

Farm Subsidy Tradition and Modern Agricultural Realities

Daniel A. Sumner*

*Director, University of California Agricultural Issues Center, and Frank H. Buck, Jr. Professor, Department of Agricultural and Resource Economics, University of California, Davis. Paper prepared for American Enterprise Institute project on Agricultural Policy for the 2007 Farm Bill and Beyond, directed by Bruce Gardner and Daniel A. Sumner. Views expressed here are those of the author and do not represent those of any organization with which he may be affiliated.

Introduction

Farm bills have become ever more comprehensive and complex (see Jones, Hanrahan, and Womack 2001). Separate titles deal with such diverse topics as food assistance for the domestic poor, research and extension, food safety, and aid to rural communities for sewage treatment or electricity. However, farm programs—including commodity subsidies, environmentally based land reserves, subsidies for some farm environmental improvements, and selected commodity marketing regulations—remain the core of the legislation (Westcott, Young, and Price 2002). International trade is a part of the policy mix for commodity programs because U.S. policies have the potential to affect commodity prices around the world and the United States has played a major role in international trade, including in creating the General Agreement on Tariffs and Trade and the World Trade Organization (Johnson 1950).

The federal government has sought to increase farm incomes through price and incomes supports for selected program crops (and dairy) since the Agricultural Act of 1933. In recent farm bills, annual land set-asides and government stockholding to raise farm prices has largely been abandoned in favor of payments tied to current or historical production. Over the decades, advocates have proffered many rationales for why such transfers from consumers and taxpayers might be justified, but these are not consistent with the facts of modern agriculture. It is hard to explain such payments as helping needy farmers when most of the payments go to the larger and more successful farms and when farm households have higher incomes and far higher wealth than nonfarm households. Furthermore, there is clear evidence that U.S. agricultural production would be only slightly reduced by eliminating the programs, with some shift from the 30 percent of agriculture that gets most of the support toward those enterprises that are largely unsubsidized.

Despite the lack of convincing rationales for their continuation, after seven decades, farm programs are well entrenched politically. Nonetheless there are reasons to think the 2007 Farm Bill may be different. Drivers of policy change include federal budget pressures, heightened demands for farm conservation and environmental programs, growing claims for more attention from growers of unsubsidized crops, pressures to comply with international trade rules, and forecasts of unusually high commodity prices over the next five years. Hence 2007 may well offer some unique opportunities for substantial reform.

This paper reviews some of the long history of farm programs, outlines often-proffered rationales for the programs, and discusses the correspondence of program rationales with the recent facts of American agriculture and the recent commodity programs. Finally, it considers some forces driving the 2007 Farm Bill, drawn from the history and rationales. The paper focuses on commodity programs. However, because environmental programs and some risk management concerns and approaches are closely related and important, the paper discusses some of these, as well. The paper deals with crop insurance or disaster programs only tangentially.¹

¹ For more on crop insurance, see Glauber (2004, 2007).

A Brief History of Farm Commodity Programs

From Colonial Days to the 1980s. Policy for agriculture goes back to the colonial period, with attempts to regulate markets for export goods and create colony-sponsored cartels to raise prices for farmers. Since the formation of the United States, there have been a long series of farm policy events (see time line, appendix A). When agriculture was the mainstay of the economy, the whole enterprise of territorial expansion could be viewed as an agricultural lands policy (Benedict 1953). Agricultural trade policy, in the form of protection from imports, has been a significant source of farm support since the beginning of the United States. Similarly, efforts to facilitate agricultural exports have also been a major theme of national policy.

Major agricultural policy innovations occurred in 1862, during the administration of Abraham Lincoln, with the founding of land grant universities, the establishment of the U.S. Department of Agriculture (USDA), and the implementation of the Homestead Act. The federal government stimulated agricultural innovation by creation of agricultural experiment stations in 1887 and agricultural extension services in 1914. Between 1916 and 1922, the federal government also established agricultural credit programs, began to regulate agricultural marketing, and supported agricultural cooperatives. Direct initiatives to raise farm prices and control production were either rejected or had minor influence (Effland 2000; Olmstead and Sumner 2006).

In the 1920s, proposals to address the collapse of farm prices after World War I were either rejected by Congress or vetoed by the president. The establishment of the Federal Farm Board did little to solve the problem of low prices and the agricultural losses that mounted in the early 1930s (Benedict 1953).

The first 100 days of the New Deal established the main commodity programs of the United States. The Agricultural Adjustment Act (AAA) of 1933 created supply controls, price supports, and income supports to attempt to correct for the collapse of commodity prices and farm incomes. The AAA of 1935 dealt with constitutional problems of the original schemes. This was followed by legislation authorizing payments for soil conservation and in 1938 by another Agricultural Adjustment Act authorizing mandatory price supports for selected crops and creation of federal crop insurance programs, among other provisions.

The New Deal programs for agriculture did not solve low price problems. Agriculture was depressed throughout the period—with some price relief because of bad weather—until World War II shifted out demand and curtailed supply. Low prices were themselves a consequence of the supply and demand conditions that grew out of the global depression, and the New Deal policies often made the situation worse. Higher supported prices led to more quantity supplied and lower quantity demanded, with the government taking the surplus that its policies created. Thus while providing some relief for farmers, these measures also tended to exacerbate the conditions that perpetuated the "over-supply" problems. Despite the massive government intervention, it took World War II to bring cash farm income back to the (already depressed) 1929 level.²

² For more on this history, see Benedict (1953); Bowers, Rasmussen, and Baker (1984); Effland (2000); Rasmussen and Baker (1979).

After World War II, there was general concern that agricultural prices would collapse and that a global depression was likely. Even though the record of farm subsidy programs in the 1930s was at best mixed, the legislative response to the threat of a new period of low prices was to reauthorize the Depression-era programs of price and income support along with supply controls.

The Agricultural Act of 1949, along with the AAA of 1938, remains the "permanent" farm legislation. Although new programs have been added, the core farm bill commodity programs in the subsequent 60 years have largely taken the form of amendments to the these earlier farm bills. The temporary nature of the laws since the 1949 Act, including the 2002 Farm Bill, means that it is not an option to simply pass no farm bill at all in 2007. In that case, a number of commodity programs would revert to the 1949 provisions, which have specific loan rates and other parameters that make no sense at all in the current context. The farm bill is authorizing legislation and most of the commodity programs are "mandatory," meaning under the authorization any implied government outlays are required—no matter what the budget implications. Budget analysts project spending implications of each authorized provision under expected market conditions and score the farm bill for its consistency with budget expectations. For each farm bill, the budget scores affect what commodity programs can be accepted. The budget implications of the commodity programs of the 1949 Act, for example, are outside the range of feasible projected outlays for commodity programs. If there is any consensus for the next farm bill, it is that some legislation is required.

From 1949 through 1981 there were few periods of supply shortfall and high market prices, when programs had relatively little influence. However, in the periods of low prices, stockpiles grew, creating pressure to enact supply controls. For example, by 1960 about 60 million acres were idled under annual commodity program set-asides or diversions and several million acres were idled under long-term land bank programs. The commodity price boom of the early 1970s and again in the late 1970s eliminated government stocks and allowed a brief period of low stocks and full production. When prices collapsed again in the early 1980s, massive stock accumulation, deficiency payments, export subsidies, and land idling again took hold. One result was one of the largest acreage reduction programs in U.S. history, idling 20 percent of U.S. cropland. Overall, the five-decade period following World War II was one of numerous adjustments, but relatively little change in the basic structure of U.S. farm commodity programs.

The Modern Period of Farm Policy. The dissatisfaction with how standard program tools dealt with the price collapse in the early 1980s ushered in the modern period of farm policy, with the Food Security Act of 1985. The 1981 Act presumed that high market prices would continue and set high and rigid price supports for program crops that were quickly out of line with markets. Exports collapsed and massive stock accumulation and land idling programs followed. At the same time, European production and export subsidies expanded and Europe became a competitor in bulk commodity markets. The 1980s demonstrated that supply control was not a successful instrument for U.S. agriculture.

The 1985 Act recognized that lower price supports were necessary to reduce the accumulation of stocks, release land back in to production, and improve the export competitiveness of U.S. commodity producers. At the same time, demands for government

support of agricultural incomes were irresistible and the urge to involve the USDA in commodity markets continued. That said, the 1985 Act did signal a change in policy direction.

The 1985 Act reduced price supports and created discretion in applications of price supports, which slowed the accumulation of government stocks. Marketing loans, introduced for rice and cotton, specified that farmers repay loans at low market-based prices rather than forfeit the crop to the government. That meant that for rice and cotton, payments replaced government stock accumulation. The price supports applied to effective producer prices but not to buyer prices; therefore markets cleared and USDA did not acquire stock. Marketing loans were authorized for grains and oilseeds, but not applied until after the 1990 Act.

The 1985 Act relaxed planting requirements as a condition for government payments. This allowed farmers some flexibility in what they could plant on a portion of their program base, while continuing to receive farm payments. The continuing demand to support incomes of program crop producers meant the 1985 Act included large payments, which replaced some of the market price support and government stock accumulation. Renewed export subsidy programs, especially for wheat and dairy products, were also used to reduce government stocks and counter subsidies from the European Union (EU). For dairy, the price support reductions had begun in the early 1980s, but dairy policy continued to use government purchases, surplus disposal, and a massive supply control program (the Whole Herd Buyout) to support prices. The result was record high farm program outlays and a gradual relaxing of government controls on farm commodity markets.

The 1985 Act also added rudimentary conservation mandates for program participants (conservation compliance) and required that they forego adding environmentally sensitive land to program base. A new long-term Conservation Reserve Program (CRP) also offered to pay landowners to remove erodible cropland from production for a ten-year period. In most of the years since 1986, about 35 million acres have been idled under this program.

The Food, Agriculture, Conservation, and Trade Act of 1990, and the Omnibus Reconciliation Act that accompanied it, continued the policy path established in 1985. Budget and policy concerns led to lower payments, lower price supports, and more planting flexibility. The 1990 legislation mandated marketing loans for oilseeds and reauthorized marketing loans for wheat and feed grains. The Omnibus Reconciliation Act required marketing loans for wheat and feed grains for the 1993 through 1995 crop years if the Uruguay Round trade agreement had not been finalized by June 30, 1992. When they were implemented in 1993, the marketing loans for these crops had no significant budget impact because crop prices were well above the loan rates, but as we shall see they laid the foundation for large outlays in the years to come.

Planting flexibility was built into the crop payment programs in two new ways. First, the law specified a share of program crop base on which no payments would be made, but in return producers could plant a variety of crops or leave the land idle if they wished. Second, producers had the option of foregoing payments on some additional base land in return for flexibility to use the land for other than the program crop.

As programs set by the 1990 farm legislation neared expiration, some farmers and others continued to raise concerns that the commodity programs limited planting and market flexibility. They argued for more flexibility to plant the crops demanded by the market and not be penalized by losing program payments. In addition, budget pressures continued to encourage Congress to consider ways to cut payments and make the budget outlays more

stable. Based on price projections made in early 1995, farm program budget limits were set and farm program parameters were discussed in that context. But then, shortly after official projections were released, prices of program crops began to rise dramatically and unofficial forecasts suggested that high prices would likely continue for several years (Gardner 1999; Orden, Paarlberg, and Roe 1999).

Analysts pointed out that under a high-price regime, farmers would receive little benefit from price supports or deficiency payments, but that the budget that had been allocated to farm programs would support generous payments if these were not tied to market prices. What was supposed to have been the 1995 Farm Bill was delayed until spring of 1996, and throughout this period high prices continued, and continued to be forecast for several years into the future. The forecast of high prices, and the implication that traditional programs would provide little benefit in the coming years, was crucial in causing farm interest groups to support converting deficiency payments, which were tied to prices of program crops, into fixed payments, which would be tied to a history of program crop production but not linked to market prices.

The FAIR Act of 1996. The Federal Agriculture Improvement and Reform (FAIR) Act of 1996 replaced deficiency payments with “contract” payments so that farmers would get payments even when prices were high (Young and Westcott 1996). The FAIR Act continued “marketing loan programs,” which provided for payments or loan benefits whenever program crop prices fell below loan rates. But these loan rates were set low enough that analysts projected very little budget outlay from this program. The marketing loan program, which had been in place for cotton and rice since 1985, meant that when low prices occurred, the government would make payments to program participants rather than acquire stockpiles of program crops. Finally, among other changes, the FAIR Act added to environmental programs, especially with a new cost share program for environmental improvements, the Environmental Quality Improvement Program (EQIP).

Despite reports in the popular press at the time, the FAIR Act did not schedule a phase-out of farm subsidy programs. Rather, the FAIR Act was an extension of the policy path of the previous decade. Nonetheless, the FAIR Act consolidated and reinforced changes in crop programs by further moderating planting requirements, eliminating price supports and government stockpiles of program crops, and eliminating annual land set-asides.

The FAIR Act set the so-called “contract” payments in advance for seven years. The idea was to assure farmers that they would receive these payments even in years of high prices (such as occurred in 1996 and 1997) and to assure the government that farm program outlays would not balloon too much in the case of low prices. The contract was maintained in 1996 and 1997, but when farm commodity prices fell in 1998, ad hoc legislation raised the “contract” payments by 50 percent. Thus the contract turned out to be a one-sided bargain; payment recipients received the full payment when prices were high but the fixed payments were not politically sustainable when prices were low. From 1999 through 2001, contract payments were doubled to offset low program crop prices. As a consequence of low prices, which caused marketing loan benefits to kick in as well, commodity subsidies jumped from about \$4.6 billion in fiscal year 1996 to \$19.2 billion in fiscal year 1999 and to \$32.2 billion in fiscal year 2000.

The attempt to limit farm subsidies proved politically unsustainable for several reasons. First, prices really were quite low from 1998 through 2001, and many farmers would have faced major losses without additional government support. Second, budget deficits that had been a major factor in limiting farm program support in the 1980s and 1990s were much less of an issue from 1998 through 2001. Finally, the weakened administration in the late 1990s was willing to accommodate farm interests in states from which Senate votes were needed.

The 2002 Farm Bill. The market context for the 2002 Farm Bill included low farm prices in the United States and a perception on the part of some farm groups that the FAIR Act and the 1994 Uruguay Round WTO deal had not created the farm prosperity that had been promised.³ This perception of policy failure, together with a budget surplus, was enough to ensure that farm spending under the new law would not be reduced from the recent outlays.

In many ways, the Farm Security and Rural Investment (FSRI) Act of 2002 continued the policy developed over the decade from 1985 to 1996. The government continued to forego annual land set asides, market price supports, and government stock accumulation. The law also reauthorized payments tied to historical production bases and not linked to commodity prices. It also reauthorized the CRP and the EQIP and instituted new environmental subsidies, notably the Conservation Security Program (CSP). Overall however, the FSRI Act reinforced the change in direction that was initiated in the ad hoc legislation from 1998 through 2001. The FSRI Act made the ad hoc payments permanent by creating the new countercyclical program payments, which are tied to specific crop prices. In a further reversal of the spirit of the FAIR Act, the FSRI Act extended direct and countercyclical payments to additional crops, including soybeans and other oilseeds. Finally, the FSRI Act allowed producers to update their historical acreage and yield information used for the direct and countercyclical payments.

Early projections indicated that the FSRI Act would spend far more than the FAIR Act, but those comparisons ignored the ad hoc adjustments of 1998 through 2001. In fact, because of relatively high prices for several commodities in several years, spending under the FSRI Act has been relatively low compared to what was originally projected.

The FSRI Act raised marketing loan rates for corn and wheat, lowered loan rates for soybeans, and made no changes for rice and cotton. These “loan rates” are used to determine the magnitude of marketing loan benefit rates, defined as the (positive) difference between the loan rates and loan repayment rates (based on market prices). Because they apply to all production of the program crop on eligible farms, the marketing loan program provides a clear incentive to increase or maintain production of the program crop.

Direct payment rates are roughly equal to those that applied in 2001, except that now farms with a history of soybean or other oilseed production are eligible. Direct payments apply to the program base area times the program base yield. In 2002, farmers were allowed to update the base area (and, of course, farms growing oilseeds had to establish a base for those newly eligible crops). The updating allowed producers to increase payments and may have encouraged expectation of future updates. Any expectation of future updates means that

³ For more on the 2002 Farm Bill, see USDA Farm Bill 2002 Web site. <http://www.usda.gov/farmbill>.

producers have an incentive to maintain production of the program crop and hence ties current production incentives to the program payments (Sumner 2003). Under direct payments, producers may exercise considerable flexibility in their land use while maintaining eligibility for direct payments, but they lose direct payments if the base area is shifted out of agriculture altogether or used for fruits, tree nuts, vegetables, melons, or wild rice.

The same planting flexibility as the direct payment program applied to the countercyclical payments. However, the countercyclical program payments are inversely related to program crop prices and tied to historical bases. Thus while the program does not require farmers to plant base land to the program crop, it does provide payments that offset low prices of the specific program crop.

Table 1 shows total annual expenditure under the programs from fiscal year (FY) 1996 to estimates for FY2006, which ended September 30, 2006. Expenditures in FY1996 were mainly attributable to programs authorized in the 1990 Farm Bill, with expenditures in FY1997 through 2001 attributable to the FAIR Act and the annual ad hoc legislation. Expenditures in 2002 through projected expenditures in 2006 are attributable to the FSRI Act. However, given the nature of the marketing loan program and the countercyclical program, expenditures vary from year to year largely in response to prices of grains, oilseeds, and cotton.

Table 1. Total U.S. CCC Net Outlays, Fiscal Years 1996–2006 (\$millions)

Year	Total expenditure
1996	4,646
1997	7,256
1998	10,143
1999	19,223
2000	32,265
2001	22,105
2002	15,680
2003	17,425
2004	10,575
2005	20,187
2006 ^a	21,257

Source: USDA, Farm Service Agency; USDA, Economic Research Service (for 1996 and 1997 figures).

a. 2006 data are estimates.

During this long history of continued commodity subsidy programs for grains, oilseeds, and cotton, U.S. agriculture has evolved substantially (Dimitri, Effland, and Conklin 2005; Gardner 2007). Agriculture's share of the total economy has declined to about 1 percent of gross domestic product (GDP), even as agricultural production has expanded rapidly. The decline in the share of agriculture occurred as productivity growth occurred faster in agriculture than in the rest of the economy. Farm prices have fallen relative to prices in the rest of the economy and as incomes grow, people tend to spend a lower share of income on food and other farm-based goods. In the United States, the fall in farm prices and the rapid

growth in per capita income have implied declines in the food share of the consumer budget. Furthermore, the share of the food budget captured by farmers has fallen as more value is added in the marketing chain after the products leave the farm. Thus the farm share of the overall consumer budget is now very small indeed. Moreover, although exports are important, the net exports of U.S. agriculture are very small as a proportion of total agricultural production.

Within agriculture, the share of farms deriving most of their income from farming has fallen. For commercial-sized farms, which produce the bulk of agricultural output, the gross sales per farm have grown. One of the most important changes in the past half century is that commercial farm operators now have higher incomes than non-farm people and substantially more wealth than the average American.

Reasons, Rationales, and Rationalizations for Farm Commodity Programs

With this background of policy evolution and the brief discussion of how economic conditions in agriculture have evolved, we turn now to potential justifications for the U.S. farm policies that exist now.

Over the years, participants and observers have cited many concerns as rationales for the creation and maintenance of farm commodity programs. The following list presents thirteen concerns or problems that government programs may be supposed to address in agriculture. There are more, but this list is representative. In the 1950s, Johnson (1958) considered rationales for government support for agriculture and, in addition to some on our list, focused on some issues that were relevant then (national defense and smoothing of macroeconomic fluctuations) that seem less relevant now. Wright considered the question in some detail in 1995 and Thompson (2006) recently considered a subset of the list presented here.

Each of the rationales on the list is phrased in the form of a problem that proponents claim farm programs address or redress, or as a problem that would occur if farm programs were not in place. This list focuses on commodity programs—not on government policies for the environment, food and nutrition issues, agricultural research, food marketing, or other matters that are also in the purview of the U.S. Department of Agriculture and within the Farm Bill.

1. Chronic low farm prices.
2. Chronic high variability in farm prices.
3. Farm and rural poverty.
4. Chronic high variability in farm income.
5. Chronic low rates of return for farm investments.
6. Without subsidies, rural asset values would fall or otherwise be too low.
7. Chronic slow rural development, dwindling rural populations.
8. Low environmental quality of rural landscape and environmental spillovers outside rural areas.
9. Chronic imbalance of power favoring commercial buyers of farm goods over farmers.
10. Without farm subsidies, food prices for Americans would be too high.
11. Without farm subsidies, food supply for Americans would be insecure.

12. Government regulations lower farm returns, and subsidies redress this loss.
13. U.S. subsidies are required to meet the subsidies of international competitors.
- 14.

The rest of this section discusses the concern(s) underlying the rationales in more detail and considers whether the concern(s) remain a serious public problem. The discussion makes a distinction between broad public issues and those that are of particular concern to farms, other firms, or industries, and to which they may respond appropriately in their own private capacity. Then, if a problem remains a concern for public policy, the discussion considers the ability of commodity programs to address the problem relative to some other measures. This section is a quick tour of arguments and analysis. There is not sufficient space to fully consider the economic evidence related to each of these rationales.

Rationales 1 and 2. Without farm programs, farmers would face chronically low farm prices and high variability in market prices. These first two concerns are part of what was historically called the “Farm Problem” (Gardner 1992). These were among the issues upon which New Deal farm commodity programs focused. Those who stress low and variable farm prices argue that unfettered markets simply do not function properly for agricultural commodities. They argue that inelastic supply and demand responses to price and variability caused by weather often cause farm prices to be lower than advocates prefer and cause prices to be overly variable. An initial problem with this diagnosis is that, with international trade available, both demand and supply are much more elastic in their response to price than when trade was less important. Furthermore, given more elastic responses in the long run, large price movements are likely to be strictly short run and self-correcting. Johnson (1947) presented a well-articulated case for a government-run forward price scheme to mitigate adverse effects of market price fluctuations without raising average prices. His analysis did not fully consider how the government could effectively operate forward prices without resorting to price support. Wright (1995) provides compelling argument and evidence that such programs are essentially impossible to operate effectively.

Of course producers would almost always like higher prices and sometimes benefit from less variability. (Producers gain from anticipated price variability because they can produce more when they correctly project high prices and produce less when prices will be low.) A further challenge for advocates of this rationale for farm programs is to explain why the prices that result from market forces are *too* low and *too* variable when interests of consumers, producers, and taxpayers are all taken into account. Furthermore, if program crop markets suffer from these deficiencies, why do markets for other goods in our economy, including those for most other farm commodities, not require such market price regulation? In any case, for the most part, current farm programs no longer attempt to regulate market prices through annual set-asides, market price supports, and stockholding, and thus no longer address this concern.

Rationales 3 and 4. Without farm programs, farmers and rural residents would be poor and have high income variability. Low farm prices are of interest largely because of implications for farm incomes. From the 1930s through the 1960s, average incomes of farm families were well below those of non-farm families and farm commodity subsidies shifted income to farmers in part to redress this relative poverty. Furthermore, advocates claimed that

smoothing market price fluctuations would reduce the chances that farm income would suffer periods of severe shortfalls. The current focus is on income directly. The marketing loan program and countercyclical program use government payments to top-up market prices for producers and thereby contribute to more production and higher farm incomes for producers of program crops. Ironically, by supporting producer returns, these programs contribute to reduced market prices.

There is no question that rural poverty is a major concern in the United States. Data assembled by the USDA Economic Research Service documents the extent and characteristics of rural poverty.⁴ However, the argument for supporting farm incomes in order to remedy farm poverty is simply no longer a viable argument, if it ever was. Rural poverty is a serious problem mostly among non-farm people who have skills that lead to unstable employment opportunities and low wages. In addition, in some regions rural poverty is tied especially to recent immigrants who do not have the appropriate mix of human capital (or financial assets) to garner higher incomes in the United States.

Some of the rural poor work on farms part of the year as employees and a few have small and usually part-time farming operations. However, they do not produce significant quantities of agricultural output, and any farm payments that they may receive are far too meager to have much impact on poverty prospects.

Because farm commodity payments are roughly proportional to production of program crops (or a history of production of program crops on base land eligible for payments), such payments flow largely to individuals who are relatively wealthy compared to most Americans. Furthermore, since a portion of the payments accrue to owners of relatively inelastic resources, such as base land or specific farming skills, some of the beneficiaries are not farm families but resource owners, including those owning farm supply firms. Removing this income transfer to owners of valuable resources used in farming would cause a loss to the recipients. But, poverty on farms is associated with hired farm workers, often working on farms producing non-program crops, or with part-time or semi-retired operators of very small farms that receive few if any program benefits. Even strong program advocates no longer claim a significant link from farm subsidies to poverty reduction. The data show conclusively that whatever poverty remains among farm operators and landlords, farm commodity programs cannot be used to remedy this concern.⁵

The argument for using farm subsidies to smooth farm incomes is somewhat stronger. Market revenue from farming is variable from year to year and farm program payments rise when market prices decline. However, in some regions, especially those in the central Midwest where program crops predominate, the negative correlation between variable

⁴ See U.S. Department of Agriculture, Economic Research Service (USDA, ERS), *Rural Income Poverty and Welfare*, online Briefing Room.
<http://www.ers.usda.gov/Briefing/IncomePovertyWelfare/>

⁵ See, for example, the data and analysis presented by the USDA Economic Research Service in Hoppe and Banker (2006).

production and variable market prices is strong. In those regions, markets provide a natural hedge and market revenue is much less variable than either prices or yield per acre. Farm programs that provide payments to offset low prices may make income more variable. But for other regions, farm incomes are positively correlated with farm prices and the marketing loan and countercyclical program do smooth incomes from year to year.

A key question is what defines a socially unacceptable amount of variability of incomes. Farmers often respond to income variability with market mechanisms, such as off-farm work and non-farm investments, diversification of farm enterprises, price hedging, or drawing on savings or lines of credit. All farms use one or more of these risk management tools, and among the larger farms that receive the large majority of farm payments, sophistication in use of risk management tools is high. It is difficult to argue that farmers who operate businesses with gross revenues of at least several hundred thousand dollars per year are not aware of the risks they face or are not competent to use available tools to manage those risks. Since most small farms earn only a very small part (or more likely a negative part) of their family income from farming, risk management for them is a much smaller issue and they receive only a small share of benefits from the programs in any case (USDA 2006a).

Even if smoothing farm income variability were accepted as a reasonable rationale for government programs in agriculture, the question that remains is: why would farm subsidies be required to deal with variable incomes for only a handful of program crops, when most of agriculture also faces variability? Table 2 shows the relationship between farm program payments and value of agricultural output by commodity. Differences are stark and reinforce the point that farm programs are specific to a relatively small share of U.S. agriculture.

Table 2. Shares of U.S. Cash Receipts and Program Payments^a for Selected Agricultural Commodities, Crop Year 2002–05 Average (percent)

	Share of total value of production	Share of individual commodity payments in total outlays
Upland cotton	1.9	22.3
Rice	0.6	7.3
Wheat	3.0	9.5
Corn	8.7	43.5
Soybeans	7.2	5.5
Other grains/oilseeds ^b	1.3	4.2
Horticultural crops ^c	21.3	~0.0 ^e
Meat animals ^d	37.8	~0.0 ^e
Dairy	10.8	5.1 ^f
Other commodities ^g	7.4	2.5
Total	100.0	100.0

Source: U.S. cash receipt data are available from the USDA Economic Research Service, Farm Income Data, accessible at: <http://www.ers.usda.gov/Data/FarmIncome/finfidmu.htm>. The commodity payment data are available from the USDA’s Farm Service Agency, Budget Division, “Commodity Estimates Book for FY 2007 President’s Budget” (for crop year 2002 and 2003 data) and available at http://www.fsa.usda.gov/dam/bud/CCC%20Estimates%20Book/estimatesbook_PresBud.htm

and the “Commodity Estimates Book Material for FY 2007 Mid-Session Review” (for crop years 2004 and 2005) and available at http://www.fsa.usda.gov/dam/bud/CCC%20Estimates%20Book/estimatesbook_MSR.htm.

a. Included in the total are production flexibility contract payments, direct payments, countercyclical payments, loan deficiency payments, marketing loan gains, and certificate exchange gains. For the dairy sector, the figure consists of payments under the Milk Income Loss Contract (MILC) Program.

b. Includes barley, oats, sorghum, millet, flaxseed, peanuts, sunflowers, safflower, and miscellaneous oil seeds.

c. Includes fruits, tree nuts, vegetables, melons, and greenhouse/nursery.

d. Includes cattle/calves, hogs, sheep, lambs, and poultry/eggs.

e. Program payments for the meat animal and dairy sector are very small and given here as approximately zero.

f. The data for the Milk Income Loss Contract Payment are available only by fiscal year. The share given is based on the average payment budgeted during fiscal years 2003–06.

g. Includes figures for tobacco, sugar, honey, wool, and mohair.

Finally, if a government program to deal with variability per se were of interest, analysts have pointed out that income stabilization does not require subsidy (Wright). That is, smoothing incomes over time could be achieved by requiring farmers to pay into a fund when prices and incomes are high and while allowing them to draw on the fund when prices and incomes were low. If systematic income subsidy were not provided, such a program could be operated at little or no government costs. In fact, there is little support among program advocates for a low budget approach, which suggests that “stabilization” is not the real motivation for the policies.

Rationale 5. Rates of return to farm investments are low. Many arguments have been advanced over the years for why rates of return to investments in farm assets might be low, including a shrinking overall size of the farm economy (in absolute terms, not as a share). A steady flow of resources out of agriculture implied that returns would be lower in farming than in other investments. Rates of return for investments in farmland do not show unusually low rates of return when annual flow rental rates and capital gains are included. Data supported this model for farm human capital through the 1960s, but no longer. Average incomes of commercial farmers are as high as incomes earned in comparable occupations. Certainly, commercial farmers have wealth at least comparable to those of similar demographic groups.⁶

Some argue that farmers are willing to accept low rates of return on farm investments in order to continue farming as an occupation. Of course, it would be odd to base an argument for subsidies on the observation that farmers undertake an occupation that they enjoy and are

⁶ Again, see Hoppe and Banker (2006).

willing to pursue even though they could receive higher incomes elsewhere. That statement would apply to many if not most workers.

To the extent that the existence of farm programs has maintained agricultural asset values higher than otherwise, this tends to reduce the flow rate of return for investments in those assets. And, again, if low rates of return provided a strong rationale for farm subsidies, this rationale should also apply to the non-program crops. The fact that farmers who grow fruits and vegetables or raise livestock continue to attract investment suggests that “low” rates of return are simply market rates, which makes agriculture no different than other segments of the economy.

Rationale 6. Without farm programs, rural asset values would be too low. There is no question that farm payments raise the prices of land and perhaps other assets to which payments are tied, including human capital. This is just the long-run or capital market manifestation of the income gains noted earlier. If payments were reduced or eliminated, prices of farmland with program base, and of other farm assets, would decline. Estimates of the potential decline in farmland values if farm programs were eliminated range from a few percentage points to 20 percent or more in some regions where payments are large and much farmland is tied to production of program crops (Kirwan 2007; Alston 2007a).

This loss of asset values represents the capitalized value of the expected benefits to the owners of farm asset. The loss of asset values would also cause losses to financial institutions, as some borrowers would fail to meet their obligations. Offsetting this loss, of course, would be the gain to consumers—and, especially, taxpayers. Standard economic models would show that the loss to the farm asset owners would be smaller than the gain to taxpayers and consumers. But removing subsidies would cause a significant loss to a clearly identifiable part of the economy.

Of course, higher farm asset values due to farm programs, while positive for existing owners, raise the capital costs of entry for those wanting to enter farming and raise operating costs for those who operate farms without owning the asset base. That means that by supporting incomes and asset values, farm programs make financing the entry into farming by young and beginning farmers more difficult.

Rationale 7. Without farm commodity programs, rural development would be slower and rural populations would dwindle. Rural population decline in some rural areas has been underway for decades. Concerns include the lack of viable community size for local provision of medical, educational, shopping, and other services.⁷ However, available evidence indicates that, with relatively few local exceptions, farm commodity programs play only a small role in rural population and development issues.⁸ The main reason is that farm population and farm income is a very small share of rural population and income. That is, almost all rural communities rely on non-farm sources for their economic viability. Furthermore, no long-term evidence supports the hypothesis that farm programs have successfully maintained the

⁷ See USDA, ERS, *Rural Population and Migration*, online Briefing Room. <http://www.ers.usda.gov/Briefing/Population/>.

⁸ See “2007 Farm Theme Paper: Rural Development.” <http://www.usda.gov/documents/Farbill07ruraldevelopment.pdf>.

farm or rural populations in a region. Farm consolidation and labor substitution has been a centuries-long trend, and farm programs have not conspicuously measurably slowed that process (see Gardner 2007 and literature cited there).

Of course, some non-farmers rely on farmers as customers, but increasingly inputs and marketing services used by commercial farms are not purchased from local rural suppliers. Furthermore, farm payments are not targeted to vulnerable rural communities or even to rural residents. Farm payments are paid on the basis of current or historical production of program crops and no non-farm considerations enter the criteria for amounts of the payments. The current farm programs do not allow, for example, higher payments to farms in high-poverty counties or higher payments to farms who buy supplies locally. Thus whatever impact farm commodity programs have on rural community viability is small and indirect at best. Spending on farm commodity programs is an inherently ineffective tool for dealing with rural development. If rural community viability were considered a major national issue, the more appropriate policy would shift funds from commodity programs toward supporting rural communities directly. Such a policy would require careful evaluation of its own merits, but would clearly be more appropriately targeted than using commodity programs as a tool for rural development.

Rationale 8. Farm programs improve environmental quality of rural landscape and reduce spillovers outside rural areas. Concerns about rural environmental spillovers have been important in farm legislation since at least the 1985 Farm Bill. To the extent that farmers and landowners have only limited private incentives to provide an appropriate amount of environmental management or services, government regulation, taxes, or support can play a positive role. However, commodity programs as currently designed cannot play this role. At best, commodity programs can be configured to contribute less environmental damage. This is the objective of “conservation compliance” rules, including the restrictions that environmentally sensitive land cannot be brought into commodity programs.

Other types of programs—those tied directly to environmental outcomes, not those tied to commodity production—must be used to deal effectively with the rural environment. Farm bill programs such as the Conservation Reserve Program (CRP), the Environmental Quality Improvement Program (EQIP), and the Conservation Security Program (CSP) were created to deal explicitly with environmental issues. Many of the most vocal advocates for more support or regulation to deal with environmental issues are also advocates for redesigning or eliminating commodity programs and shifting funds away from the commodity title of the Farm Bill and toward the conservation title.⁹

Rationale 9. Farm commodity programs address the imbalance of market power favoring commercial buyers of farm goods (and those selling farm inputs). Farm advocates have long claimed that businesses that sell to or buy from farmers exploit market power to disadvantage farmers, who because they are many, have no market power. In the 1920s this claim led to government efforts to encourage farmer cooperatives and allow them

⁹ For example, see the Environmental Working Group, <http://www.ewg.org/issues/siteindex/issues.php?issueid=5015> and the American Farmland Trust, <http://www.farmland.org/programs/campaign/newpolicyrecommendations.asp>

to exercise market power that would be illegal if undertaken by other firms. General antitrust laws against exercise of market power already limit the behavior of agribusiness firms, while farm cooperative are exempt from sanction. One policy response to damaging behavior by commodity buyers is to enforce the antitrust laws that are already in place.

Here again, commodity programs do not deal directly with market power by commodity buyers—although if prices are unfairly depressed by the exercise of buyer market power, then payments can offset these low prices. Commodity programs are an extremely blunt instrument to deal with buyer market power. The current programs are not targeted to those commodities or regions where market power is most evident and no evidence of market power is required for setting subsidy levels. Recent claims about market power by buyers have been most vocal in beef and produce markets, two commodity industries where there are no commodity payment programs. It is also inconsistent with this rationale that the highest subsidy rates are for rice and cotton, commodities for which much of the marketing is handled by farmer-owned cooperatives.

Rationales 10 and 11. Without farm commodity programs food prices for Americans would be too high and food availability would be insecure. As recently as September 15, 2006, USA Rice Federation President Al Montna stated, “That the Farm Bill benefits American consumers is apparent in every trip to a grocery, where costs of the highest-quality foods are among the lowest in the world.”¹⁰ And USA Rice Producers Group Chairman Paul T. Combs said that, “The Farm Bill represents fiscally responsible farm policy that provides support in a consistent and predictable manner, helping in a large measure to create a stable, low-cost food supply for American consumers.”¹¹ These statements are consistent with the observation that farm commodity programs stimulate production of program crops and hence lower market prices for these commodities.

However, given the very small share of farm commodity prices in retail food costs (especially in foods derived from program crops) and given the small share in all of agriculture covered by farm commodity programs, the effect of these programs on food budgets is tiny. Commodity programs lower average farm prices of the grain and oilseed commodities by at most 10 percent and the share of the farm price of supported commodities in the retail price of food is well less than 10 percent. Multiplying the price impact times the share shows that the impact on food prices using these commodities much than 1 percent. Something missing from previous sentence, but what? Moreover, most food products do not receive subsidies, so the overall impact on food costs is very small. Clearly, farm commodity programs cannot have a significant effect on retail food prices or the share of income spent on food by U.S. consumers.

Furthermore, the commodities subsidized are those that are often exported from the United States. Wheat, soybeans, rice, and cotton all have export shares in excess of 30 percent, while the export share for corn has recently dropped to just under 20 percent because of the increase in the share of corn entering the U.S. energy market. Reduced production of these crops caused by lower subsidies may mean smaller export shares, but could not make food consumption in the United States vulnerable.

¹⁰ USA Rice Federation. 2006. Press release, Arlington, Virginia, September 15.

¹¹ Ibid.

We should also ask, why would it be appropriate to use tax funds to lower the market prices of selected commodities, rather than allow food prices to be determined by market forces? Food stamps and other food assistance programs respond to concerns of consumption of the poor. Agricultural research and development has been a much more effective tool for lowering food prices for Americans and others over many decades because they increase agricultural productivity (Alston, Chan-Kang, Marra, Pardey, and Wyatt 2000). Hence to continue the long-term path of lower food price suggests continued or expanded investments in R&D rather than subsidy of program crops.

Finally, efforts to improve productivity and lower costs of fruits and vegetables are much more consistent with the nutrition goals set by the government through its food triangle and other advice than is subsidy for program crops.

Rationale 12. Farm programs compensate for government regulations that lower farm returns. As with other businesses, farms face environmental and business regulations that are costly. Even if these regulations may have benefits for society as a whole, part of the costs are borne by farms, and those costs reduce the returns to farm production and farm asset values. Subsidies may be used to compensate for these added costs of regulatory compliance. Assuming that compensation is appropriate implies that farms have a prior right to be free of regulation, and therefore, if regulations restrict use of farm inputs or use of land, farmers should be reimbursed for added costs or reduced revenues. This approach is not generally followed in environmental or other business regulation, but one could argue that farms are a special case. It is harder to argue that only farms that grow a handful of selected commodities are the special case and arguments for offsetting subsidies do not apply to growers of other commodities.

If compensation for regulatory compliance were an important rationale for farm subsidies, subsidies should be targeted, by commodity and region on the basis of regulatory costs. The farm environmental programs attempt such targeting, with payments in CRP, EQIP, and CSP all tied to environmental criteria, including in the case of EQIP regulatory compliance. Kuminoff (2007) shows that most farms are mostly outside the environmental regulations, and those that are included in the federal environmental net are the confined animal feeding operations that are not covered by the standard commodity programs.

Rationale 13. Farm programs offset subsidies by international competitors. The United States is certainly not the only nation that provides support to agriculture. Norway, Switzerland, Korea, and Japan all provide higher subsidies to farmers. Even after the implementation of the 2002 Farm Bill and various reforms of the common agricultural program, the European Union still provides more support for agriculture than does the United States. EU subsidies are higher for all commodities (except dairy in 2004), with large differentials for beef, pig meat, poultry, oilseeds, corn, and other grains (Alston 2007b). The EU also subsidizes many fruits, vegetables, and tree nuts that are not subsidized in the United States.

Other countries use a differing mix of commodity subsidies and trade barriers. Does that imply positive social benefits to farm programs in the United States? Do foreign subsidies and trade barriers for farm products imply that the United States should also subsidize those crops? Subsidies by U.S. taxpayers and consumers cost the U.S. economy

and draw resources into specific commodity industries, and global protection or subsidy does not improve the payoff to such subsidies. Furthermore, current programs are not calibrated to countervail important subsidies by trading partners and are not targeted to those commodities that face the largest subsidies by competitors. In some cases, such as cotton, import protection is minimal. Important global competitors have little subsidy and the United States is the most important subsidized participant in the market. In other cases, such as many fruits and vegetables, the United States has no subsidy while competitor products are heavily subsidized or protected.

Over the decade from 1995 to 2005, subsidies declined in other countries while those in the United States rose. Protection and subsidy remain important features of global agriculture that WTO negotiations and disputes are attempts to address. One argument is that U.S. subsidies and protection (say, for sugar) are useful strategically to encourage other countries to reduce their programs. Evidence does not support this hypothesis. In the current WTO negotiations, U.S. subsidies are a major impediment to reducing protection in other countries. Other countries have signaled a willingness to open their market further if the United States would agree to deeper cuts in subsidies.

Summary of the Thirteen Rationales. A few points resonate through all the economic rationales for commodity programs. First, none of the arguments for subsidy programs account for the current distribution of support across commodities. If they apply at all, each of the rationales would seem to apply to many non-program commodities just as much as to the program crops. Second, even if they suggest a rationale for some government involvement in markets, none of the arguments account for the form of commodity programs now used in the United States. Third, neither commodity programs nor arguments for them suggest that a goal is long-term productivity or long-term health of the industry. In fact, there is no evidence that the subsidized commodity industries are more innovative or successful on any dimension than those parts of agriculture with little or no subsidy. Thus, whatever the appropriate rationale for commodity programs, it is hard to claim that they solve any long-run problems of farm commodity industries.

So, why do the familiar farm commodity programs continue? The strongest rationale may be that we continue to have farm programs simply because we have had them for three of four generations. For the supported commodities, the programs have been so thoroughly imbedded into all aspects of the industry that producers and others find it hard to imagine how the industry would adjust to a market without the programs. Adjustment is complex. When support has been a part of an industry for longer than anyone can remember, it is not surprising that industry participants would resist change. Furthermore, removing or radically changing farm commodity programs would be likely to reduce the income of current payment recipients and thus reduce asset values at least for some adjustment period. This may be appropriate policy reforms for consumers, taxpayers, non-subsidized producers, and the economy as a whole, but it is unlikely to be positive, at least in the short run, for those who currently receive benefits.

The 2007 Farm Bill and the Farm Program Rationales

The review of farm program rationales found that many do not seem to fit the current facts of U.S. agriculture. Others do not show why the programs are in the interest of the nation (or agriculture) as a whole, rather than in the sole interest of beneficiaries involved in the production of a handful of program crops. Therefore, we should expect interests outside the traditional program crops to urge changes in the Farm Bill and we should expect those with base in the program commodities to support some variant of the status quo—or at least a continuation of support for their commodity.

Throughout 2006 and early 2007, farm organizations and other groups laid out Farm Bill positions, with a number of commodity organizations suggesting that the FSRI Act of 2002 be extended for as many years as possible. Congressional staff developed background information to help members understand the legislative options (see Monke 2006) and the USDA released relevant data and analysis in the form of commodity “Backgrounders” and “Theme Papers.”

Forces for maintaining farm commodity programs have been remarkably successful for about seven decades. Furthermore, in 1996, a case where significant change can be identified, the changes were supported by mainstream commodity groups, which expected high market prices to mean that the price-based subsidies would be of little value in the short run. With somewhat more open international markets, these groups also saw less value to land set-asides and government stock activities. Both direct payments, which arrive even when prices are high, and countercyclical payments, which do not require that land be idled, were institutionalized by the 2002 Act to join the marketing loans that pay on all production when market prices are low. It is not surprising that this package is popular with many program crop producers.

Given the long history of the commodity programs, are there forces for change? Several stimuli for market-oriented changes in farm subsidy programs can be identified and will be discussed briefly in turn (Thompson 2006; Alston and Sumner 2007).

First, and perhaps most important, the U.S. budget deficit is projected to exceed \$300 billion in FY2006 and to remain high: in the range of \$270 billion in 2007 and much higher in the longer term (Congressional Budget Office 2006). Over the past two decades, farm subsidies have been cut when budget deficit pressures were high. Conversely, farm subsidies increased in 2002 when the budget was temporarily in surplus. Budget deficit pressure was credited with moderating the inclusion of massive farm disaster payments in emergency legislation in June 2006¹² and again in November 2006. But budget pressures need to be put in perspective. Even with farm subsidy outlays of perhaps \$20 billion per year, everyone realizes that farm programs will not be a major contributor to budget reduction. Unless there is a non-budget case for deeper reforms, cuts in farm programs would be a small part of a broad-based cut in outlays: perhaps in the range of 5 to 10 percent, at most.

Furthermore, with current forecasts of high grain and oilseed prices, projected outlays from the current programs would show a large reduction relative to the recent history. In March 2007, the Congressional Budget Office (CBO) projected that a continuation of current law would imply commodity program outlays of less than \$9 billion per year, compared to

¹² R. Wolf, “Fat Days May be Over for Farm Subsidies,” *USA Today*. June 8, 2006.

2002 projections of about \$20 billion per year for these programs.¹³ Advocates for maintaining the status quo could claim credit for budget moderation even with no policy change. It seems that while budget pressures may limit outlays in other part of the Farm Bill, they are unlikely to cause elimination of the commodity program or other major policy shifts.

Some review of federal budget basics is useful at this stage. Farm subsidies are “mandatory” spending, in that the government commits to pay for the operation of the programs whether costs go up or down after the law takes effect. The commodity programs generally cost more when prices are low and less when prices are high. For other programs, including most conservation programs and R&D, the Farm Bill authorizes spending, but a different committee appropriates annual spending over the life of the Farm Bill.

The Farm Bill and the Congressional committees assigned to write it are allocated a budget that typically corresponds to the amount the CBO projects that the current programs would cost if they were continued. For the mandatory programs that vary inversely with market prices, this requires economic baseline projections. For the discretionary programs, the CBO simply projects continuation of the spending of the last complete year, adjusted for inflation. For the 2007 Farm Bill, the baseline budget is much smaller than recent spending under the 2002 FSRI Act because the CBO (and all other forecasters) are projecting much higher program crop prices for the next several years. The ethanol boom has driven up corn prices, which has driven up the prices of other feed grains, oilseeds, wheat, and even rice. Under the CBO baseline, the spending on the price-contingent subsidies is about zero, except for cotton. The only outlays left are the “direct” payments, which do not vary with price. Rather than about \$20 billion per year, the March 2007 projections are for about \$8.5 billion per year, including some spending for dairy and sugar. Additional mandatory spending for farm programs include about \$4.5 billion for conservation programs and about \$5 billion per year for crop insurance. Food and nutrition programs (such as food stamps and school lunch) are projected to cost about \$36 billion to \$39 billion per year. Congress may add back \$3 billion to \$4 billion per year to the Farm Bill budgets, but these measures would require budget “offsets” from outside of agriculture, and offsets are very hard to achieve.

The expected Farm Bill budget is now much smaller than was expected just last year. That means that it will likely be more difficult to find additional dollars from within the agriculture budget to fund budget increases for conservation and environment, research, nutrition, demand enhancement, invasive species protection, and other activities that have been advocated by groups outside the traditional program commodities. When commodity programs were expected to receive \$12 billion per year in price-contingent subsidies, many who advocated for the alternative spending saw the commodity programs as a source for expanding funding for their favored activities. However, much of that money is no longer in the agriculture budget.

The budget bottom line is that program commodities (other than cotton) are expected to be much less dependent on farm subsidies over the next Farm Bill. But, given Congressional spending rules, this does not free up more money for other agricultural spending; rather it means agriculture has much less to work with than it had five years ago.

¹³ CBO farm subsidy outlay projections are available at <http://www.cbo.gov/budget/factsheets/2007b/agriculture.pdf>

Environmental interests have been successful in attaching environmental provisions to commodity programs in previous farm legislation. But the current efforts are more ambitious. The current thrust is to replace a large share of commodity subsidy with support for conservation and environmental services. The Conservation Security Program created by the 2002 Act was a small and awkward step in that direction that tied some payments to approved practices on farms. Those with a particular interest in the conservation title of the Farm Bill are now focusing on shifting commodity program funds toward subsidies attached to practices that supporters hope will provide environmental benefits. As noted, the tiny budget likely to be available for commodity programs makes this strategy more difficult.

In addition to generally supporting environmental programs, the mainstream media seem most exercised by the fact that most farm payments go to operators or landlords of relatively large farms, and that a small share of farms receives the bulk of farm payments. (Large payments through the marketing loan programs are also paid initially to farm cooperatives for allocation to their members, and sometimes these organizations are mistakenly identified as though they were simply very large farms.) Given that the distribution of most payments is roughly proportional to current or historical production, programs that support commodities distribute most payments to those who produce most of the program commodity output (Kirwan 2007). That is, the distribution of payments is inherent in the program's structure; larger farms and wealthier individuals receive the bulk of payments, but not because of loopholes or legislative accidents, as is sometimes implied. Farm subsidy payments never were, and cannot be, effective welfare programs for the poor (Sumner 1991). It is no secret, and no mistake, that most farm program payments go to a comparatively small number of relatively wealthy farm owners. This issue is a perennial topic of the urban press that usually comes to full blossom when the Farm Bill season approaches. The argument is now even easier to make because detailed data from the Environmental Working Group are well known and available in an easy-to-use format.¹⁴

Growers of non-supported crops have begun to argue for more support for research, marketing programs including nutrition education, protection from invasive species, and opening international markets (Paggi 2007). These groups have directly challenged spending such a high proportion of the agriculture budget on income transfers that do little to improve productivity or competitiveness. These growers have not requested payments; they have consistently advocated investments in productivity growth and market expansion (Paggi 2007).

Growers of non-payment crops have pointed to their lack of direct support as one rationale for restricting production of wild rice, fruits, vegetables, melons, and tree nuts on land that receives direct payments. They have argued that allowing recipients of direct payments to shift to the restricted crops would flood their markets and drive down prices because total acreages of the restricted crops tend to be small relative to acreage of program crops and because demand is inelastic. Furthermore, they have argued that there was something inherently unfair about growers that were subsidized based on production of one crop being free to compete in production of another crop with growers who have never been eligible for subsidy. Groups such as Western Growers successfully pushed for the Specialty Crops Competitiveness Act of 2004 to redress some of these problems, not by subsidy

¹⁴ See www.ewg.org.

programs for specialty crops, but by demand promotion and research and other efforts to improve productivity. Their current goal is a title in the 2007 Farm Bill that would address concerns of non-subsidized crops.¹⁵

Compliance with existing WTO agreements is another significant driver for changing farm subsidy programs. The results of the WTO dispute over the U.S. upland cotton program suggest that several other U.S. farm programs also may be vulnerable to WTO challenges.¹⁶ This point has been made repeatedly by Congressional leadership and the Secretary of Agriculture. Two features of the cotton ruling have particular importance for commodity programs. First, subsidy programs are vulnerable to challenges if they significantly suppress market prices or if they unfairly reduce the production in other countries. In January 2007 Canada brought a case against U.S. corn policy that followed the example of the cotton case, but other commodity program challenges will not necessarily follow the model of the cotton case. One can envision, for example, cases that focus on specific foreign markets rather than the entire world market. Furthermore, with a different set of facts, challenges based on the price-depressing effects of crop insurance or direct payments could be successful—even though the panel in the cotton case did not rely upon that argument.

Second, the ruling that crop insurance, countercyclical payments, and direct payments all count toward support for upland cotton suggests that the WTO Appellate Body has a broad view of what constitutes support. U.S. programs previously declared “minimally trade distorting” may be reclassified and U.S. programs overall may be out of compliance with the WTO agreements, at least in some years. Canada also raises this issue in its January 2007 WTO filings (Sumner 2007b).

Finally, economists and advocates for the power of market forces continue to point out serious negative consequences of farm subsidy programs for resource allocation, among other concerns. Economists note that subsidies for one commodity may harm others and that some of the most dynamic, innovative, and successful agricultural industries are found among those that are not encumbered by subsidy programs. These economic arguments are not new, and economists have not been notably effective in getting their views accepted (Gardner 1992, 1996).

Concluding Remarks

Farm commodity programs are an established part of the American agricultural landscape and have strong support from program beneficiaries. Most of the programs now focus more directly on income transfers from taxpayers rather than transfers from consumers through supply control and price supports. But the thrust of the programs remains in place. This paper has explored the extent to which the current commodity programs continue to fit with the realities of American agriculture and how they correspond to rationales offered for their continuation. The summary finding of that section is that it is difficult to find any convincing rationale for continuing the current farm programs, other than that they are popular among those who receive the benefits.

¹⁵ See Paggi (2007) and Western Growers Web site, <http://www.wga.com>.

¹⁶ See Schnepf (2005); Schnepf and Womack (2006); Sumner (2005, 2007).

If farm commodity programs are removed, what if anything should replace them? The favored option for many economists and advocates for smaller government in general is to simply eliminate commodity programs as rapidly as possible (Cato Institute 2003). Other programs affecting agriculture rural affairs would then be considered on their individual merits. Others suggest that the commodity programs be downscaled so that funds can be reallocated within agriculture to focus more directly on objectives that they favor. Supporters of farm commodity program often accept the importance of these other agricultural objectives, but balk at reducing support for commodity programs in order to add funds to the other programs.

There is general acceptance that there are some broad public goods and industry collective goods in agriculture that will not be supplied appropriately without some government involvement and perhaps funding. Examples include agricultural research, information services, and control of harmful invasive species. Continued or expanded government support for these areas may require changes in commodity programs because federal policy attention and funds are now so concentrated on financial support of a few commodities that other concerns are crowded out (USDA 2006b).

There is also widespread support for using public policy to respond to rural environmental externalities. The argument is that a substantial reallocation of funds is necessary to achieve a whole host of environmental objectives through incentives and compensation rather than mandatory regulation. Many groups have urged this sort of shift, including, for example, the American Farmland Trust.¹⁷ An alternative approach to environmental concerns, which does not require additional funds, would be to use taxes and regulation to control environmental externalities, as is done in other parts of the economy. If that approach were taken, it is not likely to appear in a farm bill.

The 2007 Farm Bill is being developed during a period of particular attention to the problems of the current programs and unmet goals that could be addressed by alternatives. Whether these alternatives replace or significantly alter the historic commodity support programs is the primary issue before Congress and the public.

¹⁷ See American Farmland Trust. Web site, *Farm Policy Campaign*, <http://www.farmland.org/programs/campaign/default.asp>

Appendix A. An Agricultural Policy Time Line^a

1789. First tariff act. For revenue only.

1796. Public Land Act of 1796. Authorized federal land sales to the public in minimum 640-acre plots at \$2 per acre of credit.

1816. Tariff of 1816. Included protection for wool, sugar, hemp, and flax.

1819. State legislature set up the New York State Board of Agriculture, the first organization of this sort.

1820. Agriculture Committee, U.S. House of Representatives, established.

1820. Land Law of 1820. Allowed purchasers to buy as little as 80 acres of public land for a minimum price of \$1.25 an acre.

1825. Agriculture Committee, U.S. Senate, established.

1833. Tariff Act of 1833. Began tariff-reducing trend that lasted until the Civil War.

1839. \$1,000 appropriated for Patent Office work with agricultural statistics.

1841. Preemption Act. Gave squatters first rights to buy land.

1852. United States Agricultural Society organized.

1862. Homestead Act. Granted 160 acres to settlers who had worked the land five years.

1862. Morrill Act of 1862. Created the land-grant college complex by giving federal lands to the states to endow colleges in the agricultural and mechanical arts.

1862. U.S. Department of Agriculture set up, without Cabinet status.

1887. Hatch Act of 1887. Provided annual grants to each state for agricultural research, leading to the system of state agricultural experiment stations.

^a Adapted from “Chronological Landmarks in American Agriculture,” Agriculture Information Bulletin No. 425, U.S. Department of Agriculture, Economic Research Service, Washington, D.C., with additions by the author.

1889. U.S. Department of Agriculture raised to Cabinet status.

1890. Meat Inspection Acts. Authorized the inspection of salted pork, bacon, and live animals intended for exportation, and the quarantine of imported animals.

1914. Smith-Lever Act of 1914. Created the cooperative federal-state Agricultural Extension Service.

1916. Federal Farm Loan Act of 1916. Created the 12 cooperative federal land banks.

1921. Packards and Stockyards Acts. Authorized the Secretary of Agriculture to regulate meatpackers and livestock trading practiced at public markets having an area of 20,000 square feet or more.

1922. Capper-Volstead Act. Gave cooperatives legal standing.

1922. National Agricultural Conference to discuss farm policy reform.

1929. Federal Farm Board established.

1933. Agricultural Adjustment Act of 1933 (P.L. 73-10). Introduced price support programs, including production adjustments, and incorporated the Commodity Credit Corporation (CCC). Price support loans by the CCC were made mandatory for the designated "basic" (storable) commodities (corn, wheat, and cotton). The provisions for production control and processing taxes were later declared unconstitutional.

1934. Taylor Grazing Act. Gave the U.S. Department of the Interior power to regulate grazing on public domain in the West.

1935. Agricultural Adjustment Act of 1935 (P.L. 74-320). Gave the president authority to impose quotas when imports interfered with agricultural adjustment programs.

1936. Soil Conservation and Domestic Allotment Act of 1936 (P.L. 74-461). Provided for soil conservation and soil-building payments to participating farmers, but did not include strong price support and income support programs.

1938. Agricultural Adjustment Act of 1938 (P.L. 75-430). Made price support mandatory for corn, cotton, and wheat. It also established the Federal Crop Insurance Corporation and is considered part of permanent legislation.

1941. Steagall Amendment of 1941 (P.L. 77-144). Required support for many nonbasic commodities at 85 percent of parity or higher. In 1942, the minimum rate was increased to 90 percent of parity and was required to be continued for two years after the end of World War II.

1946. National School Lunch Act. Authorized assistance to states in establishing nonprofit school lunch programs through grants-in-aid and other means.

1947. General Agreement on Tariffs and Trade (GATT). An agreement originally negotiated in Geneva, Switzerland in 1947 to increase international trade by reducing tariffs and other trade barriers.

1948. Agricultural Act of 1948 (P.L. 80-897). Made price support mandatory at 90 percent of parity for 1949 basic commodities. Beginning in 1950, parity would be reformulated to take into consideration average prices of the previous 10 years, as well as those of the 1910–14 base period.

1949. Agricultural Act of 1949 (P.L. 89-439). Along with the Agricultural Adjustment Act of 1938, it makes up the major part of permanent agricultural legislation, which is still effective in amended form.

1954. Agricultural Trade Development and Assistance Act of 1954 (Food for Peace) (P.L. 83-480). Established the primary U.S. overseas food assistance program. The program made U.S. agricultural commodities available through long-term credit at low interest rates and provided food donations.

1954. Agricultural Act of 1954 (P.L. 83-690). Established a flexible price support for basic commodities (excluding tobacco) at 82.5 to 90 percent of parity and authorized a Commodity Credit Corporation reserve for foreign and domestic relief.

1956. Agricultural Act of 1956 (P.L. 84-540). Began the Soil Bank Act, which authorized short- and long-term removal of land from production, with annual rental payments to participants. It established the Acreage Reserve Program and a ten-year Conservation Reserve Program.

1961. Emergency Feed Grain Program of 1961. Launched a voluntary reduction program with payment-in-kind (PIK) provisions

1962. Food and Agricultural Act of 1962 (P.L. 87-703). Gave the president the power to impose mandatory production controls. This power was subject to approval by two-thirds of the producers of a commodity before controls could be put into effect.

1964. Agricultural Act of 1964 (P.L. 88-297). Authorized a two-year voluntary marketing certificate program for wheat and a payment-in-kind (PIK) program for cotton.

1964. Food Stamp Act of 1964 (P.L. 88-525). Provided the basis for the Food Stamp Program. It was later replaced by the food stamp provisions (title XIII) of the Food and Agricultural Act of 1977.

1965. Food and Agricultural Act of 1965 (P.L. 89-321). The first multiyear farm legislation, providing for four-year commodity programs for wheat, feed grains, and upland cotton. It authorized a Class I milk base plan for the 75 federal milk marketing orders, and a long-term diversion of cropland under a Cropland Adjustment Program. It also continued payment and diversion programs for feed grains and cotton and certificate and diversion programs for wheat.

1970. Agricultural Act of 1970 (P.L. 91-524). In effect through 1973, it established the cropland set-aside program and a payment limitation per producer (set at \$55,000 per crop). It also amended and extended the authority of the Class I Base Plan in milk marketing order areas.

1973. Agriculture and Consumer Protection Act of 1973 (P.L. 93-86). Established target prices and deficiency payments to replace former price support payments. It also set payment limitations at \$20,000 for all program crops and authorized disaster payments and disaster reserve inventories.

1977. Food and Agriculture Act of 1977 (P.L. 95-113). Increased income and price supports and established a farmer-owned reserve for grain. It also established a new two-tiered pricing program for peanuts.

1977. Food Stamp Act of 1977 (Title XIII). Permanently amended the Food Stamp Act of 1964 by eliminating purchase requirements and simplifying eligibility requirements.

1979. Trade Agreements Act of 1979 (P.L. 96-39). Provided the implementing legislation for the Tokyo Round of multilateral trade agreements in such areas as customs valuation, standards, and government procurement.

1980. Federal Crop Insurance Act of 1980 (P.L. 96-365). Expanded crop insurance into a national program with the authority to cover the majority of crops.

1981. Agriculture and Food Act of 1981 (P.L. 97-98). Set specific target prices for four years, eliminated rice allotments and marketing quotas, and lowered dairy supports.

1982. Omnibus Budget Reconciliation Act of 1982 (P.L. 97-253). Froze dairy price supports and mandated loan rates and acreage reserve programs for the 1983 crops.

1983. Payment-in-Kind (PIK) Program of 1983. Provided voluntary, massive acreage reduction by adding payments in kind to regular acreage reduction payments for grain, upland cotton, and rice; instituted by executive action.

1983. Dairy and Tobacco Adjustment Act of 1983 (P.L. 98-180). Froze tobacco price supports, launched a voluntary dairy diversion program, and established a dairy promotion order.

1984. Agricultural Programs Adjustment Act of 1984 (P.L. 98-258). Froze target price increases provided in the 1981 Act; authorized paid land diversions for feed grains, upland cotton, and rice; and provided a wheat payment-in-kind program for 1984.

1985. Food Security Act of 1985 (P.L. 99-198). Allowed lower price and income supports, lowered dairy supports, established a dairy herd buy-out program, and created a Conservation Reserve Program, under which the federal government entered into long-term land retirement contracts on qualifying land.

1985. Farm Credit Restructuring and Regulatory Reform Act of 1985 (P.L. 99-205). Implemented interest rate subsidies for farm loans and restructured the Farm Credit Administration.

1987. Farm Disaster Assistance Act of 1987 (P.L. 100-45). Provided assistance to producers who experienced crop losses from natural disasters in 1986.

1988. Disaster Assistance Act of 1988 (P.L. 100-387). Provided assistance to farmers hurt by the drought and other natural disasters in 1988. Crop producers with losses greater than 35 percent of production were eligible for financial assistance, and feed assistance was available to livestock producers.

1988. United States-Canada Free Trade Agreement Implementation Act of 1988 (P.L. 100-449). Implemented the bilateral trade agreement between the United States and Canada, including agricultural trade.

1989. Disaster Assistance Act of 1989 (P.L. 101-82). Provided assistance to farmers hurt by drought or other natural disasters in 1988 or 1989.

1990. Omnibus Budget Reconciliation Act 1990 (P.L. 101-508). Included a mandatory 15 percent planting flexibility and assessment on nonprogram crop producers. The law also required USDA to calculate deficiency payments for 1994 and 1995 wheat, feed grain, and rice crops using a twelve-month average market price instead of the five-month average required under previous law.

1990. Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624). Froze target prices and allowed more planting flexibility. New titles included rural development, forestry, organic certification, and commodity promotion programs. It established a Rural Development Administration (RDA).

1993. Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66). Adjusted programs in several ways to reduce budget costs.

1993. North American Free Trade Agreement Implementation Act (P.L. 103-182). Eliminated all nontariff barriers to agricultural trade between the United States and Mexico, generally

through their conversion to tariff rate quotas or ordinary tariffs, and maintained the provisions of the United States-Canada Free Trade Agreement on agricultural trade.

1994. Food Stamp Program Improvements Act of 1994 (P.L. 103-225). Amended the Food Stamp Act of 1977 by modifying reporting requirements and ensuring adequate access to retail food stores by food stamp households.

1994. Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 (P.L. 103-354). The Act, in effect beginning with the 1995 crops, supplemented the federal crop insurance program with a new catastrophic coverage level (CAT) and stipulates that producers must purchase crop insurance coverage at the CAT level or above to participate in federal commodity support programs, Farmers Home Administration loans, and the Conservation Reserve Program. The Act also created the Noninsured Assistance Program (NAP), a permanent aid program for crops not covered by crop insurance.

1994. Uruguay Round Agreements (URA) Act (P.L. 103-465). The law approved and implemented the trade agreements concluded in the Uruguay Round of multilateral trade negotiations conducted under the auspices of the General Agreement on Tariffs and Trade. It allows for the reduction of tariffs and government subsidies on agricultural products among both developed and developing countries and provided measures against dumping products heavily subsidized by governments.

1996. Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (P.L. 104-127). Removed the direct link between certain income support payments and farm prices by providing for production flexibility contract payments, whereby participating producers receive government payments independent of current farm prices and production (with some restrictions). Payments were allocated among contract commodities according to percentages specified in the 1996 Act. Acreage reduction programs were dropped, but marketing loan programs that paid the difference between the loan rate and the market price remained.

1998–2001. Ad hoc legislation

2000. Agricultural Risk Protection Act of 2000 (P.L. 106-224). For the third year in a row, raised contract payments that had been set in the FAIR Act. Also increased crop insurance subsidies and mandated expansion of the program.

2002. Farm Security and Rural Investment Act of 2002 (P.L. 107-171). The law continued most features of the 1996 Act, while creating the countercyclical program, adjusting loan rates, extending programs to soybeans and other oilseeds, and allowing for updating of program base area and yields. The law also created the Milk Income Loss Contract (MILC) payments and extended dairy price supports.

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