APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Periodic farm bills assume short-term economic conditions will persist into the future

In this series of columns, we are looking at three polarities that policy analysts are aware of as they examine various proposed farm policies. In the previous column (http://agpolicy.org/weekcol/746.html) we looked at the difference between microeconomic analysis and macroeconomic analysis and how that might put farmers who use the microeconomic tools they were taught in operating their farms at odds with policy analysts who can ill-afford to ignore the macroeconomic environment in which farmers, as a group, seek to maintain profitable operations.

The second polarity that agricultural policy analysts must deal with is long-term vs. short-term thinking and trends. Because much of what lies in the future is often foggy, the normal tendency is to assume that tomorrow is going much like today, except that we will be a day older, and, most of the time that is not a lot of difference.

The still-recent mini-depression that we continue to climb our way out of provides us with a lesson in the difference between short-term planning and long-term planning. For many people holding stocks, the trauma of watching the value of those holdings decline by nearly 50 percent was too much to bear. Just as the market was approaching the bottom, the short-term view was grim. No one knew where the bottom would be, so many investors switched from stocks to bonds, locking in the losses.

Those who took a long-term view—and had some time before they needed the earnings from their investment—remembered that even the Great Depression ended and stocks eventually recaptured their losses and continued the upward trend with a hiccup here or there along the way. By taking a long-term view of the situation, they ended up far better off than they would have been if they had sold near the bottom.

As members of Congress makes policy, they tend to extrapolate the present economic conditions into the future and then design policies that protect farmers from relatively minor deviations from the status quo. This short-term extrapolation does not take into account the long-term historical dynamics that producers face.

Thus, when prices are high at farm bill time, the tendency of Congressional leaders and many others is to assume that we have settled in on a new norm and the greatest problem that farmers face is year-to-year variation around a profitable price. In that situation the major goal is often to smooth out the variation.

But consider the long-term view. If we make policies that gild the lily of high prices and then prices experience a multi-year decline, farmers are in serious trouble. As a result, the worst time to make agricultural policy is when prices are at their highest, because decision makers and their supporters do not take the downside risks seriously.

On the other hand, consider the situation when prices are low at farm bill time. Even if Congressional leaders and others take a short-term view and design policies to address chronic low prices, and prices go up there is no problem. The policy instruments remain unused. Farmers enjoy the higher prices and taxpayers benefit from lower expenditures.

To provide balance to the tendency of policy makers and advocacy groups to focus on the short-term—the life of the next farm bill—policy analysts need to direct much of their attention to an examination of the long-term trends and risks that agricultural producers face. Key among those risks is long periods of low prices, punctuated by shorter periods of rapidly increased demand and the resulting high prices.

When the war is over (WWI and WWII), when the petro-dollars run out and the loans get too high (the 1970s), or when demand is filled and supply once again increases faster than demand (the ethanol boom), producers are faced with higher input costs—input prices increased when prices were high—and commodity prices that fall below the cost of production.

We cannot count the number of times that we have been told that our analysis does not take into account the dynamics of the "new era in agriculture," but in our lifetimes we have experienced several claims of "new eras in agriculture" and they have all ended badly. Likewise, we cannot count the number of times that we—and farmers around the globe—have been told by others that corn prices have reached a new plateau north of $4.00/bu. and low prices are no longer a problem. At this point in late-November 2014, the nearby futures price of corn is in the mid-$3 range with local prices well below that. Taking a long-term view of the historical data, it was clear that this would happen and that prices could get worse. The only thing that was unclear was when it was going to happen.

Barring weather or disease problems for the 2015 crop, prices could remain low for a period of time.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). Harwood D. Schaffer is a Research Assistant Professor at APAC. (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu and hdschaffer@utk.edu; http://www.agpolicy.org.