America, 2015). The federal agricultural insurance program is a complex portfolio of over twenty products covering 130 crops and some livestock production (Smith, 2011). Unlike the direct payment program, which formerly provided a capped at $40 thousand per farm, there are no limits on crop insurance subsidies (Lynch and Bjerga, September 9, 2013). In 1997, approximately 70 thousand farms received indemnity payments (from crop insurance programs) worth $1.2 billion (White and Hoppe, 2012). In 2009, the number of farms receiving payments nearly doubled to 135 thousand, and the direct payments nearly tripled to $5.2 billion. Under the 2014 Farm Bill, however, farmers now shoulder a greater portion of the risk.

Figure 2 outlines historical farmer-paid premium from 2004-2014. Consistent with a market-based economy, the risks premiums, inherent in the expanded crop insurance program, have increasingly shifted towards the individual producers. As displayed in the Figure, farmer-paid premiums have increased by approximately 135 percent since 2004,

[1] The commodities that benefited under the direct payment program included cotton, feed grains, oilseeds, peanuts, wheat, and rice.

with farmers paying nearly $4 billion in premiums in 2014. The increased payment structure required by producers provides a cost offset to the federal government, which lowers the taxpayers' burden for providing the program.

Figure 2. Fiscal Year Farmer-Paid Premiums, 2004-2014 (Millions USD)



Source: U.S. Risk Management Agency (2015).

"Safety net" programs such as these potentially shroud fundamental free-market principles and free trade (Katz, June 7, 2012). The 2014 Farm Bill is moving in the right direction by promoting a more market based environment, but the current crop insurance program disproportionately redistributes federal taxpayer dollars to relatively rich farm operations, as insurance premiums and premium subsidies are proportional to a farm's total liability (Smith, 2011). By continuing to restructure the insurance program, the 2014 Farm Bill is helping to minimize the potential for moral hazard. U.S. taxpayers cover an average of 62 percent of farmers' crop insurance premiums (Schilling, August 21, 2012). Thus, a market-based solution would phase out the subsidization of crop insurance entirely, or at least increase the farmer-paid premiums while continuing to lower the premium supports.

As outlined in Section 3, government intervention into agricultural markets can cause welfare losses and distortions, which can discourage efficient farm production. In competitive markets, with little to no government interference, profit-maximizing producers have the incentive to take unnecessary production risks or to adopt efficient production practices and maintain the quality of their producible farmland – that is, there is little incentive for farms to develop marginal farmland – which is arguably the farmer's largest asset.

A reduction in governmental safety net programs also limits the problem of information asymmetry between government administrators and individual producers. The crop insurance program, just like other insurance programs, can be susceptible to fraud. For example, in North Carolina, a network of insurance agents, claims adjusters, and farmers bilked the federal government for close to $100 million over a period of ten years (Lynch and Bjerga, September 9, 2013). It is incumbent upon Congress to mitigate fraud by decreasing the potential for moral hazard of both insurers and farmers. One way to accomplish this is to embrace programs run by the private sector, where private businesses have a financial interest in stamping out waste, fraud and abuse.

2.2 Multilateral Trade in Global Agricultural Markets

A recent study by DTB Associates (2014) discusses trade-distorting (agricultural) subsidies offered by our country's largest foreign, agricultural competitors. The competitors include Brazil, China, India, Turkey, and Thailand – all member countries of the World Trade Organization (WTO). The report finds, with only a few exceptions, that these developing countries offer levels of subsidization (reported for wheat, corn, and long-grain rice) that exceed U.S. agricultural subsidies. Some of the crop-specific price support levels have increased by more than one hundred percent over the past decade (DTB Associates, 2014). These foreign agriculture subsidies have placed a great deal of pressure on the competitiveness of domestic farms. The study exposes that these countries are in violation of their obligations under the WTO's Agricultural Agreement – some of the violations include delinquency in reporting the subsidy programs and underestimating the true levels of support for various programs (Farm Policy Facts, February 27, 2015).

As described in the Agriculture Agreement, all WTO member countries must abide by a set limit on the level of domestic supports and are required to report their support levels to the WTO (World Trade Organization, 2015). The WTO defines the level of all domestic support as the Aggregate Measure of Support (AMS). The report by DTB Associates (2014) found that China, India, Turkey, and Thailand had all exceeded their AMS commitment levels, and most these countries were delinquent in reporting their support levels. The U.S., on the other hand, has never exceeded its AMS limit nor has it been delinquent in reporting its annual support levels (Farm Policy Facts, February 27, 2015).

One example of these rapidly growing foreign subsidies is the production of sugar, which in the last year alone has seen the two largest sugar producing countries in the world, Brazil and India, increase supports in an effort to expand or defend their international market share as prices have declined in the face of a supply glut. The continued heavy subsidization of sugar by foreign competitors has led to market-distorting price drops in the international market, which has triggered the U.S. government to retain the price-floor based sugar program.

Multilateral trade agreements between the U.S. and its foreign competitors involve discussions to encourage competition in global agricultural markets. These negotiations to facilitate competition are collectively known as the Doha Round, after the initial trade talks were launched in Doha, Qatar in November 2001 (Elliott, 2007). It is important for policy makers, trade negotiators, and the general public to have a clear understanding of the status of international agricultural policies and how the U.S. agricultural industry fits into these global markets. Agriculture is a key component in the success of another round agreement, and “agriculture trade liberalization is much of what the rich countries have left to contribute to a reciprocal trade deal” (Elliott, 2007, pg. 1)

To have a successful round of agricultural trade agreements the U.S. cannot act unilaterally. Otherwise, our domestic farmers and ranchers will be at a competitive disadvantage in global markets. As a first step, our foreign competitors, including China, India, Turkey, and Thailand, must honor their commitments to the WTO by remaining within their AMS limits and report annual support levels in a timely fashion. Ultimately, however, the U.S. is going to have to take a hard stand on agricultural subsidization reform by enforcing past trade deals, in cooperation with the WTO, to ensure our foreign competitors do not continue to violate the rules within their agreements.

2.2.1 International Trade Barriers

In addition to a Doha Round agreement, the U.S. is also negotiating the Transatlantic Trade and Investment Partnership (TTIP), which is a trade agreement between the U.S. and the European Union (E.U.). One of the barriers to negotiations between the U.S. and E.U. involves the E.U.’s safeguards against genetically modified organisms (GMOs) including genetically modified foods and crops. The E.U. restricts or outright bans the import of GMO products and requires the labeling of all GMO foods (Lewis, December 29, 2014). The U.S. has no such labeling requirements for GMO foods. A GMO-labeling requirement under the TTIP trade agreement may constitute a violation of the WTO’s “technical barriers of trade” (U.S. Trade Representative, 2013), which could affect the competitiveness of U.S. agriculture’s food crops. U.S. policymakers must stand up to the E.U. to help ensure that welfare-enhancing trade liberalization agreements, such as the TTIP, are not stymied by the special interests of only one party to the agreement.

3 GOVERNMENT INTERVENTION AND MARKET DISTORTIONS

The federal government's current U.S. agricultural policies often lead to outcomes that reduce economic welfare. In economic theory, the term "economic welfare" is defined as a competitive market allocation of a commodity whereby the benefits for both the consumer (money saved) and producer (revenue enhanced) are maximized. Theory suggests that government intervention into competitive markets, especially for agricultural commodity markets, often leads to market distortions and, in general, non-optimal outcomes.

3.1 Intrusive Government Programs and the Cost to Agricultural Production

Today much of the costs of agricultural production are driven by intrusive government policies including environmental and tax laws.

3.1.1 Agriculture and U.S. Tax Policy

As an example, the current presidential administration proposed a fiscal year 2016 budget that includes a provision for a capital gains tax that may have profound effects on the agricultural industry and more specifically on family farms. Under the provision, an heir to a farm would be subject to a capital gains tax if he or she inherits the farm, even if the farm is not sold (Farm Policy Facts, February 13, 2015). Hence, some legislators have labeled the provision as a "death tax" (Office of U.S. Senator John Thune, February 5, 2015). This capital gains tax does not include any additional estate taxes he or she may have to pay under the existing tax law as a result of inheriting the farm.

Another controversial discussion surrounding modern family farming is whether the federal government should expand and/or extend a section 179 tax deduction under the

U.S. tax code. Section 179 allows farm operators to depreciate the cost of equipment in the year it was purchased, rather than spreading out the depreciation over multiple years (Rice, November 6, 2014). The provision allows for farmers to make a major one-time tax deduction, and as a result, it has affected the purchasing behavior of farmers investing in heavy machinery. As of the fall of 2014, the deduction level fell to $25 thousand, but the U.S. House passed a resolution to permanently restore section 179 and extend the expensing limit to $500 thousand (Rice, November 6, 2014). The resolution for section 179 stalled in the U.S. Senate at the end of the year in 2014.

It is unclear whether there is sufficient support in the 114th Congress to continue with this tax subsidization of large equipment purchases.

3.1.2 Agriculture and U.S. Environmental Policy

In addition to burdensome tax policy, the Office of U.S. Congressman Bob Gibbs (July 31, 2014) introduced legislation, entitled Reducing Regulatory Burdens Act, to restrict the regulatory overreach of the U.S. Environmental Protection Agency (EPA). The EPA has administered and enforced the U.S. Clean Water Act (CWA) for over 30 years; however, the EPA has never, until now, subjected FIFRA (Federal Insecticide, Fungicide, and Rodenticide Act) approved pesticides to CWA permitting requirements. Therefore, some critics argue that the EPA has been granted the power to enforce duplicative permitting requirements. Congressman Kevin Cramer's Office contends that the EPA permitting requirements could potentially affect 365,000 pesticide applicators at approximately $50,000 each on an annual basis. In response to the EPA's potential overreach, the House Committee on Agriculture approved a resolution (H.R. 897), the Reducing Regulatory Burdens Act of 2015 (U.S. House Committee on Agriculture, March 19, 2015). The resolution would clarify Congressional intent regarding pesticide regulation in or near waters of the United States.

The EPA's regulatory overreach is not limited to duplicative permitting requirements, but also extends to domestic water policy. In March of 2014, the EPA and the Army Corps of

Engineers proposed a rule, known as Waters of the United States, to clarify which bodies of water come under the agencies' authority to protect under the CWA (Cama, April 22, 2014). Previously, the EPA's jurisdictional authority was limited to "significant" and "navigable" waters (Cornell University Law School, 2015). However, under the EPA's proposal, the agency's jurisdiction would extend to such bodies of water as natural wetlands and streams. Arguably, the EPA proposed rule would expand the agency's authority to any waters of the U.S. – hence, the name of the proposal. The American Farm Bureau Federation president Bob Stallman called the proposed rule "the biggest federal land grab – in terms of power over land use – that we've seen to date" (Cama, April 22, 2014). Thus, the Farm Bureau has vowed to fight the EPA, which could potentially "impose unworkable regulations on the nation's farms" by extending its authority under CWA.

4 POLICY REFORMS IN U.S. AND WORLD AGRICULTURAL MARKETS

As outlined in this report, the costs of the federal government's agricultural subsidies far outweigh the benefits, in terms of reducing economic welfare by distorting competitive markets, by setting unfair trade restrictions, and by creating artificially inflated prices for U.S. domestic agricultural commodities. In this section we discuss policy reforms in U.S. and world agricultural markets. The U.S. cannot act unilaterally in reforming its agricultural policies; otherwise, any such reforms would only put domestic farmers at a competitive disadvantage. Successful reforms of global agricultural markets are going to require multilateral agreements involving trade liberalization and the reduction of domestic subsidy programs. Initially, we discuss such reforms in the context of world sugar markets to help frame the argument for zero-for-zero sugar policy. Next, we extend the argument of zero-for-zero *sugar policy* to zero-for-zero *agricultural policy* reforms.

4.1 Sugar Policy Reform

Seeking to completely overhaul the current U.S. sugar program, U.S. Congressman Ted Yoho (R-FL) has recently reintroduced a reform proposal for the sugar industry entitled zero-for-zero policy (Hayes, March 3, 2015). Under the proposal, the U.S. government would push for zero subsidies abroad, and in exchange the U.S. sugar program would be simultaneously rolled back with the elimination of the foreign programs (Hayes, March 3, 2015). Basically, the zero-for-zero policy calls for a lift of all restrictions and tariffs on trade among all countries that engage in the global sugar market.

Americans for Limited Government wrote a letter to Congress signed by five other conservative-oriented groups supporting Congressman Yoho's proposed zero-for-zero reform program and the American Sugar Alliance praised the eight original co-sponsors of the policy reform (U.S. Congress, February 27, 2015).[2] Carolyn Cheney, chairwoman of the ASA (a special interest group representing the U.S. sugar industry), stated: "U.S. producers are highly efficient and would thrive in a subsidy-free market" (Hayes, March 3, 2015).

4.2 Zero-for-Zero Agricultural Policy Reform

In the previous sub-section we observed that by leveling the playing field in the global sugar market, the zero-for-zero policy would benefit domestic consumers, food manufacturers, producers, and processors. Ultimately though, the program would benefit all stakeholders including consumers, both domestically and abroad, by removing all government distortions and creating a uniform price for sugar in the global market.

Just as a zero-for-zero policy could greatly benefit world sugar markets, the same argument could be made for any globally traded agricultural commodity. As the U.S.

[2] Co-sponsors of the zero-for-zero policy include Representatives Lois Frankel (D-FL), Alcee Hastings (D-FL), Richard Hudson (R-NC), Ted Poe (R-TX), Tom Rooney (R-FL), Kurt Schrader (D-OR), Mac Thornberry (R-TX), and Frederica Wilson (D-FL).

government is taking a leadership position in demanding freer global markets and the elimination of foreign trade-distorting policies, the debate should continue domestically about how to continue reducing taxpayer spending and encouraging more market-oriented U.S. policies. Recent reforms to U.S. agricultural policy have favored providing more subsidies for programs such as crop insurance instead of the direct payment program. These are positive movements in reform; however, some organizations insist that the reforms do not go far enough to achieve economic efficiency (Collins, February 7, 2014). Minimizing, if not absolutely removing, any form of subsidies in U.S. agriculture would greatly encourage the fundamental principles of competition and economic welfare.

However, as outlined in the above arguments, the U.S. cannot and should not act unilaterally in its reforms, which would only reduce the competitiveness of domestic farms in international markets. To ensure the long-term competitiveness and viability of our industry, the U.S. needs to establish multilateral trade agreements with its foreign competitors. Congressman Yoho's proposed zero-for-zero reform policy provides the basic fundaments for a successful subsequent Doha Round trade negotiation. However, the federal government, in close cooperation with the World Trade Organization, must take a hard stand in these negotiations to ensure that our foreign competitors are not in violation of the WTO's Agriculture Agreement. U.S. policy makers must also stand up to foreign interests, such as the E.U.'s requirements for GMO-food labeling, to ensure that our negotiating trade partner is not putting up unfair trade restrictions, which are inconsistent with a zero-for-zero approach to trade liberalization.

Finally, U.S. policy makers need to examine how tax and environmental policies adversely affect and contribute to the costs of domestic agricultural production. Further, policy makers should work to create a more business-friendly environment for farmers by easing regulatory and tax burdens, thus making future subsidy reforms more palatable in rural America. The presidential administration's new "death tax" proposal could have profound affects on family farms – which own 96 percent of (crop) farmland and contribute 87 percent of total U.S. agricultural production – by charging an heir a capital gains tax even if the farm is not sold. Further, policy makers need to help safeguard domestic farmers against the EPA's duplicative permitting processes and regulatory overreach efforts by extending the Clean Water Act.

As the federal government continues to make sweeping reforms to domestic agricultural policy and engage in zero-for-zero trade negotiations to reform international agricultural policy, policy makers need to keep in mind that no other industry affects Americans on a daily basis more than agriculture (McIntyre, March 7, 2015). By reducing subsidies and tearing down trade restrictions, the federal government can help ensure the economic strength and self-sufficiency of the U.S. agricultural sector.

5 CONCLUSION

The United States has one of the largest and most robust agricultural sectors in the world today. However, the industry is faced with challenges, many of which have been created by the federal government. Government support programs harm the industry's competitiveness and create entitlements, which make it increasingly more difficult to remove subsidies.

The Environmental Protection Agency, under the Obama presidential administration, seems insistent to expand its regulatory reach by seeking a reinterpretation of the Clean Water Act and its jurisdiction over the Waters of the United States. Such an expansion could have detrimental affects on farmlands and further reduce the competitiveness of our domestic farm sector. That is, this expansion would subvert exemptions under the current law and potentially create expensive new regulatory burdens for today's family farmers, many of whom could not afford the legal fees to remain in compliance. Congress should continue to push for House Resolution 897, entitled the Reducing Regulatory Burdens Act of 2015. Such resolutions will ensure that any potential expanded EPA powers will not increase the regulatory costs and burdens for rural America.

Estate tax policies place an unfair burden on family-owned farms. Such a policy could threaten the family's livelihood, for example, by having the heirs parcel the farm to meet the cash demands of the tax. More specifically, a proposal by the current presidential administration seeks to add a capital gains tax for the transfer of ownership of property, as the result of death, even if the property is not sold. Such a tax would be devastating to farm families and should be rejected outright by Congress.

The United States' relationship with the World Trade Organization, as a result of decades of compliance and transparency in disclosure, could be used as a potentially powerful tool to increase pressure on our nation's foreign competitors to lower and ultimately to end agriculture subsidies. Unfair foreign agricultural subsidies effectively increase the cost to U.S. citizens as taxpayers subsidize domestic agriculture to level the international playing field. The World Trade Organization, with U.S. government continually pressuring to end agricultural commodity subsidization, needs to aggressively enforce the existing international trade deals to ensure that American agricultural products are competitive in foreign markets. The passage of zero-for-zero legislation, House Concurrent Resolution 20, is a good first step, which provides a relatively simple framework for U.S. multilateral trade negotiations, to encourage other nations to end their agricultural subsidies.

There has been a dramatic shift in U.S. agriculture policy over the past thirty years – away from federal command-and-control to a more market oriented system dependent upon partially funded farm crop insurance.

These gradual steps away from dependency are to be commended, but there is much more to do. As Congress and future Administrations act to lift unfair foreign crop subsidies abroad, domestic taxpayer-funded crop insurance premiums should be lifted as well.

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