The Economic Impact of Agricultural Subsidies in the United States
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The purpose of this paper is to examine the negative impacts of governmental corn subsidies on the American and global economies. This paper's analysis will examine how such policies, which were first passed in 1921, enable the United States government to manipulate the supply of corn, and thus directly influence international food prices. Specifically, the focus will be on the various externalities and long-term consequences associated with this policy, including inefficiencies in the global market for food, the rise of government sponsored monopolies in the agriculture industry, the negative health implications of diets heavily weighted in corn and corn derivatives, and the prevalence of ethanol as an inferior alternative to carbon-based fuel sources.

Key Words: Food prices; Agricultural subsidies; Externalities of farm subsidies; Agricultural monopolies; Global market for food; Diets weighted in corn; Ethanol.

I. Introduction

Our thesis in this paper is that free enterprise, private property rights and very limited government are the best recipe for economic welfare, and that agriculture is no exception to this general rule. We discuss in this regard several governmental farm policies that have had deleterious effects on this economy. In section II we briefly discuss agricultural history. Section III discusses subsidies and agribusiness concentration. We conclude in section IV.

II. History

In the 1800s, the U.S. government’s agricultural policy was aimed at

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the exploration and development of arable land. The Land Act of 1820\(^1\) encouraged settlers to purchase property in the Western Territory by reducing the price of an acre of land, while the Homestead Act of 1862\(^2\) enabled farmers to develop unclaimed territory, thus becoming the property owner. A third legislative enactment, the Morrill Land-Grant Colleges Act,\(^3\) created schools specifically devoted to research on agriculture. These three laws laid the foundation for programs designed to incentivize and support family farms in the U.S.

During World War I, the U.S. became a large supplier of food, supplies, and weapons to Allied nations fighting in Europe. U.S. growers saw this as an opportunity to increase the size of their farms to meet Europe’s growing demand for U.S. crops. However, the Treaty of Versailles created a heavy burden for the Central Powers, as they were required to pay reparations for the war, thus bankrupting Europe\(^4\) and causing major U.S. export markets to close. This sharp drop in Europe’s demand for U.S. goods left American farmers with large debt and a surplus of crops, resulting in a brief recession from August 1918 to March 1919. At the conclusion of World War I, Herbert Hoover, then the head of the Food Administration, provided shipments of food to the defeated German nation and famine-stricken Bolshevik-controlled areas of Russia in 1921.

The period from 1922 to 1935 caused the U.S. to reevaluate its agricultural policy, mainly because of the poverty and economic turmoil experienced during the Great Depression and the Dust Bowl\(^5\) which caused crop prices to fall by approximately 60% (Cochrane, 1958). To stave off the inevitable downfall of the U.S. family farm\(^6\) as a result of technological advancements and low demand, Congress passed the

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\(^{1}\) http://www.worldlingo.com/ma/enwiki/en/Land_Act_of_1820
\(^{2}\) http://www.archives.gov/education/lessons/homestead-act/
\(^{5}\) http://www.ncdc.noaa.gov/paleo/drought/drght_history.html
\(^{6}\) This fourteen year period, 1922-1935, included various Republican Administrations, plus of course, FDR’s. Yet, the move away from the (family) farm occurred all throughout this period.

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Agricultural Adjustment Act of 1933.

The AAA ordered farmers to reduce crop surpluses, thus raising the value of their crops and helping American farmers who had been hurt by the economic downturn (Ganzel, 2003). The government levied a tax on companies that processed farm commodities in order to compensate farmers for forgone profits. Tactics used to artificially restrict the supply included destroying massive quantities of crops, killing millions of heads of livestock, restricting the amount of a commodity a farmer could produce, paying farmers to not produce, and having the government buy large quantities of commodities to keep them off the market, all while Americans were reeling from the debilitating effects of the Great Depression (Blevins, 2002; Bovard, 1990; Kelly, 2008; McLaughlin, 2007). The bill also put the USDA in charge of regulating the production and marketing of farm products.

Attached to the Agricultural Adjustment Act was the Thomas Amendment, which increased the U.S. government’s power over the money supply (Webb, 1978). The Thomas Amendment gave the president power to authorize open market operations of the Federal Reserve, reduce the gold content of the dollar by as much as 50%, and, with the addition of the Pittman London Silver Amendment of 1933, allowed the government to require the U.S. mints to purchase silver from U.S. citizens.

By artificially limiting supply and maintaining prices significantly above market levels, the Agricultural Adjustment Act misallocated resources. The effects of high prices on food, clothing, and other normal goods during the darkest years of the Great Depression, along with increased taxes to pay farmers, exacerbated the hardships of U.S. citizens.

An unintended consequence of the AAA was the elimination of sharecroppers, who were once a major force in agriculture. When the

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7 http://www.livinghistoryfarm.org/farminginthe30s/water_11.html
8 http://digital.library.okstate.edu/encyclopedia/entries/T/TH007.html
9 http://www.enotes.com/topic/Agricultural_Adjustment_Act
10 For an Austrian economic analysis of the depression of the 1930s, see Rothbard, 1975

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government offered landowners acreage reduction contracts, landowners received compensation for what they would have normally earned for selling those crops on the open market. The law then required the landowners to pay sharecroppers and tenant farmers on their land a portion of the revenues. Not only was this nearly impossible for the government to enforce, but it incentivized landowners to get rid of their sharecroppers and tenant farmers and replace them with wage laborers, thus virtually ending the once common practice of sharecropping.

After the Agricultural Adjustment Act was ruled unconstitutional in 1936, a new version, the Agricultural Adjustment Act of 1938, mandated that the government grant subsidies for corn, cotton, and wheat. This was to maintain a sufficient supply of staple goods through periods of low production, along with keeping export quotas aligned with market demand.

After World War II, U.S. farmers experienced technological advancements that introduced the mechanization of farming activities, which drastically increased productivity. The introduction of self-propelled combines and mechanical cotton pickers reduced the amount of labor needed to harvest crops, and the launch of electric powered motors and irrigation pumps further helped boost efficiency. The mechanization of the family farm also modernized milking parlors, grain elevators, and confined animal-feeding operations, which further increased productivity and reduced the demand for labor (Conkin, 2009). The advent of modern chemistry, advances in herbicides, insecticides, and fungicides further improved crop yields. The combination of advances in agricultural technology provided liquidity to banks that were now willing to lend, and to public investments in research, teaching and extension through the Land Grant system. But this is difficult to demonstrate. Even if true, there is no warrant for assuming these programs promoted overall economic well being. Quite plausibly, increasing productivity in agriculture, even if emanating from these sources, might well have been more than offset by losses elsewhere. After all, the state has no magic wand. Additional expenditures in this sector of the economy necessarily had to come from other areas.

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mechanization and increasing crop yields through chemical innovation has boosted agricultural labor efficiency from 27.5 acres/worker in 1890 to 740 acres/worker in 1990.\textsuperscript{13}

The 1970s introduced a new approach to agricultural policy: as opposed to encouraging the small family farm, Secretary of Agriculture Earl Butz began to promote large capital intensive farming operations (Frkyholm, 2008). This contributed to the fall in the number of American farms to 2.1 million in 2002, in contrast to its peak of 6.8 million in 1935. In 2008, according to the Department of Agriculture, large commercial firms, those with gross annual sales in excess of $250,000, received 62% of all government payments while small rural residence and intermediate farms each received only 19%, despite representing approximately three-quarters of the subsidized farming market. Most of this money went to the largest producers. From 1995 to 2010, the top 10% of the America’s subsidized farmers collected 74% of all farm subsidy payments. In nominal terms, farmers in the 90th percentile received $30,751 per year, while the bottom 80% collected only $579 annually.\textsuperscript{14} As a result of concentrated, capital intensive farms becoming the norm, the agribusiness lobby has become one of the largest in America, and has a powerful political influence. It includes crop producers, meat producers, poultry and egg companies, dairy farmers, timber producers, tobacco companies, and food manufacturers and wholesalers; all of whom donated a total of $65,292,201 to both Republicans and Democrats\textsuperscript{15} in the 2008 election season (Center For Responsive Politics).\textsuperscript{16}

\textsuperscript{13} http://www.epa.gov/oecaagct/ag; 101/demographics.html

\textsuperscript{14} Environmental Working Group: http://farm.ewg.org/region.php?fips=00000&statename=theUnitedStates

\textsuperscript{15} Of course, it cannot be denied, the $65 million in lobbying efforts is the total spent by many different groups. More than a few opposed each other (e.g., the recent debate over ethanol in which different groups inveighed against one another) so it must not be claimed that all of this money tugged in the same direction. According to scholars, the effects of PAC money on public policy are ambiguous. See on this Aparicio-Castillo, 2006; Endersby and Munger, 1992; Grenzke, 1988; Grier and Munger, 1991; Snyder, 1990; Kroszner and Stratmann, 2000, 2005; Wright, 1989). We owe this point to a referee of this journal.

\textsuperscript{16} http://www.opensecrets.org/industries/totals.php?cycle=
Policies advocated by the agribusiness lobby include the increased production of ethanol as a biofuel additive. The rise in U.S. ethanol production is directly attributed to artificially cheap maize, which has caused energy markets to be placed in competition with food markets as both industries compete for arable land, thus driving up food prices as the supply of land becomes limited. As of 2007, 25% of lands once used to grow crops for human consumption are now used specifically for ethanol production, even though converting the entire U.S. grain harvest to ethanol would only produce 16% of America’s auto fuel needs (Brown, 2007). According to a World Bank policy research working paper, large increases in biofuel production in the U.S. and Europe are the main reason for the steep rise in global food prices experienced in early 2008 (Mitchell, 2008).

In the global food distribution market, U.S. farm policies tend to favor the agribusiness giants, and leave developing countries in the dust. Subsistence farmers in poor, underdeveloped nations are even more adversely impacted when American farmers, overproducing in response to government incentives, dump their cheap abundant crops on foreign economies. Commonly celebrated as “foreign aid”, these donations are hardly relieving to farmers in developing countries who cannot compete with the below-market prices of American crops. Eventually, many are driven out of the market and must locate work in other industries or descend into poverty.

To many, this is a natural and inevitable progression for the economies of undeveloped countries because, according to the theory of Comparative Advantage first described by David Ricardo, nations should specialize in capacities in which they excel relative to other economies and then trade accordingly. Unfortunately, the scenario does not play out so neatly in the arena of international food distribution because America’s agricultural sector is reinforced by billions of dollars siphoned from...
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The economic impact of agricultural subsidies in the U.S. is significant. As a result, the growth prospects of underdeveloped economies are undermined. In the case of Tanzania, which has received more foreign aid than any other country, large deposits of American corn surpluses have inverted the country’s economy from an exporter to an importer of corn and subsequently have reduced per worker output by half (Schoolland, 1998).

It is difficult to fathom how farm bills improve economic vitality in the global food markets. Yet, policy makers and supporters of farms bills cling to the notion that these policies are vital because they provide safety nets and stabilize/increase incomes for American farmers whose livelihoods depend on unpredictable weather and fluctuating commodity prices. While it may be true that farmers work in an often uncertain industry, it is not the government’s responsibility to insure participants in risky industries. Nevertheless, they continue to spend billions of dollars on economically-bankrupt policies that reward idleness and dissuade productivity. Tracing back to 2000, the federal government has paid approximately $1.3 billion to landowners who do not even farm, preventing prices from falling by limiting the supply of crops that could potentially be produced had the money actually been allocated to productive farmers (Morgan, 2006). Additionally, many farm bills designed to stabilize or boost the incomes of farmers have failed because subsidies have the unintended impact of driving down prices, and thus incomes, by creating surpluses (Edwards, 2001).

As we have said, the removal of government subsidies and other regulatory baggage would improve efficiency. If markets were allowed to function, distortions and misallocations caused by intervention would be remedied. Overproduction would no longer be rewarded and inefficient businesses that were previously compensated for growing crops in excess of the quantity demanded would have to adopt new business models or be forced out of the industry.

The top subsidy recipients are fearful of this scenario, as it would recalibrate the competitive environment and force a return to sound business practices. To maintain their favored status in the rigged food market, Big Agriculture colludes and forms special interest groups whose sole purpose is to keep the pipeline of subsidy dollars flowing their way.
These groups, called political action committees (PACs), lobby on the behalf of large corporate farmers and provide massive financial donations to both political parties as a form of persuasion. In the past twenty years, the PACs have contributed nearly $200,000,000 (Agribusiness, 2010).

IV. Subsidies and agribusiness concentration

The dense concentration of market share in the agribusiness industry is testament to the tremendous influence of these political action committees. Today, a handful of agribusiness firms, namely Monsanto, ConAgra, and Cargill, have a distinct and unnatural advantage over their unsubsidized rivals. For the small and medium sized farms, it is nearly impossible to compete. To many, the oligarchical power structure of the industry is confirmation of a market failure in which heavy-handed capitalists have used price gouging and predatory pricing techniques as means to expel competition. Unfortunately, this tired and shortsighted assertion overlooks the true genesis of monopoly: government intervention.\textsuperscript{18} The outsized revenues of corporate farmers are facilitated not because of superior business strategies but rather due to their benevolent relations with those on Capitol Hill. As result of this sort of pork barrel politics, unsubsidized farmers have been forced to the margins of the industry, while subsidized enterprises have blossomed into tycoons who continue to ascend in power as a result of the economies of size they now enjoy.

America’s agribusiness industry supplies a food basket that is not congruent with consumer preferences, since a few crops receive a vastly disproportionate amount of the subsidy money. The recipients are large producers of corn, wheat, and soy beans. The impact of such policies is disastrous to the diversity of affordable produce and grain. Farmers cannot effectively respond to the demands of buyers who may prefer crops that the government has not chosen to subsidize. This has profound effects on consumers.

\textsuperscript{18} For a critique of the view that high concentration ratios are a threat to competition, and are even logically coherent, see Anderson, et. al., 2001; Armentano, 1999; Barnett, et. al., 2005, 2007; Block, 1977, 1982, 1994; Block and Barnett, 2009; Boudreaux and DiLorenzo, 1992; Costea, 2003; DiLorenzo, 1997; DiLorenzo and High, 1988; High, 1984-1985; McChesney, 1991; Rothbard, 2004; Shugart, 1987; Smith, 1983; Tucker, 1998A, 1998B

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the types of foods that are available for cheap consumption.

As the most heavily subsidized crop in America, corn has become an irrationally cheap and abundant commodity. Today, one cannot walk down an aisle in a typical grocery store without passing tens, if not hundreds, of items that contain some type of corn derivative or polymer. Ketchup, yogurt, cheese spreads, peanut butter, and even batteries, all contain a form of corn extract. The ingenious applications of corn have developed for one simple reason: profits. In America, it is simply more economical for Coca-Cola to use high fructose corn syrup, rather than sugar, to sweeten its soft drinks. Commercial livestock farmers respond just as predictably, using corn as the primary ingredient in their animal feed.

Over years, massive injections of subsidy dollars have transformed America’s food industry to the extent that fast food, red meat, sodas, and other fat-laden products have become drastically more affordable than healthier alternatives such as fruits and vegetables. According to Darius Lakdawalla, an economist at the RAND Corporation and the National Bureau of Economic Research, as much as 50% of the increase in obesity may be attributable to falling food prices. For a nation already plagued by obesity, the ramifications are life threatening, especially if commodity prices continue to edge higher and influence consumers to purchase cheap, yet unhealthy food choices. Endowed with versatility and artificially cheap, it is no wonder why corn continues to appear on dinner tables, at school cafeterias, and, even, in our gas tanks.

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