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

What happens when WTO sees agriculture as just another industry?

The Doha round of trade talks foundered on agricultural issues because those involved failed to understand the deeper issues surrounding food and agricultural production and instead attempted to impose a cookie cutter approach to the issues.

There are many layers of discussion that can be pursued concerning the Doha round of the World Trade Organization (WTO) and agriculture.

For farmers in developed countries like the US, one is the need for protection against long periods of low prices. Certainly this issue, which is the one that we will focus on in this column, was not communicated that directly by most US farm groups, but the size of and the nature of payments under the newly passed 2008 Farm Bill would suggest that income stability-the fear of low prices-was at the top of their concerns.

The WTO trade negotiators and many who write about or analyze proposed WTO trade agreements, fail to understand that the economics of total crop agriculture is different from the economic sectors most often portrayed in economics textbooks.

In the textbook paradigm low prices do indeed cure low prices. If the market overproduces widgets, the price drops, consumers purchase more widgets, producers make fewer widgets, and a profitable equilibrium price is re-established-the market works its wonders. Many of the products included in the WTO negotiations work just that way, but not in the case of the agricultural market in total.

When prices drop precipitously, people do not increase their food consumption from three to four or five meals a day. They will, so to speak, eat higher off the hog, but the aggregate consumption of food will remain relatively stable. There will be reduction, even in the short-run, of grains used for feedstock for livestock and other uses but not by much compared to the price drop. From the demand side, markets do not quickly sop up excess supply to help in the restoration of a market equilibrium that covers long-term costs of production.

At the same time, crop farmers have a narrow window of time in which they can get their crop in the ground. Farmers have little choice but to grow something whether prices are high or low, in hopes that by the time they market the selected mix of crops some 5 to 17 months later the price will have recovered.

In the worst-case scenario, they will plant as long as the expected price is above the variable cost of production. Any extra money above these costs can be applied to the fixed costs.

Unlike with widgets, low prices do not induce crop producers to produce less crop output in total. They produce about the same volume, which offers little to no improvement in prices but keeps incomes low and causes the price of land and other fixed capital items to plummet-output volume continues, land prices plunge. In fact, they hope that they have a record crop so they have more bushels to sell and they don't complain if there is a crop failure somewhere else in the world that will help lift prices.

At one time there was a Blue Box in trade negotiations that allowed for payments made to manage supply by reducing production and storing accumulated surpluses that could then be released in times of an increase in demand or a production failure.

But in a market-will-solve-all environment, supply management and storage programs fell into disfavor. Soon negotiators began to try and take Amber Box payments and get them classified as Blue Box-no one was fooled by that sleight of hand.

By failing to recognize that for the last hundred and fifty years and for the foreseeable future, agriculture's basic problem is characterized by a supply that exceeds effective demand resulting in long periods of low prices. These low price periods are punctuated by two different kinds of price spikes.

The most common price spike is brought on by bad weather or a crop disease, resulting in a short crop. These usually affect prices during a single season. The second type of price spike is demand driven. The current run-up in prices is an example of this. Corn users were concerned about the dramatic increase in the demand for corn by current and future ethanol plants. Demand spikes can last

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for three of more years until supply catches up with the increased demand.

This multi-year run-up in prices has occurred several times before and while crop farmers enjoyed the ride up it did not last. It was the same old story-a few years up and many years down.

US farmers have surrendered a number of policy instruments over the last couple of farm bills. But they are unwilling to completely sever the payment programs that have replaced the inventory management programs of the past-programs that now backfill low prices with government checks.

By treating agriculture like any other industry, not as the uniquely different industry that it is, the expectations of WTO negotiators for the Doha round were stymied.

But extended periods of low farm prices is only one of many elements that characterize agriculture and food's role in international life that seem to have been inadequately considered in the Doha negotiations-things to analyze in the weeks ahead.

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