No Farm Safety Net

Luther Tweeten, Ohio State University

Background

A *farm safety net* is defined as a public policy to assure farmers of at least minimal economic security in the face of uncertain markets and forces of nature. The policy safety net for a farmer can be comprised of one or more public programs directed at supporting commodity price, yields, revenue, or whole-farm gross or net income. Possible instruments include the entire range of past support programs: recourse or non-recourse loan rates, supply management, crop yield or revenue insurance, ad hoc disaster assistance, coupled or decoupled compensatory payments, market orders, stock accumulation, import restraints, export subsidies and promotion, and long-term land retirement. Related programs not ordinarily considered part of the safety net include public protection of the environment, and public provision of research, education, extension, and information programs. *No farm safety net* would end federal safety net programs designed to support the farm economy above market levels.

Alternative Policy Goals and the Role of a Farm Safety Net

Measuring the economic justification for a farm safety net begins with assessing the purpose of that net. The purpose can be broad, such as improving the well being of people by promoting economic equity and efficiency. Or, the goal may be preserving the environment and family farms or reducing risk, poverty, and food insecurity. It is traditional for economists to list alternative goals and how a safety net contributes to each. The policymaker judges which goals (and their attendant means) are to be achieved. Several goals and farm problems, and the implications of a farm safety net to achieve or resolve them are discussed below.

Economic efficiency

This goal is furthered by allocating resources and products to their highest and best uses in a competitive market corrected by taxes, subsidies, and the like so that private costs (benefits) are aligned with social costs (benefits) at the margin. Consequently, actions that raise utility for individuals

and profits for firms also produce benefits for society. The public sector provides an institutional environment where markets can work — through property rights, rule of law, sound macroeconomic policy, and other public goods.

Compelling evidence indicates that farm commodity markets work efficiently to allocate and reward farm resources. Competently managed commercial farms (the top half of farms with crop and livestock sales of over $250,000 annually) on average have earned returns at least comparable to what their resources would earn elsewhere (see Tweeten 1989, pp. 118-122). In 1997, for example, farms with sales of over $250,000 earned rates of return averaging nearly three times that of nonfarm businesses (Hopkins and Morehart). Of course, small and inefficiently operated farms earned low returns just as do small, inefficiently operated nonfarm businesses.

Farm commodity programs operating as a safety net tend to cause too little output (supply management) or too much output (insurance subsidies, commodity loan support rates), hence distorting domestic as well as international markets. These distortions reduce real national income (see Tweeten 1989, p. 366). Taxpayers lose more than producers gain from commodity programs — the difference is lost to farm resource-use distortions and to administrative costs and lobbying cost that could be avoided in the absence of a farm safety net.

Economic equity

Measures such as broad-based investments in human capital serve both economic equity and efficiency. If the well being of people is a social goal, economic transfers are inappropriate from lower income/wealth individuals to higher income/wealth individuals. A related issue is farm poverty. Commercial agriculture, the principal focus of commodity programs, has almost no poverty except among hired workers — a group not served by the current commodity program safety net. Few farm commodity program benefits go to limited resource families.

If farm commodity safety net programs are suspect in providing economic equity and economic efficiency, perhaps they better address farm problems of environmental degradation, economic instability, exploitation by concentrated agribusinesses, family farm loss, rural community decline, or food insecurity. Evidence indicates that either these are not problems, or that current farm commodity programs do not cost-effectively address the problems.

Family farm loss[1]

Farm numbers fell by only 0.1 percent per year from 1992 to 1997, a rate well below that of previous decades since the 1950s (U.S. Department of Agriculture, March 1999). In the long run, farm size and numbers are determined mainly by technology, economies of size, and land market laws rather than by commodity programs. In fact, commodity programs provide capital and financial security, encouraging farmers to buy out and consolidate their smaller farm neighbor over the long run.

Commodity programs have been highly useful in preserving family farms in the short run such as during the financial crisis of the early 1980s.

Instability

Annual and cyclical yield and market instability are perhaps the major economic problems of commercial agriculture. Small farms accounting for most farms diversify to handle farm risk through off-farm income that dwarfs their farm income. Many larger farms have sufficient resources and managerial capability to utilize effectively the multitude of private risk management tools available such as insurance, forward pricing, contracting, storage, liquidity, and the like.

The mid-size family farms that frequently are least able to cope with risk can be provided with a risk safety net most cost-effectively by focusing stability on the "bottom line," net farm income, rather than on price, yield, gross revenue, or cost

[1] The family farm is a prized American institution that 82 percent of American adults say they wish to preserve (Jordan and Tweeten). Farmers seem to adapt pretty well to employment off the farm. By a 3:1 margin, Oklahoma farmers who have left the farm in mid-career said they were better off (Perry et al.). Similar results have been found in other states (Bentley et al.).

components of income that can vary to offset and hence stabilize each other.[2] An investment retirement account type program with the government matching a farmer's contribution and giving tax-exempt status to interest is an option to address farming instability at low cost, and might be administered by the Internal Revenue Service.

Environment

Degradation of land, air, and water resources and depletion of natural resources such as phosphate reserves entails externalities not addressed by the market alone. For example, soil erosion brings "downstream" costs or "takings" from farm neighbors and urban people utilizing water-supply reservoirs impaired by soil sediment and chemicals. Such problems are real, but may be dealt with cost-effectively through public purchase of easements for riparian strips or conservation tillage rather than through farm safety net programs.

Rural community loss

Rural areas, defined here as nonmetropolitan counties (no cities of over 50,000 residents), have been growing in population. Farming-dependent counties, defined as those in which at least 20 percent of income is derived from farm labor and proprietor income, accounted for one-fifth of U.S. counties in 1990 and many are losing population. Less than one-tenth of the rural (nonmetroplitan) labor force works in production agriculture, and 93 percent of the rural population resides in non-farming-dependent counties (having less than 20 percent of their labor force in agriculture) (Wright, p.17). Many farming-dependent counties are located in the Great Plains that are suited by climate and sparse population to deal with environmental problems associated with livestock feeding-processing clusters to which the nation is headed. They can expand livestock feeding and processing to raise income and employment.

Farm safety net programs may not be a cost-effective means to assist rural towns and cities. Many farming dependent communities are best helped with extension programs to effectively use their resources. In many cases, greater federal and state resources can be justified to better prepare local rural youth for employment at home or elsewhere. Thus, local communities do not have to be burdened with paying the cost for human resource development programs that accrue benefits to communities elsewhere — often to growing urban areas — where former rural resident live and work.

Food security

Food insecurity is a huge problem in many parts of the world. At issue here is whether American farm commodity safety net programs are essential to ensure future food security. The answer is no. The world has been blessed with food availability, even abundance, since World War II. The food insecurity problem traces to lack of productivity and buying power in poor countries. As the world's largest exporter of food, the United States will likely remain food secure with or without a farm safety net.

International competitiveness and agribusiness concentration

It is said that a farmer can compete with other farmers at home or abroad, but he/she cannot compete with foreign governments subsidizing competing exports. Similarly, many farmers view a safety net as essential to countervail the market power of agribusinesses that are growing larger and more concentrated.

Several observations are warranted. First, neither economic theory nor empirical evidence indicates that American farmers are systematically exploited by foreign governments or domestic agribusiness firms (Persaud and Tweeten). However, as the least concentrated sector in the food and fiber system, the U.S. farmer is the residual claimant of international decisions made by both the U.S. and foreign governments.

To be sure, imperfect competition characterizes many agribusinesses. If they do indeed exercise market power, fewer resources will be used in farming than if agribusiness industry were competitive. However, the oligopolistic (few firms)

[2] The most comprehensive and efficient "bottom line" to stabilize could be total household income from farm *and* nonfarm resources.

market structure that characterizes much agribusiness is recognized for massive advertising to expand food and fiber sales. This characteristic, plus the prominence of cooperatives in agribusiness, points to a farming sector as large and paid as high commodity prices as would a more competitive market.

Multilateral and regional trade agreements can further reduce unfair competition from abroad. Considerable progress has been made in reducing trade barriers with major competitors such as Australia, Canada, and New Zealand. More open global trade also encourages American agribusinesses firms to price farm inputs and commodities more competitively.

Consequences of No Safety Net

Taxpayers would be major beneficiaries of no safety net for farmers. Less cost to consumers of sweeteners, tobacco, and selected other commodities might be offset by slightly higher costs for livestock and poultry. Gains to taxpayers are estimated to be greater than losses to producers so that the nation as a whole would gain real income.

It is impossible to precisely estimate how many farms would exit in the absence of a safety net. Attrition, however, would likely be high on some types of farms, as indicated below:

- **Sugar, tobacco, and peanut farms.** These farms have been especially favored by safety net programs.
- **Southeast and Plains states farms.** Farmers in these states have especially benefited from price support and federal cost sharing of crop and revenue insurance programs.

MPCI ratios have averaged over 2.0 for cotton, tobacco, peanuts, sorghum, and wheat and much lower for corn and soybeans. Up to an estimated 25 million acres currently in crops would be in grass, trees, or other non-crop uses without safety net payouts (Skees). Many of those acres are in the Southeast and Plains states. Agribusinesses also would experience a decline in economic activity in the Southeast and Plains states.

- **Mid-sized farms with sales of $100,000 to $250,000.** These farms would be especially hard hit because many are too large to allow much off-farm work for the operator and spouse, but too small to achieve economies of size essential to compete with other farms.
- **Landowners.** Farmland prices would fall in the absence of a farm safety net. Landowners would lose, but new entrants to farming would face lower entrance barriers and mortgage payments.
- **Livestock and poultry feeders.** Favorable commodity support loan rates and crop insurance assistance from government-induced production of crops. That additional production lowered crop prices and hence feed costs to feeders. Hence, feed costs would rise without safety net programs.

If there are net economic benefits from an end to the safety net, gainers could in principle compensate losers and still be better off. That compensation could come in a number of forms, although admittedly it is difficult to identify who gains or loses or by how much. Production flexibility contract transition payments under the 1996 Farm Bill were justified in part as compensation for the phase out of the safety net — an expectation that was not realized but could be more successful in a later farm bill. Another form of compensation is adjustment assistance, patterned along the lines of that to workers displaced by freer trade under the North American Free Trade Association (NAFTA). Assistance could include counseling, job training and information, and mobility assistance loans or payments.

Continuation of a farm policy safety net slows but does not stop farming adjustments. Adjustments will continue to occur and, indeed, are likely to be similar in the long run with or without a farm safety net. Science and markets are moving agriculture to fewer and larger farms, towards more vertical coordination in the form of production and marketing contracts, and to ever more sophisticated marketing, management, finance, and technology. Having or not

having a farm safety net is likely to have little influence on these forces and how they impact agriculture and rural communities, except in the short run.

Finally, an end to broad agriculture safety net does not imply an end to public involvement in agriculture. Exercising the public policy option of ending the large umbrella of safety net programs would release billions of dollars of public funds to target agricultural problems: mid-size family farm loss, instability, and environmental degradation. Options to address such problems cost-effectively may look very different from the current farm safety net, as noted in the text.

References and Suggested Readings

Bentley, Susan, et al. *Involuntary Exits from Farming: Evidence from Four Studies*. Agricultural Economic Report No.625. Washington, DC: Economic Research Service, U.S. Department of Agriculture, November 1989.

Blue, E. Neal and Luther Tweeten. "The Estimation of Marginal Utility of Income for Application to Agricultural Policy Analysis." *Agricultural Economics*. 16(1997): 155-169.

Hopkins, Jeffrey and Mitchell Morehart. "An Empirical Analysis of the Farm Problem: Comparability in Rates of Return." Paper presented at Tweeten Symposium held at Columbus, Ohio, September 10-11, 2000.

Jordan, Brenda, and Luther Tweeten. *Public Perception of Farm Problems*. Research Report No.P-894. Stillwater: Agricultural Experiment Station, Oklahoma State University, 1987.

Makki, Shiva. "Crop Insurance: Inherent Problems and Innovative Solutions." Paper presented at Tweeten Symposium held at Columbus, Ohio, September 10-11, 2000.

Persaud, Suresh, and Luther Tweeten. "The Competitive Structure of the Agribusiness Sector." Paper presented at Tweeten Symposium held at Columbus, Ohio, September 10-11, 2000.

Perry, Janet, Dean Schrener, and Luther Tweeten. *Analysis of the Characteristics of Farmers who Have Curtailed or Ceased Farming in Oklahoma*. Research Report P-919. Stillwater: Agricultural Experiment Station, Oklahoma State University, 1991.

Skees, Jerry. *The Potential Influence of Risk Management Programs on Cropping Decisions*. Selected paper presented at American Agricultural Economics Association meeting in Nashville, Tennessee, August 2000. Lexington: Department of Agricultural Economics, University of Kentucky, September 2000.

Tweeten, Luther. *Farm Policy Analysis*. Boulder, CO: Westview Press, 1989.

Tweeten, Luther. "Impacts of Unilateral Liberalization of Farm Programs." Paper presented at annual meeting of the Southern Agricultural Economics Association in Fort Worth Texas, January, 2001. Columbus: Department of Agricultural, Environmental, and Development Economics, Ohio State University, 2001.

U.S. Department of Agriculture. *1997 Census of Agriculture*. "United States Summary and State Data." AC97-A-51. Washington, DC: National Agricultural Statistic Service, March 1999.

U.S. Department of Agriculture. *Agriculture Income and Finance*. AIS-75. Washington, DC: Economic Research Service, USDA, September 2000.

U.S. Department of Agriculture. *Agricultural Outlook*. AGO-279. Washington, DC: Economic Research Service, USDA, March 2001.

Wright, Brian. "Goals and Realities for Farm Policy." Chapter 2 in Daniel Sumner, ed., *Agricultural Policy Reform in the United States*. Washington, DC: AEI Press, 1995.