APAC Agricultural Policy Analysis Center
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PolicyPennings by Dr. Daryll E. Ray

Whence low prices? High payments or the lack of an effective throttle?

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When it comes to World Trade Organization negotiations, the recent Trade Disputes Panel ruling in Brazil's case against the US cotton program, the burgeoning deficit, and the desire on the part of many to move trade agreements forward, put agriculture on the front burner both domestically and internationally. The prevailing argument is that US crop programs as evidenced by high payment levels have artificially driven up US production sending prices into the basement. As a result many have called for the elimination of domestic support programs in developed countries, primarily the US and the EU.

These advocates anticipate that the elimination of domestic support programs in developed countries (US and EU) will lessen incentives to overproduce and thus open up import potential for others and eliminate or reduce dumping of under-priced exports onto international markets.

But suppose—after the programs are eliminated—total production and the overall price level of major crops remain virtually unchanged from current levels. Based on what we know about how agriculture operates, those results are exactly what would be expected.

There is little reason to believe that a reduction in farmers' revenue, whatever the source, would significantly reduce the cropland devoted to major crops. Farmers tend to farm all the land all the time. That is not to say that there would not be impacts.

Among the effects that would occur include: Acreages would switch among crops to eliminate any net return discrepancies caused by the government support programs. Land prices would plummet. Rural communities would deteriorate at a faster rate. Current farmers would carryout every financial maneuver they could think of to stay on the farm, but many would fail and turn their land and operations over to another owner and/or operator.

Over time, some of the least productive land would cease production but it would happen after several years and, since it is marginal land, its abandonment would have little impact on the total level of agricultural production.

Note that these results, though having significant domestic effects, would be of little help to the farmers in developing countries. Neither the configuration of farmers who operate US farms nor the health of rural US economies is of concern to farmers in Africa or Brazil.

Farmers in developing countries are interested in how eliminating or reducing support payments would affect their prices and incomes. And the answer is: Very little. Any adjustment in land use and production would be too slow and too small to achieve the degree of price enhancement that WTO, policy makers, and farmers in developing countries have been led to expect.

This does not mean that current US farm policy is blameless. Far from it. Excess production and fire-sale prices did not occur because farmers responded to payments and increased production. It occurred because the US no longer has the means to throttle its ever expanding productive capacity or to establish a floor on commodity prices.

Acreage set aside and effective price supports are no longer part of the current US farm program so all of agriculture's productive capacity is used all the time. Predictably, when additional production from the acreage—that would have been set-aside in previous legislation—flooded the market, prices were driven below formerly-available price-floors. Once the land was brought back into production, it remained in production.

In the longer-run, it is the expanding size of agriculture's productive capacity that has the most depressing effect on prices. The most striking conclusion of all this is that, given the nature of agricultural markets and the mammoth and likely accelerating growth in productive capacity, a subset of the domestic programs that the WTO and others have worked hard to dismantle may be ones needed to prevent dumping and to achieve politically acceptable price levels and stability, especially in developing countries.

If those or other programs were reinstated, most of the issues concerning government payments would be mute. Government payments don't influence total crop production much no matter what. But payments also would be de-emphasized if more price-oriented policies were implemented.

With regard to the longer-run pervasive reason for excess capacity, it would be unwise to seriously consider reducing or eliminating expenditures on programs that increase agriculture's productive capacity. It is essential to keep well ahead of maximum demand needs not only for this generation but generations to come and the best way to do that, given the relatively long cycle time for research, is to continue to invest in technologies that push productive capacity ever larger.

It is the use of that productive capacity that is in need of attention. In any other business setting, it would be unnecessary to point that out.

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