POLICY PENNINGS

By Daryll E. Ray

Free-Market Ag Economists and Agricultural Markets: Premises and Results

Some, if not many, agricultural economists would like to see farm programs totally eliminated. They view these programs as archaic relics that have somehow survived their depression era beginnings.

Several lines of reasoning are used to reach a no-farm-program conclusion. One is that farming is now so much different from when the first farm legislation was passed. There are fewer farmers; agriculture makes up a much smaller proportion of the rural economy; agribusiness provides many of the inputs farmers, themselves, previously provided; and farmers are more highly educated and more adept at utilizing risk moderating devices such as futures markets, crop and revenue insurance, contracting and other methods.

Others believe that changes in the output markets, especially the export market, require eliminating any farm-program-caused price distortions that could jeopardize American price competitiveness in the world markets. They are adamant that price competitiveness is necessary to win sales from our export competitors and to ensure, short and long-term, export-driven farm prosperity.

For others, it matters not whether changes in agriculture or its markets have occurred. They staunchly believe that there never has been, and never will be, an acceptable justification for government intervention in agricultural markets. Citing the nicely sloping supply and demand curves of economics textbooks, they argue that to eliminate government intervention in the supply and demand of agricultural commodities is to let markets work, and work they will.

Free-market agricultural economists enthusiastically embraced the 1996 Farm Bill. To them, the 1996 Farm Bill accomplished a couple things. First, it moved agriculture closer to a "cash out" of farm programs. That is, closer to a fully decoupled farm program in which farmers' are given the cash equivalent of all farm program benefits with no strings attached. By doing so, farmers are free to adjust supply to market prices, unfettered by government rules or interventions.

Secondly, as passed, the 1996 Farm Bill sounded the "seven-year warning." Free-market proponents heralded the bill as the long-sought vehicle to transition agriculture away from its dependence on government price and income supports to unconstrained free-markets, and the cash out idea was part this. Thus, the cash out of farm programs, as portrayed by free-market agricultural economists, went beyond decoupling current benefits to include compensation for lost future farm program benefits—severance pay, you might say.

To me, the premises used to draw the free-market conclusions, some identified here and others not discussed, are wrong. Going in reverse order. Those who do not believe there is an acceptable justification for farm programs often view farm program benefits as economic rent—read undeserved goodies—that are extracted, some might even say extorted, from unsuspecting taxpayers. Are there areas of agricultural policy where political pull enhances or explains certain benefits? Yes, there are.

While "rent seeking" explanation is easy to trot out, to me the real justification for farm programs is the nature of agricultural markets. The total crop supply virtually does not respond to changes the overall price level. Demand is just as unresponsive to price.

So rather than the nicely sloped supply and demand curves that free-market economists assume for agriculture, the supply and demand curves are almost straight up and down. This means the composite price for all major crops can drop from $5 per unit to $1 per unit and the quantity supplied virtually does not change. Same deal for demand. The quantity demanded remains almost fixed no matter what the price.

In theory, price changes should force a self-correction on the market. If supply and inventories become large, the textbooks predict that the resulting lower price should cause less to be produced and more to be demanded. Inventories are rebalanced and price recovers. This works with those nicely sloped supply and demand curves in economics textbook but not in crop agriculture.

The other two groupings of free-market agricultural economists came to think during the export driven euphoria of the 1970s and mammoth changes in the structure of agriculture of the last couple decades that 1) the demand for major crops has become more responsive to price, more price elastic and 2) the supply of major crops has become more price responsive, more price elastic. The markets have spoken: neither is true.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of the UT's Agricultural Policy Analysis Center. (865) 974-7407; Fax: (865) 974-7298; E-mail: dray@utk.edu: Web Address: http://apacweb.ag.utk.edu/.

Originally published in *MidAmerica Farmer Grower*, Vol 17, No. 34, August 25, 2000
Reproduction Permission Granted with 1) full attribution to Daryll E. Ray and the Agricultural Policy Analysis Center, University of Tennessee, Knoxville, TN;
2) Copy of reproduction sent to Information Specialist, Agricultural Policy Analysis Center, 310 Morgan Hall, Knoxville, TN 37996-001