PolicyPennings by Dr. Daryll E. Ray

Earning a living from the marketplace

Recently, we have been at meetings where we have had the chance to hear presentations by people who view agriculture and agricultural economics differently than we do. Listening to them has caused us to ponder the question of how we can look at the same data and come to such radically different policy conclusions.

Agricultural economists have long known that the price elasticity of food on both the demand side and the supply side is very low. Translated from economist-speak, what that means is that when aggregate farm commodity prices are low, consumers, livestock feeders, and industrial users of these commodities do not increase their utilization enough to sop up the "excess" production.

Similarly, when prices drop, crop producers do not cut back on their production in the same ways that other industries do. We have described a number of reasons for that behavior in previous columns, so we will not repeat those here. Interestingly, animal production-with its livestock cycle-that traditionally has been more price responsive than crops now appears to be less price responsive than it used to be as the result of the integration and consolidation of the industry.

In the early 1980s, with the rise to dominance of the supply-side, market oriented, anti-government-involvement style of economics that was espoused during the Ronald Reagan era, we began to see colleagues argue that-because of the increased importance of exports-agricultural demand had become more price responsive and that domestic agricultural supply was also becoming more price responsive because farmers were using more purchased inputs.

There is the old saying that "time reveals all," and it certainly has never been more true than in the last 25 to 30 years. It turns out that exports provide little buffer when prices decline. And, even with purchased inputs, crop producers are no more price responsive when it comes to total crop acreage than when they were using manure and saved seeds.

As a result, most of our colleagues are now more willing to admit that there is a low price elasticity on both the supply and the demand sides of the economic transaction. With little price responsiveness, prices tumble, farmers quickly face a serious financial problem and the usual orderly market self-correction is thwarted. In economist-speak, we call this a "market failure."

While we are willing to use the term market failure in describing aggregate crop agriculture, many of our colleagues are unwilling to use that language, not because it is not true, but because they do not want to deal with the policy implications of diagnosing aggregate crop agriculture's situation as a market failure.

Farmers, on the other hand, have long recognized that there is a market failure in crop agriculture, though they don't use that term. What we have heard them say over and over again is they would rather earn their livelihood from the marketplace than the mailbox-a metaphor for government payments.

From our perspective, farmers are correct. The only justifiable rationale for farm programs is to correct the market failure so that markets can work better, allowing farmers to earn most of their livelihood from the marketplace. By taking excess production out of the marketplace and inducing farmers to reduce production, farm policy can provide an arena in which supply and demand come closer to balancing out while at the same time protecting consumers during periods when supplies are short.

Because many of our colleagues are unwilling to admit that a market failure exists, they are constrained when it comes to developing policies for times when prices are in a long, low trough.
Not wanting to intervene directly in the marketplace, they seek other ways to keep large numbers of farmers from going belly-up. As a result, in the US we have direct payments, marketing loan payments, counter-cyclical payments, ACRE payments, and heavily subsidized insurance programs.

The discussion in the US and European Union is centered on income support and not on helping farmers manage production when prices are low. In their thinking there is no need to provide a reserve to assure domestic and export customers of adequate food and feed quantities when supplies are thin relative to demand.

Policy makers in the US and around the world will be at this impasse as long as there are those who believe that "the government is the problem." As long as they believe that, they will not utter the words "market failure" and will end up supporting welfare-type payments for which there is less economic justification than dealing directly with the root of the problem.

Farmers would rather receive their income

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Originally published in *MidAmerica Farmer Grower*, Vol. 29, No. 39, September 25, 2009
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from the marketplace than government programs. Admitting that a market failure exists and designing programs that will provide a context in which the markets will function more efficiently will allow farmers in the US and around the world to earn most of their income from the marketplace.

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). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.