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Shallow Loss: The 2012 Farm Bill's New Subsidy Program

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The Senate recently passed the Agriculture Reform, Food and Jobs Act of 2012, which repeals a set of wasteful and antiquated commodity programs. Yet it supplants those program cuts with a costly new subsidy—the Agricultural Risk Coverage (ARC) program. The House draft farm bill also gets rid of the so-called direct payments and replaces them with a similar new subsidy.

The Senate bill's new subsidy program, also called "shallow loss," would provide yet another layer of subsidized insurance to farmers. It would further drain the pockets of taxpayers and consumers and harm international trade. At a time of tight budgets and record high crop prices and farm revenue, it is especially poor policy and irresponsible budgeting to expand the already lavish safety net.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3662**

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Current Farm Policy. Current subsidies, including direct and counter-cyclical payments, are collected by farmers regardless of whether they grow even a single plant. Commodity subsidies for eligible crops are not based on the market price for those products but rather on the historical number of acres planted and a farm's yield. Large commercial farms reap most of the benefits of such criteria, while small farms, which are more vulnerable to fluctuations in crop prices, receive less assistance. Moreover, producers of just five crops—wheat, cotton, corn, soybeans, and rice—receive nearly all farm subsidies.[1]

The existing federal safety net is already overly generous. Not only does the federal government subsidize 60 percent of a farmer's crop insurance premium on average; it also *pays* insurance companies to administer the policies.[2] Crop insurance subsidies have increased substantially during the past two decades, rising from $200 million in 1991 to $5.4 billion in 2009.[3] Farmers can also draw on disaster assistance programs when extreme weather causes crop failure.

Farming today is experiencing record-high crop prices and revenues. The agriculture industry also possesses the strongest debt-to-asset ratio it has seen in decades,[4] which indicates its firm financial footing.[5] Net farm income is projected to reach its second highest level of $91.7 billion in 2012.[6] Despite these positive trends, federal subsidies to farmers are projected to reach an estimated $11 billion in 2012.[7]

The Senate Bill's New Shallow Loss Program. It hardly seems logical to eliminate commodity subsidies only to replace them with others, yet both the House and the Senate bills would do just that. Shallow loss would shield farmers from even smaller (shallower) revenue losses than under the existing federal insurance programs. It would be triggered when a farmer of eligible crops sees revenues fall below 90 percent of the previous five years' average level. This rolling average would be artificially high, though, because of recent record-high crop prices.

Shallow loss would significantly reduce risk in farming and provide an income guarantee enjoyed by no other industry, one based on booming farm prices and revenues. So generously supporting an industry is not the federal government's job.

The Congressional Budget Office estimates that spending on the shallow loss program would total $28.5

billion over 10 years, and payments would average $3.2 billion per year.[8] But this assumes that average commodity prices remain at or near current, record-high levels. If prices stay at the levels of the previous five years, then the program would cost slightly more than $3 billion a year.[9] But if prices subside to their average levels during the 1996–2011 period, taxpayers would be on the hook for $5 billion to $7.5 billion annually.[10] Shallow loss could essentially negate any savings gained from eliminating the current commodity programs.

The ARC program would likely propagate what in economics is known as "moral hazard" behavior: Taxpayer subsidies so heavily mitigate farmers' risk that they are incentivized to make imprudent farm management and planting decisions. Scholar Vincent Smith describes the perverse incentive: "To the farmers, the losses do not matter anymore; they have become the taxpayer's burden."[11] ARC would mean more wasted resources and inefficient production—hardly the goals of sound farm policy.

Shallow loss could also violate World Trade Organization (WTO) rules, because payments would be tied to crop production. The U.S. could find itself subjected to retaliatory tariffs imposed by a WTO trade-dispute panel. Brazil has subjected the U.S. to such retaliation because U.S. cotton subsidies disadvantaged its cotton industry and distorted trade. As a result of the settled dispute, the subsidies remain in place, but the U.S. also pays for a $147 million annual "technical assistance fund" for Brazil's cotton growers.[12] If similar cases arise for shallow loss, U.S. farmers would experience unnecessary setbacks as they try to increase exports, and taxpayers could wind up paying comparable retaliation tariffs.

The House Agriculture Committee will soon mark up its draft farm bill legislation. Like the Senate bill, the House draft legislation eliminates the current commodity subsidy programs. Even though the House scales back on its own shallow loss program, it introduces a new Price Loss Coverage option that is equally misguided and wasteful.

Replacing One Bad Policy with Another. To its credit, the Senate bill gets rid of flawed, archaic subsidy programs for crop production. However, its new shallow loss program would invite other problems, including distorting farmers' planting decisions and violating WTO trade rules. It would also shower subsidies on large, commercial farms and landowners, with far less going to the small family farms that advocates claim subsidies are intended to protect.

The best farm policy would be a clean elimination of the subsidies and avoiding the fatal flaw of replacing one set of costly, wasteful subsidies with another.

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