

Policy Pennings by Dr. Daryll E. Ray

Financial and food crises shock one and all—even revered policy wonks

It is amazing how a crisis forces people to re-think long held beliefs. In the case of the financial crisis, we see in testimony before the House Committee on Oversight and Government Reform that former Federal Reserve chairman Alan Greenspan admitted, "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief."

As the New York Times reported in an October 23, 2008 article by Edmund L. Andrews, "Mr. Greenspan admitted that he had put too much faith in the self-correcting power of free markets and had failed to anticipate the self-destructive power of wanton mortgage lending."

Similar sentiment was put forward with regard to the food crisis by former President Bill Clinton at the United Nations World Food Day, where he was the keynote speaker.

He said, "We need the World Bank, we need the International Monetary Fund, we need all the big foundations, we need all the governments to admit that for thirty years we all blew it, including me when I was President.

"We blew it! We were wrong to believe that food was like some other product in international trade."

Clinton went on to draw some conclusions from the current food crisis that resulted from commodity price that peaked this summer as well as the recurrent food crises that plague many countries in the rest of the world.

Like Clinton and Greenspan, we also believe that some lessons can be drawn from the current crisis, particularly the food crisis.

First, the extremely low prices we experienced in the period beginning with the 1998 crop were brought about by a deliberate change in policy in the US.

With the adoption of the 1996 Farm Bill during the Clinton administration, the established floors that had been put under program crop prices for over six decades were removed.

The explicit goal was to increase the US's share of world grain and oilseed markets by allowing the price of these commodities to fall to world levels without recognizing that the US price was the world benchmark price. The US's export competitors routinely price their exportable surplus—that is, quantities not needed for domestic consumption—relative to this benchmark price. That is true regardless of the price level.

The 1996 Farm Bill allowed this benchmark price to fall below what used to be a policy-established floor. We saw prices plummet within two years after the passage of the new legislation.

US farmers received large Loan Deficiency Payments (LDP) and, at first emergency payments and then "counter cyclical payments," to offset price levels that at times fell below farmers' out-of-pocket costs of production. Government payments often exceeded net farm income in some states and on many farms.

During the post 1996 Farm Bill period we witnessed periods when the nation's farmers of the time became more dependent on the federal government for their net income than anytime in their farming careers.

In addition to the unprecedented level of government payments to crop agriculture—which would not have occurred with the application of farm programs that were in effect for the previous half-century—the policy-generated disruptions to the livestock sector and other grain and oilseed users via highly subsidized prices for these inputs were also unprecedented.

Farmers in developing countries were the most negatively affected by US policy-generated market disruptions.

In the absence of support programs or even their governments' ability to provide support, farmers in the developing countries were, in many cases, devastated by the low price regimen that resulted from US policy decisions in 1996.

The failure of the 1996 Farm Bill was its treat-

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ment of "food like it was some other product in international trade" instead of recognizing that given reasonable weather conditions overall food prices can remain low for long periods of time, punctured occasionally by a spike driven by a weather event or more rarely by a sudden shift in demand.

Second, the low prices result from what some would term "overproduction" and "overcapacity" and in other industries that would be true. But, food is not like some other product. We need to maintain a growing productive base to meet the needs of a world that is projected to have more than 9 billion people by mid-century.

We always need to maintain degree of overcapacity to be able to meet challenges that result either from weather or sudden changes in demand.

There is a need for policy to deal with short-term food emergencies and policy to keep our productive capacity way ahead of needs. But there also is a need for policy that adjusts the use of productive capacity to real world conditions.

Can you imagine the reaction you get if you tried to convince other industries that they should not throttle the use of their productive capacity to meet demand conditions? In other industries, the firms are large enough to individually affect industry supply, and/or only produce products when orders come in, and/or produce highly distinguishable and differentiated products. Crop-commodity agriculture has none of these characteristics so the "throttling" requires a coordinated effort, usually available only at the federal government level.

Third, and this is a point Clinton made several times in his speech, developing countries need to be allowed to strive for a measure of food self-sufficiency through the growing of their staple crops, be it rice, wheat, corn, or cassava. The growing of staple crops often needs to be a priority over the growing of crops for export.

While the growing of export crops like cotton and roses by some growers makes sense, the growing of staples needs much more emphasis and technical support than it has received in the past 30 years.

Fourth, we need to implement policies that provide both a floor and a ceiling for agricultural commodities. The floor price protects farmers from long periods of low prices, while the ceiling price protects consumers from price spikes that result from weather events or sudden shifts in demand.

At times over the last 30 or 40 years, we have

had policies that established such a band. An examination of the data shows that during this time the markets did a good job of responding to price signals. And we have learned something from the 1996 Farm Bill-the management of production does not have to be done crop by crop, aggregate acreage will work just as well as farmers respond to prices in the allocation of acreage to the various possible crops.

Despite the emphasis on free trade over the last seven years, export volumes of farm program crops did not expand much even when prices were near or below variable costs of production. Similarly, current agricultural policies resulted in less international trade during this time of food crisis than would have occurred had the reserve stock programs of years past been in effect.

A number of countries felt they had no choice but to take measures designed to protect their own population from high prices and shortages. Trade advocates were incensed that countries would do this. But why would we expect countries to do anything else?

As we have said most countries deal with food as a national security issue because food is different. When there are no formal grain and oilseed reserve programs to draw on during times like these, countries will protect the food needs of their population ahead of exporting to others.

International trade is extremely important. In no way should the importance of international trade be minimized, but neither should it have priority over, or trump, a country's desire to feed its own people.

As Clinton said food is "not like color TVs."

As Congressional leaders said in the Greenspan hearing, as a result of the current crisis we need to rethink the role of sensible regulation in the financial markets.

Similarly, we think that as a result of the current food crisis we need to rethink our approach to agricultural policy and international trade remembering that "food is not like other products in international trade."

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