Farm or Agribusiness Policy?

Let me ask you something. When General Motors contemplates production cuts because of bloated inventories, which do you think receives the most weight in the decision making process: a) the impact on GM's thousands of parts suppliers, b) the impact on GM's hundreds of car dealers, c) the impact on its share of the domestic or export market, or d) the impact on GM's profits and returns to its stockholders?

Can you imagine the thrashing that the CEO of General Motors would receive by the financial press and the drubbing that GM's stock would experience if he even hinted that any of a) through c) would now dominate GM's decision making?

It's not that General Motors does not recognize that down-stream and up-stream sectors are affected by its actions; it most certainly does. But its decision making approach, or private policy rules, puts GM's interests above all else. General Motors responds to reduced consumer demand by producing fewer vehicles. GM's parts suppliers, in turn, reduce output in response to lower derived demand for parts.

It is in GM's interest to reduce output since GM is large enough to influence the price of its products. General Motors knows that it is better off to nearly hold the line on car prices by reducing output rather than allow vehicle prices to fall precipitously by ignoring demand conditions with full-production assembly schedules.

Switching production from pickups to sports utility vehicles works fine if pickup demand has dropped and the demand for SUVs is growing. But having production flexibility does GM little good during a time of general oversupply of all types of vehicles.

A major reason the U.S. instituted commodity programs in the 1930s was because, unlike GM, individual agricultural production firms (farms) are unable to affect the supply of their product and therefore influence the price it brings. Recognizing that farmers have no incentive but to produce on their land, even when prices are low, legislation was put into place that provided public policy mechanisms similar to the private policy prerogatives of a firm like GM.

As we have previously explained in this space, the fundamental nature of crop markets is virtually unchanged from six decades ago—that is, neither total crop supply nor total crop demand are any more responsive to sharp price drops today than they were in the 1930s.

But over the last decade or more, farm legislation has seemed to gradually embrace a "do agribusiness no harm" posture. Beginning in the 1980s, the agribusiness bias, as manifest by policies to maximize export volume and market shares, was relatively obscure. It became more apparent during the debate of the 1996 Farm Bill when agribusiness actively lobbied for the elimination of farm policies that reduce the volume of crop production such as set-asides and the Conservation Reserve Program. The discussion often focused on the impacts that crop acreage reduction programs have on local businesses like grain elevators and ag-chemical and equipment dealers. If crop agriculture supply really is more price responsive with farmers using "private policy rules" to reduce acreage and production, wouldn't the effect on agribusiness be nearly the same as if the Secretary of Agriculture, acting as the CEO of U.S. Agriculture, used "public policy rules" to reduce acreage and production?

From my perspective at least, the reason for considering the use of farm programs is because the market fails, in a timely manner, to adequately adjust total crop quantities supplied and demanded in response to sharp price movements. In contrast, agribusinesses can adjust operation size just like most other sectors in the economy when profitability wanes or sales volumes decrease.

Even though non-farm industries can and do use "private policy" to adjust production levels in response to demand declines, the use of this same approach via "public policy" for agriculture has been stigmatized. In its place we have adopted a policy of producing at full tilt with government payments that are used to compensate for prices that are well below the full economic cost of producing the products. This approach, in contrast to the standard method used in the private sector of reducing production, forces little adjustment on the tonnage of inputs sold and the tons of output processed and transported by the agribusiness sector.

Crop agriculture does not have to receive multi-billion dollar subsides to be profitable. If, like General Motors, production levels were better gauged to meet demand at prices that cover their full economic cost (and more in the case of GM), crop farmers could receive about the same income they presently receive, but from the market rather than from government payments. And, just like GM's parts suppliers and dealerships, agribusinesses would have to adjust to the reduced volumes.

Since crop agriculture could obtain its income from the market without government payments if public production-level policy toward crop production mimicked private production-level policy as practiced by non-farm industries, a couple of questions come to mind. Are the billions and billions of federal dollars subsidizing farmers? Or, are they really subsidizing agribusinesses, livestock integrators and our export customers with prices that do not reflect the full economic cost of producing the grain?

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