A common misconception: Farm operations are no different from non-farm businesses

In arguing that farm operations are no different from other local businesses on the Main Street of towns across the country and thus ought to be treated the same, critics of farm programs ignore some very real differences. Two weeks ago, we examined the price responsiveness of agricultural commodity markets (http://tinyurl.com/h3chwo2). We discussed the reasons that low commodity prices neither induce consumers to purchase more food nor cause farmers to cut production to any significant degree. The result is that farmers face long periods of low prices interspersed with brief periods of high prices.

Last week, we pointed out that crop farmers tended to use 100 percent of their capacity all of the time (http://tinyurl.com/jzf3oj9). That is quite different from the industrial firms that used 76.7 percent of their production capacity in 2015. Even when one farmer gives up a lease on a field, there are often five others standing in line waiting for a chance to pick up that lease. In addition, agricultural land cannot be used by another industrial sector to return to agriculture when prices are higher. Once a field sprouts a housing subdivision, that change is permanent. Economists call this the fixity of resources.

Before moving on to other topics in the next column, we want to identify other crucial differences between the typical farm operation and the business on Main Street. Most businesses have a range of products and/or services that they offer while crop farms typically have a small range of choices of what they can grow.

The vast majority of crop farmers produce a commoditized standardized product—number 2 yellow corn, number 2 yellow soybeans, number 2 hard red winter wheat, etc. That means that the corn produced in Kansas is put into the commodity stream along with corn from Iowa and Illinois. They are competing with farmers across the nation and around the world.

It is true that farmers can gain a price advantage by producing for a niche market, but get too many farmers entering that niche market and the price premium quickly disappears.

By way of contrast, Main Street firms selling the same or a similar set of products or services can differentiate themselves from each other on the basis of the personality of the owner or salesperson, location, product selection, or quality of service. They develop a loyal customer base and a niche whether they recognize it or not.

Both farmers and Main Street business owners have little control over the cost of the inputs they purchase for their business. They both generally face a limited number of suppliers. The difference comes in terms of the number of customers. Farmers typically have few customers and their price is figured off the futures market. They have little leverage in getting a better price unless they are willing to ship their product to distant markets, and even then the choice is limited. Farmers are price-takers on both the supply side and the demand side of their business.

Another difference is that farmers face a technology treadmill that is fiercer than the one faced by the average business firm. In general, there are a small number of farmers who quickly adopt a new technology that often increases total production, having the effect of reducing the per unit cost of production thereby either reducing their losses or increasing their profits.

As more and more farmers begin using this technology, supply increases and the extra profits are lost. By the time most of the farmers are on board with the technology, the early adopters are implementing another new technology to maintain their cost advantage.

The result is lower food costs for consumers and increasing consolidation in the farming sector with a small number of farmers getting larger and larger and most farmers supplementing their farm income with two jobs in town—one for each spouse.

In summary, looking from the outside it might seem that farming is no different from any other product-producing business. And it is true that all businesses are subjected to outside forces over which they have no control. Typically, businesses and their consumers react to those outside forces by quickly adjusting output and consumption and thereby rebalancing supply with demand at profitable prices.

But farmers, consumers and the major-crop sector in general react much differently to outside forces, especially outside forces that cause "over-production" relative to the quantity demanded. Resources used to produce major-crops tend to be fixed, or trapped, in agriculture. Couple the slow adjustment in agriculture's resource-use—which translates into slow adjustment in total crop production—with consumers lack of willingness to adjust consumption, and the result is relatively long periods of "low" prices.

The Heritage Foundation and others use changes in census numbers on the size of farm operations, number of farmers, the comparison of farm-family income with non-farm family income and other such metrics to argue that now agriculture can fend for itself. But those metrics are irrelevant.

The relevant evidence that crop agriculture can fend for itself would be that total-crop agricultural supply and demand quantities now respond quickly enough to cause prices to rapidly bounce back to total cost of production levels. We are unaware of such evidence. In fact, the reaction of farmers and crop demanders to the plunge in crop prices of late suggests that the supply and demand of the total major-crop sector are as unresponsive to declining prices as ever.

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