APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Commodity policy choice: Treat the symptoms or address the cause of low crop prices

When it comes to developing policy prescriptions to deal with the dynamic of long periods of low prices interrupted by much shorter periods of high prices, two approaches are possible: one approach provides symptomatic relief and the other treats the cause of low crop prices. One must choose one approach or the other.

If policy analysts develop and policymakers adopt public policies that treat the proximate cause of low prices—the presence of a supply that exceeds demand—there is no need for symptomatic relief. On the other hand, providing symptomatic relief (to short term price disturbances when prices are high and little relief when prices are low) ultimately becomes very expensive and risks losing public support for agricultural programs when farmers need them the most.

For many years, agricultural economists understood that agriculture was different from many other sectors of the economy in that an oversupply of grain and oilseeds and the ensuing low prices did not bring about a timely self-correction in agricultural markets. Low crop prices did not cure low crop prices within a reasonable time frame.

In other sectors of the economy, low prices cause suppliers to reduce their production of the item in excess supply and consumers to increase their purchases. The result is that supply and demand come back into balance at a profitable price level quite quickly. This timely self-correction does not occur in agricultural commodity markets.

Because they understood the dynamics of the market, policy analysts worked to develop policies that would isolate a portion of the supply from the marketplace, bringing about a balance between supply and demand and the return of prices that kept producers in business. To keep from accumulating ever-larger isolated stocks, policies were also developed to reduce production to allow demand to catch up with production.

Understandably, farmers were often frustrated with these policies. And from the perspective of an individual farm operation this made sense. If they had been allowed to produce more they could have earned more, they reasoned. And that is true for an individual farm. But when all farms seek to increase production, the result is an oversupply that drives prices downward for everyone, and the size of the decline in prices is greater than the increase in production.

In recent years, policy makers and many agricultural economists have simply chosen to ignore these dynamics and instead argue against policies that manage supply. In place of traditional supply management policies, they have advocated for policies that use crop insurance to protect farmers against variations in prices—symptomatic relief.

The problem is that these policies only work well when prices are at or above the cost of production. If prices remain low for an extended period of time, farmers end up paying premiums for policies that do not even cover the cost of production.

We understand that farmers do not want to hear this kind of analysis; they would rather hear about booming export demand, a growing ethanol demand, and a new "price floor." When we are invited to speak to farm groups, producers come up afterwards and emphatically say, "I don't like what you are telling me!" and then they continue, "But I needed to hear that." When prices were high, many economists were telling farmers that there was a new price floor undergirded by increased input costs.

During this period, we continued to tell farmers about the low prices that would come when the yearly increases in ethanol demand began to stagnate and supply continued to increase. We cautioned farmers to put some of the increased profits in the bank instead of buying lots of new machinery and driving up the price of land. Today, some of those who talked only about high prices and a new plateau are saying to farmers, "I hope you put some money away during the good times." Good advice, but a couple years late.

The trend in recent decades is toward policies that tend to provide producers with little income support when prices are low for an extended period of time. As a result, the associated costs of maintaining a vibrant agriculture can actually be more costly to U.S. taxpayers through emergency programs/payments. Failing that the results could be devastating to a large swath of farmers. For farmers in less developed countries, lower prices have severe consequences. When price are low in countries where agriculture is a large portion of the economy, the impact on the economy is severe.

The challenge of policy analysis is not to design public policies that make the good times even better; rather it is to have policies in place to help protect farmers during the long periods of low prices. Over the last century, the periods of low prices have been much longer than the boom times.

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