Strengthening anti-trust laws is important but falls short of solving long-term farm problems

We ended a recent column on strengthening anti-trust laws writing: “Will this solve all the economic-challenges farmers face? No, but making agricultural input and output markets more robust is a part of the equation” (https://tinyurl.com/y4d7bb28).

Reflecting on the late winter attention Iowa received from Democratic candidates and their support of the strengthening of anti-trust laws, our reader writes, “What this all boils down to is that antitrust is usually presented, implicitly, at least, as an adequate solution for the problem of low prices. So, they ask: ‘Why do we have cheap farm prices?’ They answer: Lack of antitrust.’ They ask, ‘How do we get fair prices?’ They answer, ‘Adequate antitrust’….

“Today, it seems to be that the various agribusiness sectors actually often have 60 percent or more share for the top 4. Implied [in this argument] is that some lesser share would give crop farmers fair prices. What lesser share? Would 10 percent share for the top 4 give fair crop prices? 5 percent?”

Our reader is writing with tongue in cheek because he knows the answer. He continues: “It seems to largely leave out the question of the lack of price responsiveness, and the major causes for that.… Yes, ‘making agricultural input and output markets more robust is a part of the equation.’ We need the rest of the story.”

On the input side of the crop production equation, breaking up monopolies in the seed, and farm chemical industries should have the positive impact of reducing the variable cost of production. Similarly, breaking up machinery giants would result in increased competition for sale of these products and lower fixed costs.

Reducing input costs and the amount they need to borrow from the bank and the level of financial risk farmers need to take when they plant their crops: a positive in the farm financial management equation. But these anti-trust actions would have little to no impact on ensuring that farmers receive a crop price that covers the full cost of production.

Likewise, breaking up the grain merchandising giants might increase the price a crop sells for by a nickel or a dime here or there, but it would not guarantee that the price level covers the full cost of production.

So why, if we take these important actions, do they not result in profitable prices for crop agriculture?

The answer can be found in the economic characteristics of extensive land-based crop agriculture production as well as food consumption—characteristics that economists and policymakers know about but often choose to ignore when they countenance various agricultural policy proposals.

When it comes to crops and food, the issue is one of price responsiveness to low prices. For many products, but not food, the response to low prices is increased consumption. With low prices, people purchase more Christmas lights they use to decorate their homes and yards.

With food, in response to low prices people may purchase a more highly processed food product, but the total amount of food they eat, and purchase remains relatively the same. Surplus production is not removed from the marketplace. As a result, prices remain low.

Economic theory predicts that in response to low prices farmers would quickly reduce production. But that does not happen, especially the "quickly" part.

Crop farmers have high fixed costs relative to variable costs, so as long as farmers have the hope that the price will be above the variable cost of production they have every incentive to put in a crop because the income above variable costs can be applied to the fixed costs of inputs like land and specialized machinery that has few uses other than agricultural production.

With little price responsiveness on both the production and consumption sides of crop agriculture, farmers experience long periods of low prices, punctuated by short periods of high prices. These short periods of high prices are triggered either by temporary crop production problems or a short burst of demand from an unexpected source.

While farmers do not reduce production very much in response to low prices, they do respond to high prices by increasing production. They shift pasture and other acreage to higher priced crops and in general pile on additional fertilizer and other yield-enhancing inputs. The result is that high prices kill high prices and one way or another, prices decline to a level less than the full cost of production.

As a result, some farmers with limited capital reserve may be forced to sell their equipment and either sell or lease out their land. While low prices may reduce the number of farmers, they do not reduce the number of acres that are in production.

When it comes to crop agriculture, anti-trust action with regard to farm input firms and farm product merchandisers will reduce input costs and provide a more competitive market for crop production, but these actions do not change the low price elasticities of either the production or consumption of crop-based food products.

As Paul Harvey said on his radio program between 1976 and his death in 2009, "And now you know…the rest of the story."

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