United States General Accounting Office 141688

GAO

Testimony

141688

For Release on
Delivery
Expected at
1:00 p.m. EST
June 28, 1990

Opportunities for Budget Savings in Domestic Agricultural Programs

Statement of
John W. Harman, Director
Food and Agriculture Issues
Resources, Community, and Economic
Development Division

Before the
Urgent Fiscal Issues Task Force
Committee on Budget
House of Representatives

048856/141688

Mr. Chairman and Members of the Task Force:

We are pleased to be here today to participate in your efforts to deal with the difficult budgetary decisions that lie ahead. As you requested, my statement focuses on the price- and income support programs for domestic agriculture. Specifically, I will be providing you with our views on several of the programs that we believe are candidates for reduced federal spending.

Current budgetary constraints and potentially negative impacts on consumers and international competitiveness have led us to increasingly question many aspects of current agricultural price- and income support programs. While we recognize that these programs can have some beneficial effects--including maintaining sufficient levels of commodity stocks--we believe that in general these programs deserve close examination from the Congress and the administration in light of current budget priorities to see if they are the most appropriate ways of achieving their goals.

My statement today focuses on three programs that we have studied in detail and believe should be reformed. These are the programs supporting the dairy, wool and mohair, and honey industries. Essentially, we found that these programs simply are not doing what they were originally designed to do. Thus, we believe they offer significant opportunities for decreasing federal spending--by about $1 billion annually. Substantially revising or eliminating these programs would not only reduce federal spending but would also foster a more market-driven agricultural sector.

In addition to the opportunities offered by the 3 programs I just highlighted, we are currently studying a range of related issues and may be in a position to make further recommendations on these in the future. These issues include work on the cotton, sugar and peanut programs as well as other agricultural issues like disaster assistance programs and credit issues. We are also examining budget strategies generally and, at your request, the effects of agricultural support and trade policies on consumers. When these analyses are complete, we will certainly make the results available to the Task Force.

Before providing you with the details of our analysis, let me briefly provide some overall comments on our work on agricultural issues.

BACKGROUND

For the most part, the information we are providing today is based on a body of work we have done since the enactment of the last farm bill--the Food Security Act of 1985. Revised every 4 or 5 years, the farm bill governs about $40 billion to $50 billion in annual federal spending and affects virtually all aspects of the nation's economy, including trade, the environment, rural development, and domestic social welfare. As such, the 1990 farm bill will be one of the most significant pieces of legislation to be developed this year.

The farm bill establishes policies and programs to help ensure the provision of a safe, reliable, and affordable food supply. The heart of the farm bill, and its most controversial provisions, are the farm programs that subsidize the prices of various agricultural commodities and the incomes of individuals that produce them. During the 1980s these programs have become very expensive and have been criticized in the Congress and by others for maintaining price- and income- support levels higher than those that would be received in the marketplace. The issues I am raising in my statement deal with the farm program aspects of current farm legislation.

MOVING TO A MORE MARKET-ORIENTED DAIRY INDUSTRY

Our work on federal dairy programs over the past few years shows that a more market-oriented approach can reduce the federal budget costs associated with dairy surpluses under current dairy policies. To achieve a more market-oriented approach, federal dairy policies need to be refocused so that the industry depends less on federal programs and can respond more to domestic and international market conditions. Depending on how this refocusing occurs, the federal government could reduce future spending by about $1 billion annually.

Federal involvement in the dairy industry began in the 1930s when low milk prices were perceived as threatening the nation's milk supply. A rather complex web of federal dairy policies has evolved over the past 60 years. Today, we have a set of programs designed to support dairy prices and producers' incomes, expand consumption, ensure an adequate supply of good quality milk, and stabilize dairy prices and markets. Two programs--milk marketing orders and dairy price supports--are the principal federal policies for this industry. Milk marketing orders regulate the pricing of milk that can be used for fluid consumption--called grade A milk--and other marketing practices in the areas of the United States where producers have voluntarily adopted them. Dairy price-supports stabilize milk prices by, in effect, guaranteeing a minimum price for any amount of certain dairy products that can be produced. Together, these programs work to support farmers' income.

Since the federal government first became involved in the dairy industry, the efficiency of milk production has increased tremendously. In addition, the price-support and milk marketing order programs have contributed to periodic surpluses by creating incentives to produce more milk than could be sold at prevailing prices. The price-support program does this by guaranteeing the purchase of all dairy surpluses. The milk marketing order program promotes surpluses by encouraging and maintaining locally produced supplies of milk even though grade A milk is produced in all regions of the country and technologies are now available to transfer it between regions as needed. During the 1980s, excessive milk production resulted in dramatic increases in government spending. Federal spending for this program grew from $251 million in 1979 to $2.6 billion in 1983. While in recent years spending has declined, for the 1980s as a whole government spending has totalled $17 billion.

Consequently, government policies during the 1980s have been primarily directed toward curbing milk production by reducing price-support levels, or paying producers to stop marketing milk and to slaughter or export their entire herd and leave dairy farming for a period of time. However, our analyses have shown that while the efforts to reduce surpluses through production controls have had some temporary success, they are not the solution for the long term. In addition, we have found that the dairy pricing policies established by the milk marketing orders are outdated. A more market-oriented approach to dairy programs would provide a more lasting solution to the chronic surpluses and reduce federal expenditures.

As we recommended in our February 1990 report, we believe that the Congress should increase market orientation by reducing federal involvement in the dairy industry[1]. This could be accomplished by the orderly phase out of the features of the milk marketing orders that are encouraging increases in milk production and by continuing the use of the supply/demand adjuster as outlined in the 1985 farm bill. Continuing to use the supply/demand adjuster would reduce

---

[1] Federal Dairy Programs: Insights Into Their Past Provide Perspectives on Their Future, (GAO/RCED-90-88, February 28, 1990).

price supports if surpluses exceed specified levels. Eventually, a market oriented dairy industry could reduce federal spending by about $1 billion annually.

Of immediate concern, however, are the legislative proposals in the House and Senate versions of the 1990 farm bill that, if enacted, would make dairy production less market oriented and substantially increase federal costs. The supply/demand adjuster as contained in the 1985 farm bill is working. However, as currently proposed, the supply/demand adjuster is prohibited from going below a floor price. Rather than letting the price go below the floor, the proposal envisions that alternative supply controls will be put in place to reduce production. We don't think this approach would provide an effective remedy. As we have previously reported, past supply control programs have only provided short term solutions.

REEVALUATING THE NEED FOR THE WOOL AND MOHAIR PROGRAM

Another area that offers an opportunity for reduced funding is the wool and mohair program. We believe that the Congress should reevaluate the need to continue this program in light of its high per unit subsidy costs and the lack of any significant achievements. Eliminating this program would reduce federal spending by about $100 million annually.

The federal government established a program to support wool and mohair prices in 1954 following a decade of dramatic decline in the U.S. sheep industry. Essentially, the program was established to encourage domestic wool production in the interest of national security. At the time, wool was a strategic material for the military. The program's other objectives were to encourage a viable domestic wool industry, a positive balance of trade, and the efficient use of the nation's resources.

Since it began, the program has provided about $2 billion in payments to about 115,000 wool producers and about 12,000 mohair producers. About 6,000 producers receive 80 percent of all payments made under the program.

Industry representatives and current studies contend that the program has assured producers of continued income, stabilized the industry, and helped slow declines in production. However, we initially questioned the effectiveness and the merit of the program in 1982.[2] As we reported at that time, despite $1.1 billion in wool payments from 1955 to 1980, U.S. wool production declined substantially from 283 million to 106 million pounds. While the wool program slowed the production decline and supported producers' incomes, it did so at a very high cost. In 1980 alone the government was spending $2.63 to $6.01 a pound to encourage production; but that year's average market value for wool was only $.88 a pound. In addition to being costly and having limited impact on production, the program was no longer justified for strategic reasons since wool had been removed from the strategic materials list in 1960.

In the updated study that we provided to you in March 1990, Mr. Chairman, we found the same problems as in our previous analysis.[3] The program is still not effective. Domestic wool production has continued to decline, reaching all-time lows in the mid-eighties. The program's cost for additional wool output in 1988 was $3.04 a pound, while the average market price was only $1.38 a pound. And, the program still is not justified as a strategic commodity.

---

[2] Congressional Direction Needed on Necessity of Federal Wool Program, (GAO/CED-82-86, August 2, 1982).

[3] FARM PROGRAMS: Wool and Mohair Program: Need for Program Still in Question. (GAO/RCED-90-51, March 6, 1190).

The justification for the mohair portion of the program is even more questionable because it has never had any specific objectives. Nevertheless, mohair producers received $50 million in 1989.

As a result of our analysis, our March 1990 report suggested that the Congress should reconsider the continued funding of this program. Although it has stabilized income and helped slow production declines, the program is expensive and can no longer be justified for national security reasons. Program costs vary yearly, but termination of the program in 1989 would have reduced federal spending by about $100 million.

PHASEOUT OF THE HONEY PROGRAM

The last issue I will comment on is the honey program. This program serves little public purpose but to raise the income of a relatively few producers at a high cost to the public. Accordingly, we think the program should be phased out. Doing so would reduce federal spending by about $40 million to $100 million annually, depending on the amount of honey production.

The U.S. honey program began in 1950. It is designed to stabilize prices and maintain sufficient bee populations for pollinating food and fiber crops. Since the program began, USDA has used nonrecourse loans to support honey prices. This price-support mechanism permits honey producers to forfeit their honey to the government as full repayment of the loan. These nonrecourse loans, in effect, assure producers a guaranteed minimum price for the honey they pledge as loan collateral.

The program supports relatively few producers. Presently, 2,000 commercial beekeepers--those who own 300 or more colonies--produce 60 percent of the annual average of 200 million pounds of honey. An additional 10,000 people are part-time beekeepers, and 200,000 are hobbyists. About 1 percent of all beekeepers--mostly commercial producers--participate in the program.

The honey program is no longer needed to ensure crop pollination because producers of crops requiring pollination can rent bee colonies or purchase their own. In addition, since the program began, beekeepers have generally emphasized honey production over crop pollination. The principal purpose of the honey program now is to support beekeepers' incomes, according to USDA.

Before 1985, the legislated price-support rate for honey resulted in a higher support price than both the import and the domestic market price. Accordingly, because producers could get higher prices from the government than they could in the marketplace, they were encouraged to forfeit their honey to the government instead of selling it. These conditions caused honey imports to increase. In addition, because of all the forfeitures, program costs increased from virtually zero in the 1970s to $164 million between 1980 and 1983.

The Congress tried to correct this problem in 1985 by lowering the price-support rate and allowing the Secretary of Agriculture to lower the loan repayment rate. These changes helped reduce government acquisitions of honey, and honey imports declined. However, overall program costs have remained high because the higher support prices that existed before the 1985 changes induced increased production. After initially declining through 1987, government costs increased to about $100 million in 1988, largely because of the largest honey crop in 5 years. Honey production will probably remain at a relatively high level because the price-support program still provides a very strong incentive.

In 1985, we recommended that the Congress repeal the Honey Price-Support Program and direct the Secretary of Agriculture to reduce the price-support incrementally to ensure an orderly phaseout of the program.[4] At that time, USDA agreed that the Congress should eliminate the program.

Nothing has changed since our earlier work to cause us to reconsider our recommendation. The program still serves little public purpose but to raise the income of a relatively few producers at a high cost to the public. We continue to believe the Congress should legislatively mandate a termination date for the program.

Mr. Chairman, before concluding, there are 2 other points I would like to highlight for you. As I mentioned at the beginning of my statement, we are now analyzing the budget in some detail--not just the agriculture budget--in response to a request from Senators Exon and Grassley. The focus of this more far-reaching effort is to identify and develop deficit reduction options. We plan to have the results of this analysis in the fall. I think you may find our results quite useful in addressing the somewhat daunting fiscal challenges that are now before the nation.
In addition to any savings available from agricultural programs, I believe that we also need to consider the impact of the commodity programs on consumers. In this regard, the 1987 Economic R ort to the President indicated that all USDA commodity programs were estimated to annually cost consumers from $4 billion to nearly $8 billion. While we have not updated those figures or verified their accuracy, we believe that it is useful to consider these costs as you proceed with your discussions in this area.

- - - - -

[4] Federal Price Support for Honey Should Be Phased Out, (GAO/RCED-85-107, August 1985).

Mr. Chairman, this concludes my prepared statement. My colleagues and I will be happy to answer any questions you may have.