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

How to really disrupt international agricultural trade, now and in the future

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If you really want to mess up agricultural trade, let the supplies run low. Over the last decade or so, we have repeatedly been told that subsidies are the major problem in the distortion of agricultural trade. The current situation would suggest that subsidies are the mole hill and unpreparedness for short supplies and sky-high prices is the mountain.

By lumping all agricultural support programs together and pushing for their elimination, we may have thrown out the baby with the bathwater. We would be the first to admit that export subsidies and the marketing loan program distort agricultural markets and harm producers in other countries—witness the extremely low crop prices in following the adoption of the 1996 Farm Bill.

The same legislation that was designed to make US agricultural policy more market responsive also made ineffective provisions that enabled the government's role in holding grain reserves. With the marketing loan program, farmers no longer need to forfeit their grain to collect the difference between the loan rate and a lower market price. They can both collect their Marketing Loan Gains/Loan Deficiency Payments (MLG_LDP) and keep title to the grain.

Along with Liam Dunne, an economist with Teagasc, the Irish Agriculture and Food Development Authority, we believe that the elimination of reserve programs is linked to the current crisis in international grain and oilseed markets.

As he wrote in the Independent (http://www.independent.ie/business/world/going-against-the-grain-with-a-global-cereal-reserve-would-stabilise-prices-1325874.html): "Explanations for the large and unexpected increases in food prices in recent times are manifold. They include a combination of the ongoing shift to Western-type diets in China; the diversion of grain to bio-energy production; and drought in a number of the larger grain-producing countries.

"But there are more fundamental issues at play here, including declining international grain inventories and the global move to freer trade.

"The dissipation of international food stocks, particularly for grain, is the primary cause of the sudden and sharp increases in the prices of cereals and milk."

By failing to take the importance of food seriously, policies have been put into place that leave the provision of grain reserves to farmers, speculators, and other commercial enterprises.

The problem with that logic is that private enterprise has no incentive to hold stocks of grains and oilseeds in anticipation of a major supply or demand disruption; these disruptions are too unpredictable. In addition, futures markets provide the kind of price protection and profit potential that commercial enterprises need without all of the hassle associated with holding physical quantities of grains and oilseeds over long periods of time.

The last time we had a major demand disruption was the mid-1970s (WWII was the time before that) and the last time we had a major world supply disruption was 1995. Only governments interested in providing a stable supply of food for their citizens have the societal and political incentives to hold stocks in the face of unpredictable disruptions in the supply of grains and oilseeds.

In the absence of these reserves during a period of tight supplies, we see governments around the world enacting other policies to make sure that their citizens are not priced out of the market for essential food ingredients. Some have increased export taxes, while others have restricted exports.

We believe these actions have done far more to disrupt international agricultural markets than a well-managed program of stock reserves would. The current turmoil strongly suggests that the presence of a well-managed reserve program to help stabilize markets for grains and oilseeds would provide long-term benefits to both producers and consumers.

Liam Dunne concludes his piece in the Independent by suggesting that the cost and responsibility for maintaining a reserve be shared by the international community in proportion to each country's production/consumption of agricultural staples.

Producers should not want prices to be this high!! Because, as sure as night follows day, sky-high prices will cause production increases on a mammoth scale. The same inelastic demand that has caused prices to shoot up will cause prices to be shot down. As the song says "It's just a matter of time."

Foodstuffs are not like computer parts or manufactured goods. Consumers can handle disruptions in manufactured goods, but they need to have a supply of food on a daily basis.

The arguments against establishing reserves seem particularly irrelevant in the current context. The top arguments are:

1) Don't worry, the commercials will carry stocks for times like these;
2) Don't worry, if the usual supplier of food and feed can't fill an import order, there are plenty of other countries that can;

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3) Public reserves cost too much (compared to what—in the U.S. annual storage costs would average millions not the billions of dollars per crop the US spends on the current program, much of which would be recouped including interest when sold on the market in times like these);
4) Reserve stocks put downward pressure on prices (compared to what—LDPs?); and
5) Reserve stocks put a lid on "high" prices that interfere with the "produce more" signal to producers (depends on where you set the release price—prices over twice the cost of production in the non-reserve case cause great price and income damage later on).

This gets us back to the trade argument. If you really want to mess up international agricultural trade, take away all policy mechanisms that ensure that the feeding of countries' citizens comes first and in the case of exporting countries provide reasonable quantities for export customers. Taking those mechanisms away creates short-run and long-run problems.

In the short-run, international trade is disrupted by export limitations, imposition of or increase in export taxes, if not out right embargoes. In some countries not engaging in such market interference means starvation, malnutrition, or food riots, not to mention political upheavals.

In the longer run, such experiences foster a distrust of international markets as a reliable means of securing food and feed. When international markets prove to be undependable at the very time they are needed the most, it makes an indelible impression.

During times of tight supplies, food sovereignty, food security, and food self-sufficiency tend to move way up on the priority list of society in general and politicians in particular. At the same time, the economic efficiency arguments of static trade theory are less likely to resonate as strongly.

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