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Farm Subsidies, Free Trade, and the Doha Round

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While trade negotiators are striving to find a way forward for the Doha Round of World Trade Organization (WTO) talks, politicians from around the world are balking at making any changes to domestic policies towards that same goal. The negotiating agenda includes some of the WTO member countries' most politically sensitive and difficult trade issues. For example, the United States and the European Union must make meaningful offers to cut agricultural protection, and countries such as India and Brazil need to offer reductions in manufacturing and services barriers. All countries need to commit to some level of liberalization if Doha is to progress.

The initial U.S. proposal was the strongest proposal for eliminating tariffs and subsidies and opening markets across all agriculture, manufacturing, and services sectors. It went too far, however, for Europeans in agriculture and too far for many other countries in opening services markets and slashing manufacturing tariffs. In order for these countries to consider the U.S. plan for trade liberalization, they needed to see the U.S. make cuts in an area that would actually have some bite, namely domestic support programs for agriculture. Moreover, with WTO Director-General Pascal Lamy's recent announcement that negotiations in the current Doha Round of trade talks are again moving forward, the importance of reducing subsidies in the U.S. Farm Bill, which is soon due for reauthorization, becomes even more critical.

Much like the EU, the U.S. is constrained on what agriculture concessions can be offered in trade negotiations. While the U.S. Farm Bill differs in both size and scope from the EU's Common Agriculture Policy, it is supported by similar well-funded, solidly entrenched special interest groups. Real and significant reforms to U.S. programs, as called for by other WTO members, will be very difficult to manage with Congress now committed to preserving the policies embraced in the 2002 Farm Bill. Without extensive commitments by other countries in services and manufacturing market access, there is little likelihood that America will take necessary steps to reform agricultural policy.

Though farm policy reform will be difficult at best to achieve, it would have two positive benefits. It would end nonsensical, distorted subsidies for a handful of select crops, resulting in a more equitable domestic market. Unilateral reductions in farm subsidies and bailouts would give U.S. trade negotiators the second benefit: ammunition to break the impasse over agriculture protection with the EU and other countries in world trade talks, allowing them to continue to credibly lead the world in opening global markets. Successful conclusion of the current WTO round of negotiations would also expand economic opportunity and economic freedom and promote prosperity for all nations, including the U.S.

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Massive Subsidies Worldwide. Subsidies supporting agriculture producers are significant and widespread. WTO members report average subsidies totaling more than $221 billion per year,[1] a little more than 18 percent of global agricultural value added.[2] Based on World Bank and WTO data, the EU and the U.S. each contributed a little more than a third of the total subsidies in 2001.[3] A 2005 Cato Institute study indicates that farmers in Organisation for Economic Co-operation and Development (OECD) countries received $279 billion in some form of production support, or 30 percent of total farm income.[4] U.S. farmers received $46.5 billion from the American government, or 18 percent of total U.S. farm income.

America's Incoherent Farm Policy. The way subsidies are targeted is arbitrary and irrational. Nearly 90 percent of all subsidies go to growers of just five crops (wheat, cotton, corn, soybeans, and rice), while the vast majority of farmers specializing in livestock, fruits, vegetables, and all other crops flourish in a free market without subsidies.

And it is not small family farms or cash-strapped farmers who get the bulk of subsidies, but big agribusinesses. Agriculture is increasingly moving away from family farmers and is being consolidated into large, profitable agribusinesses. Consequently, farm subsidies are no longer necessary to keep most farmers solvent. A Department of Agriculture report states that "on average, farm households have higher incomes, greater wealth, and lower consumption expenditures than all U.S. households."[5] The average farm household now earns $79,961, which is 26 percent above the national average. Farmers' average net worth is double the national average. Farming is not a teetering industry; the farm failure rate is just one-sixth the rate for non-farm businesses. Yet taxpayers subsidize (mostly large) farms with approximately $25 billion annually.

Furthermore, two-thirds of subsidies are distributed to the wealthiest 10 percent of farmers. In 1999, the 136,000 households with annual farm sales of more than over $250,000—the group that also receives the largest farm subsidies—reported an average income of $135,397, which was two-and-a-half times the national average.[6] Lawmakers, Fortune 500 companies, and even celebrity hobby farmers such as Ted Turner, David Rockefeller, and Scottie Pippen collect subsides that dwarf what the average family farmer receives.[7] Subsidizing large agribusinesses that grow certain crops while excluding many family farmers who grow other crops has earned farm subsidies the title "America's largest corporate welfare program."[8]

In addition, U. S. farm subsidies embody an economic incoherence that is stunning even by government standards. Farm policy is based on the premise that surpluses have driven down crop prices and so farmers need subsidies to recover lost income. The federal government's remedy is to offer subsidies that increase as a farmer plants more crops. But planting more crops creates greater crop surpluses, further driving prices down and spurring demand for even greater subsidies. Then, while paying some farmers to plant more crops, Washington turns around and pays other farmers *not* to farm

1. Congressional Budget Office, *Policies That Distort World Agricultural Trade: Prevalence and Magnitude*, August 2005, at *www.cbo.gov/ftpdocs/66xx/doc6614/08-22-Doha.pdf*.
2. Heritage Foundation calculations using data from World Bank, World Development Indicators database, at *devdata.worldbank.org/data-query/* (January 22, 2007).
3. *Ibid.*
4. Daniel Griswold, Stephen Slivinski, and Christopher Preble, "Ripe for Reform: Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers," Cato Institute, *Trade Policy Analysis* No. 30, September 14, 2005.
5. U.S. Department of Agriculture, "Income, Wealth, and Economic Well-Being of Farm Households," *Agricultural Economic Report* No. 812, July 2002, p. 42, at *www.ers.usda.gov/publications/aer812/*.
6. *Ibid.*, pp. 16 and 52.
7. Brian M. Riedl, "Another Year at the Federal Trough: Farm Subsidies for the Rich, Famous, and Elected Jumped Again in 2002," Heritage Foundation *Backgrounder* No. 1763, May 24, 2004, at *www.heritage.org/Research/Budget/bg1763.cfm*.
8. *Ibid.*

40 million acres of cropland each year.[9] Different farm policies simply cancel each other, with the only net effect being higher taxes on Americans.

The President's Proposal. In late January, the Department of Agriculture unveiled President Bush's proposal for reauthorizing the farm programs that expire in September. These reforms would marginally improve the current system. The President would close a loophole that currently allows excessive marketing loan payments. Counter-cyclical payments would be slightly altered to better target low-revenue farmers. Best of all, the President would eliminate subsidies for farmers earning over $200,000 annually.

However, these tweaks generally retain the bloated and economically incoherent farm subsidy programs that in 2002 replaced the innovative 1996 "freedom to farm" reforms. The watershed 1996 reforms largely ended market distortions, allowing farmers to make production decisions without government interference. While farm subsidy costs have more than doubled in the past decade, the President would spend only slightly less than the previous farm bill (and likely more than the Congressional Budget Office baseline for these programs). Anti-free market milk and sugar policies would be only slightly changed.

The President's proposal represents a small step in the right direction. Better still would be a return to "freedom to farm" policies. If these fail, the next test would be whether the President draws a line in the sand and threatens to veto the expensive and inefficient farm legislation Congress appears ready to write.

Worldwide Cost of Farm Subsidies. Global barriers to trade in agricultural products artificially prop up domestic prices for food and food products. They raise the cost of living for families forced to buy food products that are made overly expensive in these distorted markets. According to a 2004 OECD study, U.S. farm programs resulted in higher food prices and had the effect of transferring more than $16 billion from American households to domestic farmers over and above what the farmers received from direct government assistance.[10] This is in addition to the $25 billion annual cost to taxpayers.

Barriers to agricultural trade are not only a burden on American households. They also depress world prices of agricultural products, negatively affecting farmers in developing countries and blocking their efforts to rise from poverty and improve their living standards. The U.S. argues for free trade and economic liberalization, and yet it refuses to eliminate the very policies that would truly allow developing countries to pursue and achieve economic prosperity. William Cline of the Institute for International Economics has estimated that by removing trade barriers, developed countries would convey economic benefits to developing countries that are worth about twice the amount of their annual aid transfers.[11]

The Price of Failure. Failure to conclude the Doha agenda successfully would mean significant lost opportunities for countries around the world to make economic gains. Numerous studies have attempted to measure these gains under various trade-liberalization scenarios. While their results and methodologies differ, these studies consistently show real economic gains associated with further trade liberalization:

- The Institute for International Economics has calculated that moving from today's trade environment to one characterized by perfectly free trade and investment would generate an additional $500 billion in annual income for the U.S., or about $5,000 per household each year.[12]

9. Brian M. Riedl, "Top 10 Reasons to Veto the Farm Bill," Heritage Foundation *Backgrounder* No. 1763, April 17, 2002, at *www.heritage.org/Research/Agriculture/BG1538.cfm*.
10. Organisation for Economic Co-operation and Development, *Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005* (Paris: OECD, 2005).
11. William R. Cline, "Effective Economic Growth for People: The Role of the United States," Center for Global Development, February 11, 2005, at *www.cgdev.org/content/opinion/detail/2958/*.
12. William R. Cline, Trade Policy and Global Poverty (Washington, D.C.: Center for Global Development, 2004).

- A University of Michigan study concludes that reducing agriculture, manufacturing, and services trade barriers by just one-third would add $164 billion, or about $1,477 per American household, annually to U.S. economic activity. Completely eliminating trade barriers would boost U.S. annual income by $497 billion.[13]
- The World Bank estimates that the continued reduction of tariffs on manufactured goods, the elimination of subsidies and non-tariff barriers, and a modest 10 percent to 15 percent reduction in global agricultural tariffs would allow developing countries to gain nearly $350 billion in additional income by 2015. Developed countries would stand to gain roughly $170 billion.[14]

Conclusion. Two vital policy issues are at stake in the U.S. Farm Bill: limiting the size of government and advancing world trade. Defending free trade and fighting for further trade liberalization should be a top priority for Congress this year. Expanding global trade is one of the keys to building a stronger economy at home and promoting better relationships abroad. Specifically, reducing the burdens of the Farm Bill would be a breakthrough in the Doha Round. The President has proposed some good, albeit small, steps for Congress to consider, but much more should be done to achieve a sensible market-based farm policy.

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13. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Multilateral, Regional, and Bilateral Trade-Policy Options for the United States and Japan," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 490, December 2002, and "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.
14. World Bank, *Global Economic Prospects 2004: Realizing the Development Promise of the Doha Agenda* (Washington, D.C.: World Bank, 2004).