Δ **Contact Dr. Daryll E. Ray** at the UT's Agricultural Policy Analysis Center by calling (865) 974-7407, faxing (865) 974-7298, or emailing dray@utk.edu.
For more info, visit: www.agpolicy.org

Financial And Food Crises Shock One And All – Even Revered Policy Wonks

DR. DARYLL E. RAY
Agricultural Economist
University of Tennessee

It is amazing how a crisis forces people to rethink long held beliefs. Looking at 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 the1996 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.

Arguably, we have witnessed during the post 1996 Farm Bill period the greatest and most disruptive government intervention in agricultural markets since the 1930s.

In addition to the unprecedented level of government payments to crop agriculture – which would not have occurred with the application of farm programs 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 going all the way back to the beginning of this country.

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 treatment 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 a degree of overcapacity to be able to meet challenges that result either from weather or sudden changes in demand.

There must be policy approaches to deal with short-term emergencies and on average to keep our productive capacity way ahead of needs – but adjust productive use to real world conditions.

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.

The importance of international trade should not be minimized but neither should it have priority over the food needs of developing countries.

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, when faced with a food crisis, a number of countries took 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 act any differently?

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 have no real choice but to choose protecting the food needs of their population ahead of exporting to others.

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 the place of food in international trade, remembering that "food is not like other products in international trade." Δ