POLICY PENNINGS By Daryll E. Ray

Low Prices Here and Abroad: Are U.S. Subsides the Cause or the Result?

Over the years and especially the last few months, the U.S. has been accused of catapulting world agriculture into a state of depression. I say, guilty as charged! But, from my point of view, the indictment is based on the wrong evidence.

Farmers around the world, including the poorest of farmers in the developing world, have seen their prices and incomes plummet to new lows. Critics contend that the mammoth U.S. agricultural subsidies are to blame. While I would be the last one to defend such enormous subsidies, I think the critics have the argument backwards. The subsidies did not cause the low prices, the low prices caused the subsidies.

Their argument is that because subsidies are high, U.S. crop production has increased, causing prices to plunge. As logical as that sounds, that wasn't the way it happened, was it? No, what happened was that the dam holding back excess production and the floor that was supporting prices were demolished by recent farm legislation. Without the "dam" of annual acreage reduction programs and without the floor under prices, the U.S did indeed create price and income problems worldwide. The U.S. subsidies patched U.S. farmer income to resemble incomes that would have been received from the market before the wrecking crew destroyed the "dam" and jackhammered the price "floor." But patching U.S. farm incomes does nothing to the fix the price blowout experienced by farmers world-wide.

Yes, total U.S. acreage, and therefore total production, of the eight major crops has increased in recent years. Total acreage of corn, wheat, soybeans, cotton, rice, grain sorghum, barley and oats was up 5 million acres on average during 1996 to 2001 compared to 1990 to 1995. And no wonder. Annual set-aside acreage often hovered around 20 million acres during the earlier period.

Another thing that was effectively lost under the 1996 Farm Bill was the non-recourse loan program (earlier for some crops). Until recently, the non-recourse loan rate had a significant role in setting a floor on commodity prices as changes in CCC stocks buffered price fluctuations. The loan rate is still there, it just doesn't affect prices anymore. Prices go as low as excess production drives them which in recent years have been well below the loan rate. Now the loan rate is primarily used as a vehicle to dispense direct payments. Farmers receive 50 cents more in loan deficiency payments per bushel if the price drops $1.25 per bushel below the loan rate compared to $0.75 per bushel below the loan rate. Again, this helps U.S. farmers but the loan deficiency payments do nothing to help Ethiopian farmers. But neither, I would argue, did the loan deficiency payments and other "market-make-up" payments materially cause the low prices faced by farmers in developing or other developed countries.

Not that crop prices might not be a few cents higher if subsidies subsided. Sans subsidies, there easily could be one or two million acres of the country's least productive land that would go out of production. But land idling would be the exception not the rule. In general, cropland would stay in production with or without the recent subsidy levels. The price of land would drop, maybe a lot; and many of those now farming would have to hand their tractor keys over to highest bidders at farm sales. It definitely would be a rural America catastrophe. Outside the U.S., farmers may receive some price help but the increase likely would be inconsequential compared to price freefall they have endured over the last six years.

Clearly, the U.S. continues to play a dominant role in determining world crop prices. Otherwise, other countries would not be accusing the U.S. of sabotaging "their" crop prices.

To me, it is not a question of whether the U.S. is responsible for low world-wide crop prices. The question is how did we accomplish such a disgusting feat. While bloated U.S. subsidies may have been a contributing factor, the main reasons U.S. prices have fallen-and therefore world-wide prices have fallen-are because without set asides farmers max-out crop production and with loan deficiency payments there is no price floor. To my mind, it's really a "symptom" versus "root causes" distinction.

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