

Trade Liberalization Expectations And Other Issues

Daryll E. Ray

University of Tennessee
Agricultural Policy Analysis Center

**Agricultural Trade Liberalization and the Least Developed Countries
H. E. Babcock Workshop organized by Cornell University, Wageningen University,
and the African Economic Research Consortium
Wageningen University, Netherlands
December 3, 2004**

Introduction

- **Problems caused by current US farm policy**
- **Logical solution may not deliver expected result—if premises are false**
- **Two major components of commodity policy**
- **“New era” expectations**
- **Chronic price and income problems in Ag?**
- **Is the Green Box really Green?**
- **Some alternatives and final comments**

Problems? What Problems?

- **US commodity prices plummeted**
- **Lower US prices triggered low prices in international ag commodity markets**
- **Accusations of US dumping**
- **Countries in the South unable to neutralize impacts of low prices**

The “Obvious” Source and Solution of these Problems

- **Source:** Billions of dollars spent on farmers, up to \$25 billion in US alone
- **Result:** Overproduction and depressed prices
- **Solution:** Eliminate or greatly reduce government payments
- **Logical Expectation:** Problems solved

While Logical, Reasoning Is Based on Two Premises

- **US overproduction was occurring because of high government payments**
- **Doing away with payments will cause production to decline substantially**

But it is not that simple

- **Expanding agricultural productive capacity is a long-time US public policy**
- **Farmers do not always react as expected**

US Policies That Expand Productive Capacity

- Land distribution
- Experiment Stations and Extension
- Land Grant Universities
- Credit and infrastructure

These are major US public-policy interventions in agriculture markets

Farmers Produce at Full Productive Capacity

- **Productive capacity not usually fully-used**
- **But in agriculture it is, because:**
 - **A farmer cannot influence supply**
 - **Banding together has not worked in past**
 - **Farmers readily adopt new technologies as means to reduce costs in the hope of increasing income**
 - **Land stays in agriculture even as operators go bankrupt and are replaced by other operators**

In the U.S.—historically—there have been Two Major Components of Farm\Commodity Policy

- **Policy of Plenty: Ongoing public support to expand agricultural productive capacity through research, extension and other means**
- **Policy to Manage Plenty: Mechanisms to manage productive capacity and to compensate farmers for consumers' accrued benefits of productivity gains**

We Have Dropped the “Managing Plenty” Part

In the past farm policies included:

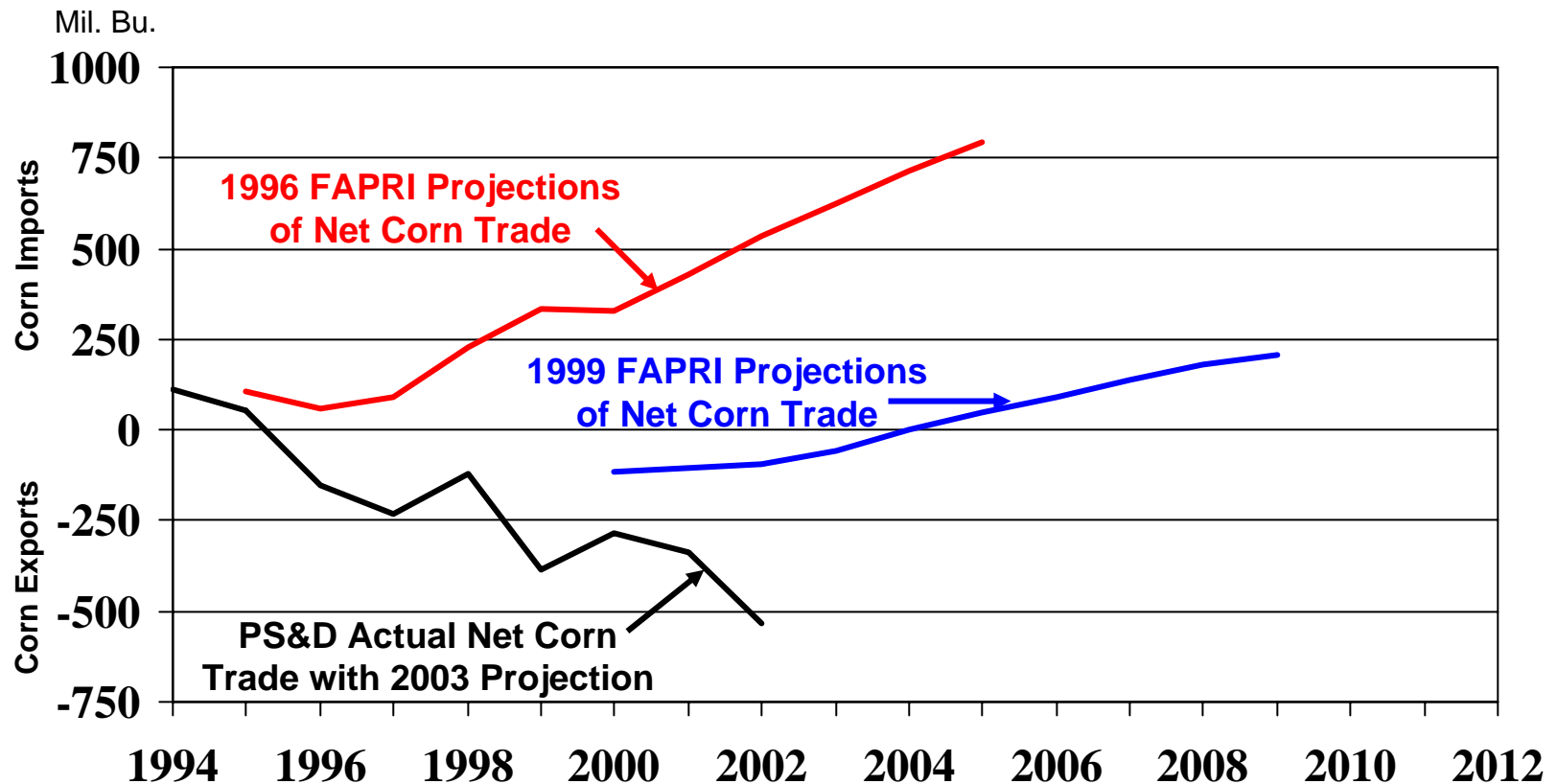
- Floor price
- Supply management tools
- Price stabilization

Over the years and especially since 1996:

- All three were eliminated because of expectations—expectations that:
- Exports would drive agricultural growth and prosperity, besides that...
- *If markets are allowed to be allowed to work agriculture will do just fine*

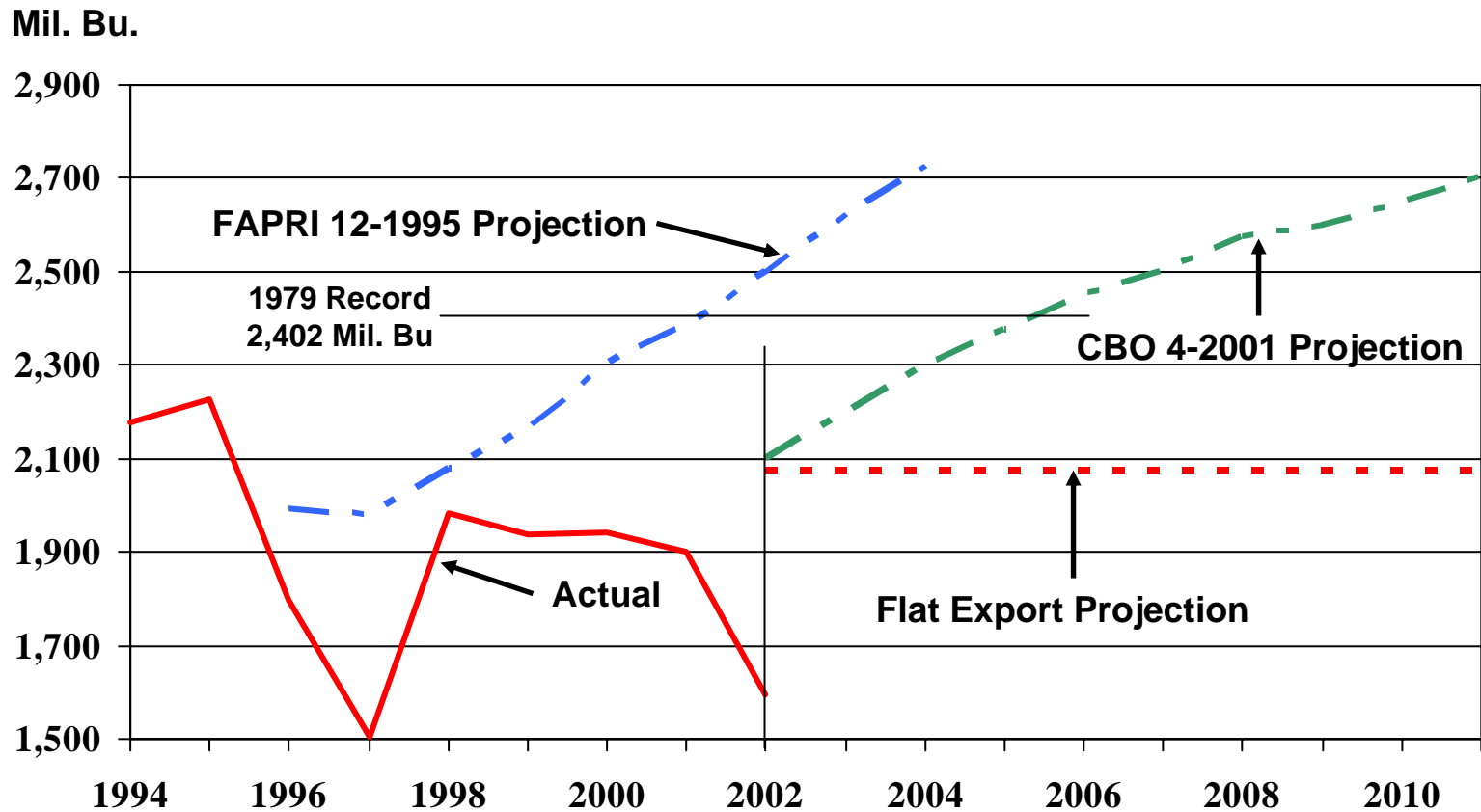
China Net Corn Trade

Comparison between 1996 and 1999 FAPRI projections and PS&D actual

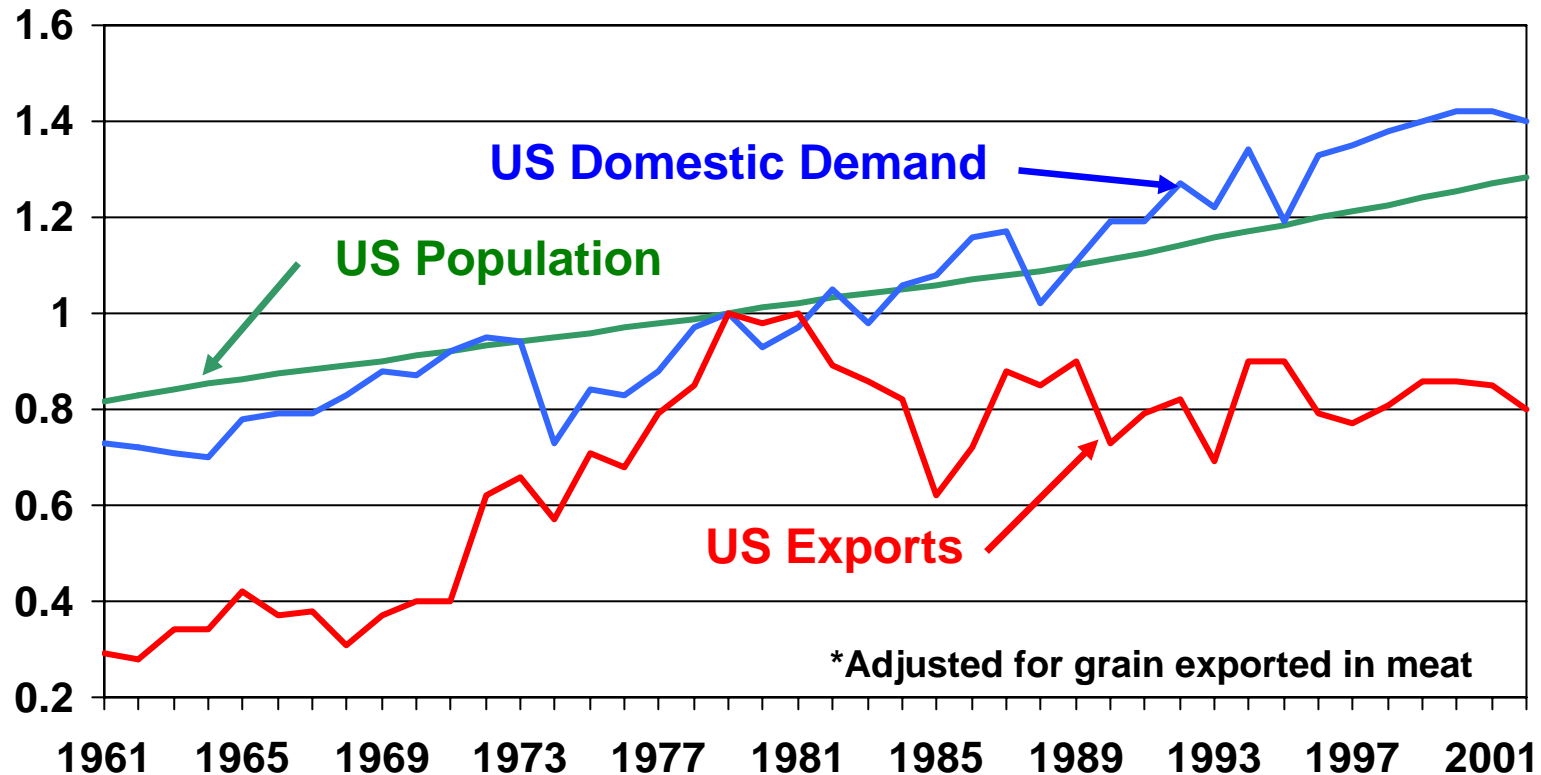


Corn Baseline Projections

U.S. Exports



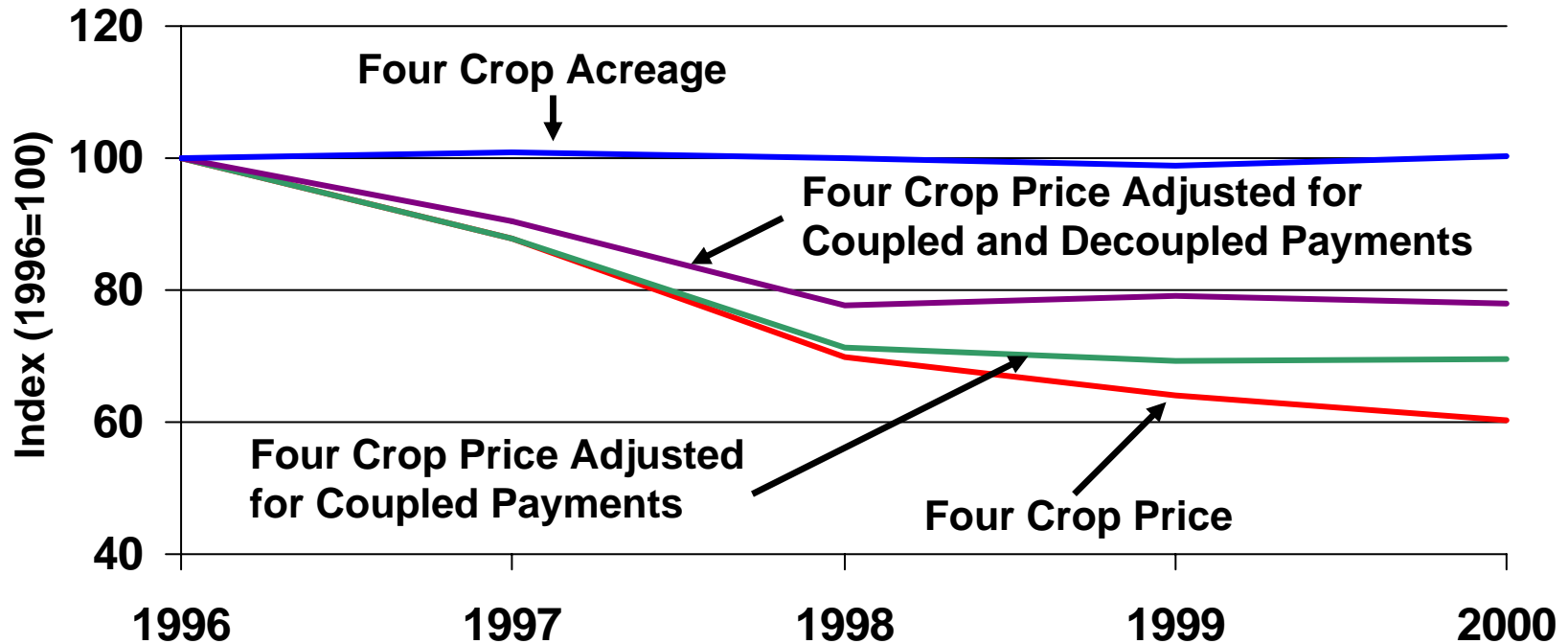
Exports Did Not Deliver



Index of US Population, US Demand for 8 Crops and US Exports* of 8 Crops
1979=1.0

- Exports have been down to flat for last two decades
- Domestic demand increases steadily
- Since 1979, exports have **NOT** been the driving force in US crop markets

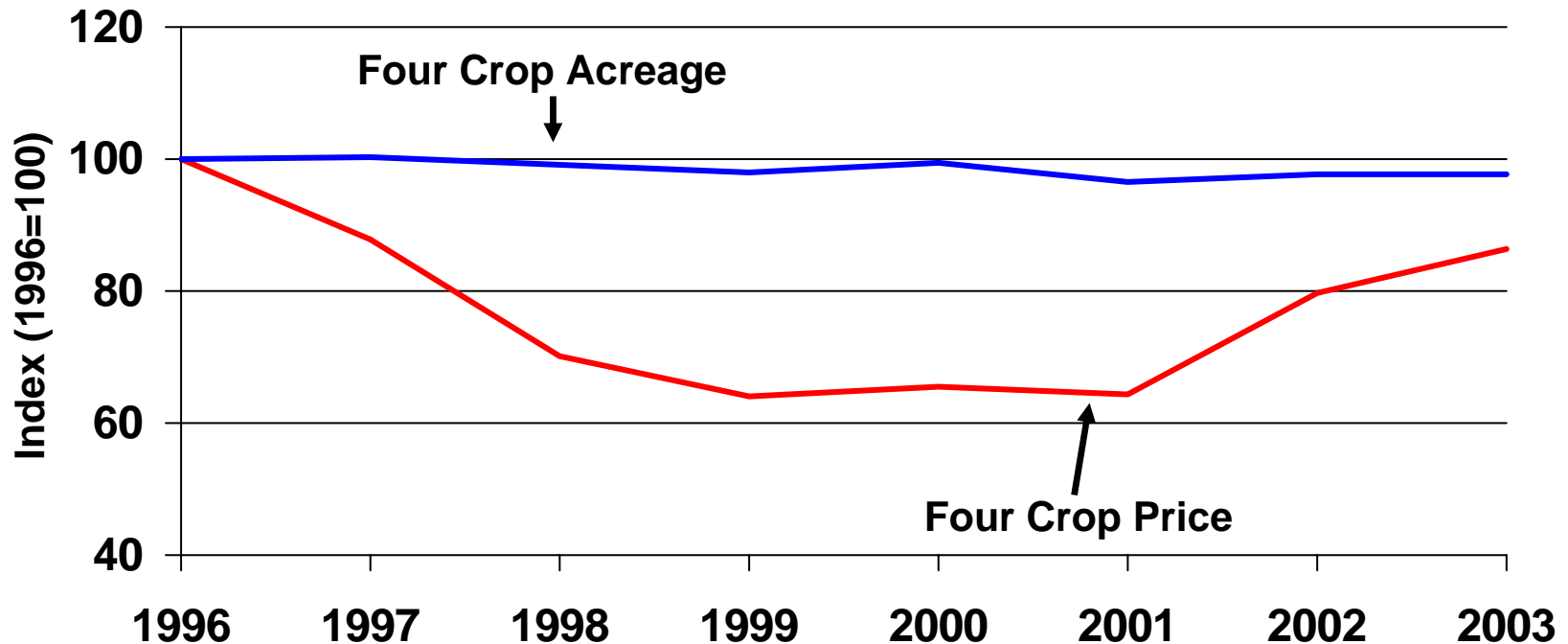
Acreage Response to Lower Prices?



Since 1996

- *Aggregate US corn, wheat, soybean, and cotton acreage changed little*
- *While “prices” (take your pick) dropped by 40, 30 or 22%*

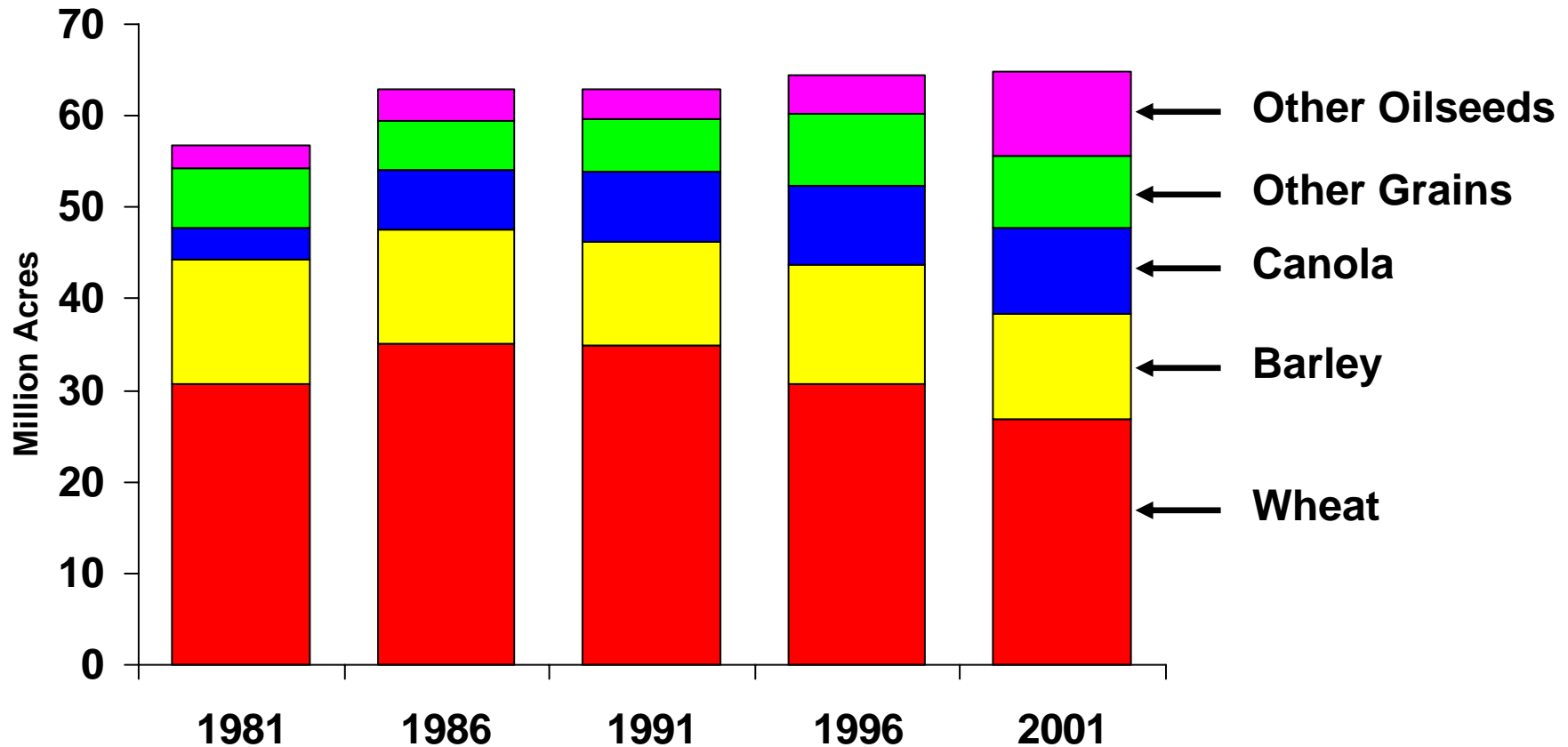
Acreage Response to Lower Prices?



Since 1996 "Freedom to Farm"

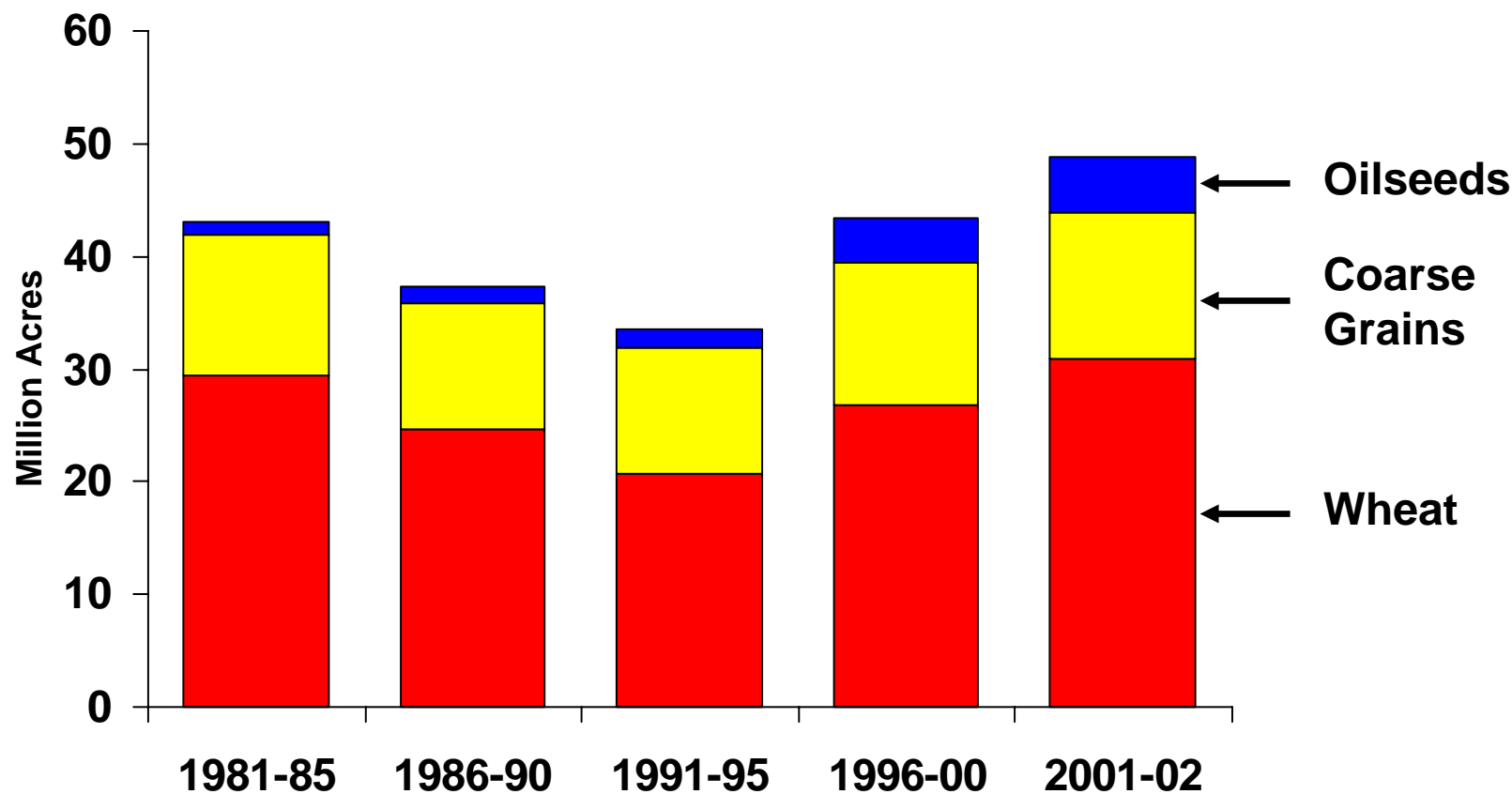
- *Aggregate US corn, wheat, soybean, and cotton acreage changed little despite a wide fluctuation in price*

Canada: Farmland Planted



- Canada reduced subsidies in 1990s
- Eliminated grain transportation subsidies in 1995
- Crop mix changed, total acreage remained flat

Australia: Farmland Planted



- Australia dramatically reduced wool subsidies in 1991
- Acreage shifted from pasture to crops
- All the while, prices declined

Chronic Price and Income Problems in Agriculture—How Could That Be?

- **Technology expands output faster than population and exports expand demand**
- **Prices decline and the magic of the market causes self-correction but in agriculture...**
- **Little self-correction on the demand side**
 - People will pay almost anything when food is short
 - Low prices do not induce people to eat more
- **Little self-correction on the supply side**
 - Farmers tend to produce on all their acreage
 - Few alternate uses for most cropland

Picking Back up on the Earlier Question

- **Will eliminating US commodity programs cure low worldwide prices?**
 - The preceding would suggest the answer is no
- **There would be impacts...**
 - Land prices, rural communities, operator changes
- **But these US changes do not put money in the pockets of farmers in developing countries**
- **So what are we saying here?**

Overall, Which Policies Have Pushed Prices Down the Most

- **US public policies that expand productive capacity**
- **Ditto other countries**
 - Infrastructure
 - Subsidized inputs at farmer and/or multinational collaborator levels
- **In comparison US commodity programs depress prices by relatively little** (Depends on levels, configuration, etc.)

Implied Analysis Issues

- Eliminating “pillar” problems will not cause supply and demand curves to snap to free market positions
- All government policy shifts in supply and demand are analytically equivalent
- Apply what we teach in welfare economics

Policy Alternatives

- **Do away with policies that expand productive capacity**
 - Very short-sighted; not advisable
- **Do away with existing subsidies**
 - Won't accomplish goals
 - But could be changed since existing policies...
 - Are of no help to crop farmers: US and worldwide
 - Those that benefit are the users of agricultural commodities because they do not pay full cost of production:
 - Large livestock producers
 - Agribusinesses: input and machinery, processors, marketing and retailers
 - Importers
 - Consumers, if marketing system transmits lower prices

Policy Alternatives

- **Repackaging of policy instruments used previously (short-run)**
 - **Assumes US is a major determinant of crop prices**
- **Combine agricultural and energy policy (intermediate-run)**
- **Multinational cooperation (longer-run)**

1. Traditional Policy Instruments

- **Supply Control**
 - Short-term
 - Long-term (Continuation of Conservation Reserve Program)
- **Farmer-Owned Reserve**
- **Price Supports**

But More Is Needed

- **Create a fresh, bold policy vision that catches people's imagination and is farmer-centered**
- **I think the time is right for a merging of agricultural and energy policy**
- **Energy could/should be the next soybeans**
- **A way to absorb excess capacity in place of set-aside**
- **More than ethanol and biodiesel**

2. Merge Ag and Energy Policy

- **Biofuels recycle atmospheric, not fossil, carbon**
- **Look at crops not in food equation & NOT internationally traded**
- **Switchgrass (as an illustrative example only)**
 - **Perennial**
 - **Reduced inputs**
 - **Multi-year setaside**
 - **Burned in boilers for electricity**
 - **Converted to ethanol**
 - **Less costly than present ag programs**

3. Multinational Cooperation

- **International supply management program**
 - **Major Crops**
 - **Three or more major exporters or producers**
- **Storage program with a price stabilization objective**
- **Humanitarian Food Reserve**

Final Thoughts

- **What if the past combinations of developmental and compensation policies have been free market superior?**
- **Economists should not selectively ignore market interventions in their analyses**
- **But beyond that—are we slaves to aggregate welfare measures?**
- **Is trade liberalization an end or part of a means?**

Thank You

Agricultural Policy Analysis Center

The University of Tennessee
310 Morgan Hall
2621 Morgan Circle
Knoxville, TN 37996-4519

www.agpolicy.org

