Recent Trade and Agricultural Policy: Tough Questions about the Market and Policy for Agricultural Trade

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The ultimate test of a set of economic ideas. . . is whether it illuminates the anxieties of the time. Does it explain problems that people find urgent? Does it bear on the current criticism of economic performance? . . . Does it bear upon the issues of political debate? For these, though many have always preferred to believe otherwise, do not ignite spontaneously or emerge maliciously from the mouths of agitators to afflict the comfortable.
--John Kenneth Galbraith, Economics & the Public Purpose, 1973

INTRODUCTION

The efficiency model and, by extension, academic programs by economists such as us have continued to assert (while claiming objectivity), "Trade is good; protection is bad; trade agreements that reduce protection are good." The question I think we must begin, if belatedly, to ask is "For whom?" The purpose of this paper is to look back at the historical reality of so-called free markets, the reality of how markets actually function, the apparent result of government involvement in the agricultural sector of the economy, and a look ahead at what is likely to occur in the coming decade.

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A general review of trade data suggests, just as many of us predicted, that major trade agreements such as NAFTA and WTO have resulted in increased trade. With a review by commodity, however, the story gets a bit more confusing. Then, looking at net farm income, two points become obvious: (1) government support has greatly increased; and, (2) the market contribution to net farm income has declined. Recollections of many well-intentioned academic and industry analysts' forecasts pre-NAFTA or pre-WTO or pre-FAIR Act of 1996 are to the contrary: (1) government support would decline; and (2) the market would more than compensate for the loss of government support; and (3) with reduced government intervention, efficiencies would be captured by the industry.

A closer examination of government support suggests an apparent distributional inequity of payments to participants. An examination of market structure and the composition of productivity and sales shows see that concentration has continued among both farms and agribusinesses. Is it any wonder there is a populist backlash against such policies as recent trade agreements and farm bills?

BACKGROUND

One of the most enduring success stories of economic education is the concept of the free market: that the free market as a self-regulating institution is real, it exists (at least in the US and Western economies of the free world), and it is good. Those basic truths are taught not only in the classroom, but extended to producer meetings and even adopted as gospel in the business popular press.

Agriculture has long been touted as one of the last bastions of the free market: many buyers and sellers, each operating in their own best interest, unfettered by government intrusion, will move resources to their most efficient uses, with the result being market nirvana where consumers and producers are better off. While reality has suggested these characteristics are in fact questionable, most have held to the pretense of a free market, or at least it is a noble goal for which to strive. And the dismal failure of centrally controlled markets, stand as the clear point of reference as to why free markets are the "obvious" choice. If there were indeed market forces or external forces at work challenging the free market, these free marketeers would say it is the government's job to intrude in ways to approximate the free market or move the market in that direction.

When there were 6 million US farms, or perhaps even 2 million farms, actively engaged in providing food and fiber for domestic and global markets, perhaps it was reasonable to provide government funds and government protection. As we enter a new century, however, there are 200,000 to 300,000 farms providing most of the food and fiber produced in the US. The trend toward concentration of resources in production, processing and distribution raises questions about the intent and outcome of government involvement in the sector.

HISTORICAL & PHILOSOPHICAL REVIEW

In 1776, Adam Smith gave the world the paradigm-shifting concept on the glory of free markets and the caution that state-regulated economies would fail. While his message of the advantages of "unfettered" markets has been generally accepted, his additional caveat about the need for some government oversight is seldom promoted or even recalled. Free markets as self-regulating markets have become to goal to which most democratic societies strive. The toppling of the Soviet centrally controlled economies in the latter half of the Twentieth Century proved Smith right on his caution about state-regulated economies. Karl Marx in the 1800s and Karl Polanyi in the 1940s focused on the importance of economic institutions on lives and livelihood and warned of the failure of self-regulated markets. To date, no dramatic event similar to the Soviet demise has taken place to prove Marx and Polanyi correct. However, the non-existence of any self-regulating market economies speaks volumes. In fact, the real contribution of Polanyi in introducing the concept of "the protective response", has largely been ignored, at least by mainstream economists. His explanation of the artificial "disembedding" of the market from the social and cultural fabric is worthy of study, review and application to today's conundrums.

The hope of free marketeers over the past two centuries has been to reduce the interference of government in market activities with the twin goals of efficiency and profit maximization. Less or no regulation, less or no government oversight, less or no taxation, less or no barriers are the oft-spouted desires of the free marketeer. What occurs in reality, however, are requests and demands from the same group of marketeers for government to intervene when markets are threatened by nature or competitive forces or other nation's intervention. This protective response is testament itself to the perceived failure of self-regulating markets. With the transition to self-regulating markets, threats of harm or harm in fact occur to economic agents and the social and political institutions in the system.

The only thing certain about self-regulating markets is destruction; they are brutal. In their wake, fortunes are made and lost, cultures are worn down, and progress of a kind occurs. Conservative economist Joseph Schumpeter referred to the process of creative destruction, or the destructive gales of capitalism. In judging such change, beauty, as it is said, is in the eye of the beholder. The logic of Schumpeter suggests that, if what precedes a self-regulating market is perceived as backward, then the introduction of a self-regulating market can accelerate the pace of change (called progress), not only economically, but necessarily socially and politically. However, Polanyi explains that institutions, if they desire to remain unchanged (traditional), must fight and actively resist. Often, this leads to other forms of the protective response. This can be governmental, such as tax breaks for churches and nonprofit organizations, support programs for farm families and selected businesses, anti-trust exemption for cooperatives, trade protection or subsidy for various sectors or commodities, and other rent-seeking rewards.

Or, the protective response can be non-governmental, such as unionization, private or communal sharing and gifting, bartering, etc. The existence of the protective response negates the self-regulating market. In fact, it suggests proof for the practical impossibility of the sustainability of so-called self-regulating markets. Also, it sets in motion the ongoing antagonism and conflict: "free" marketeers and government are in perpetual battle; also, there is ongoing conflict between "free" marketeers and any organized action such as unions or consumer awareness groups to counter the so-called "destructive gales" and pro-self-regulating market governments wage battles with much of the public who feel threatened.

Consider development of the economic concept of market failure as one of the few attempts to recognize that self-regulating markets do not work. And, the prescriptions for resolution of market failure are precisely forms of the protective response. To be specific, these are the commonly identified examples of market failure (for example see Hackett):

1. Monopolies, cartels and market power
2. Externalities
3. Common-pool resources and public goods
4. Imperfect information

5. Differences in fairness, equity and distributional justice (there is some debate on this point being included in the list).

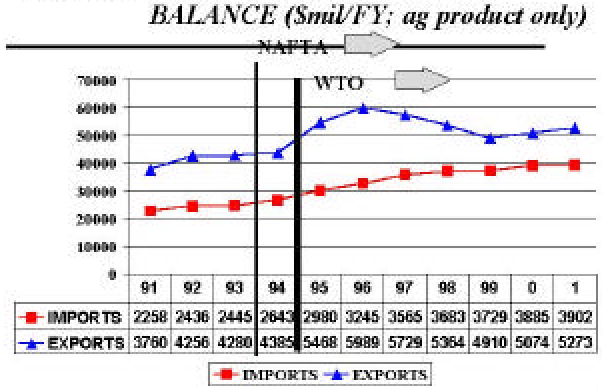
In fact, all examples of the protective response are the result of the certain failure of the self-regulating markets. The market, free or otherwise, is a human artifact. There is nothing sacred or holy about it. It is simply an institutional mechanism, maintained and revised by human intervention. When it is free, we can praise its automatic nature, or we can criticize its brutal impersonality. When it is rigidly controlled, we can praise its certainty and fairness, or we can criticize its tyranny of dogma and anti-efficiency. By training, economists tend to want to worship the ideal of the free market, and what often distinguishes us is not whether the free market is real or good (it is assumed it is both) but rather how much government intervention is needed to fix market failures so as to approximate a free market.

Another factor to consider is the organic nature of self-regulating markets. Specifically, they must adhere to the Second Law of Thermodynamics–entropy (see Goergescu-Roegen for application of this concept to economics). They are necessarily in an evolutionary state of decay, going from more to less order, from less volatility to more volatility. What makes humans unique in nature is their (our) creative and intellectual capacity to adjust to change with institutional mechanisms. Thus, the protective response to the certain entropy and failure of self-regulating markets is the development of institutional mechanisms. If these mechanisms are governmental, they are called public policy. Thus, policy areas such as agricultural policy or environmental policy or trade policy are simply ways to discuss the protective response in these respective areas of the economy.

WHAT THE DATA TELL US

Trade Picture. A general review of agricultural trade data, as noted earlier, suggests that major trade agreements such as NAFTA and WTO have resulted in increased trade. Figure 1 shows that both US exports and imports have increased since the implementation of NAFTA and WTO.

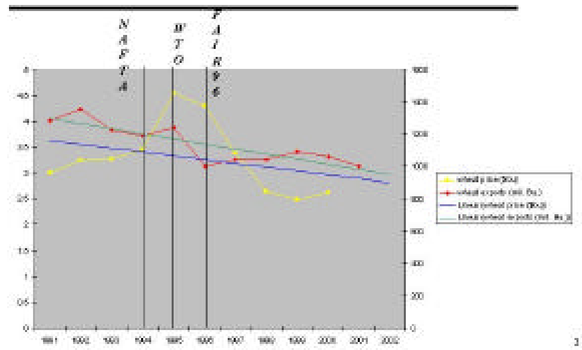
Figure 1. US AGRICULTURAL TRADE BALANCE ($mil/FY; ag product only)



	91	92	93	94	95	96	97	98	99	0	1
IMPORTS	2258	2436	2445	2643	2980	3245	3565	3683	3729	3885	3902
EXPORTS	3760	4256	4280	4385	5468	5989	5729	5364	4910	5074	5273

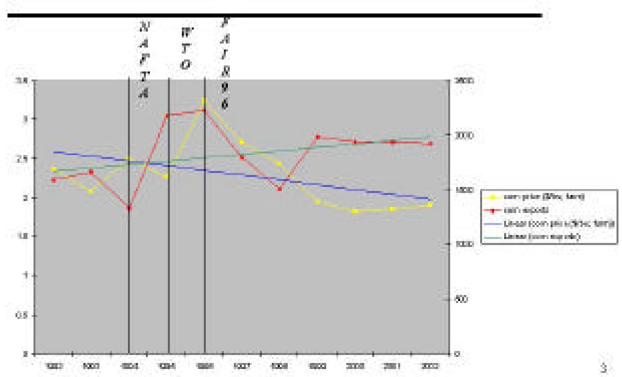
As noted earlier, a by-commodity focus, however, provides perhaps a more confusing story. For example, wheat markets have not shown wild responsiveness to either price drops or trade agreements or the 1996 farm act (see Figure 2a).

Figure 2a. US Wheat price & exports, 1991-2002



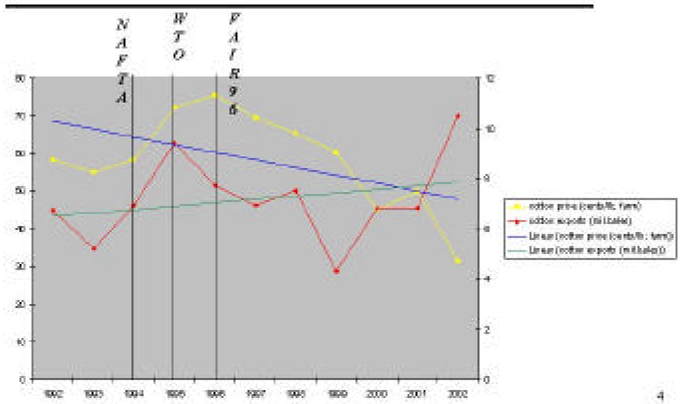
In fact, it could be argued that trade agreements coupled with domestic farm policy have had an adverse impact on wheat trade and prices. Simple linear trend analysis suggests a depressing future. Corn markets, prices and exports have shown mixed response to trade agreements but mostly down, and are lower with the 1996 act (Figure 2b).

Figure 2b. US Corn price & exports, 1992-2002



Differently than wheat markets, however, corn exports do show an upward linear trend, while prices are trending down. Cotton prices have trended down with trade agreements of the 1990s and the 1996 farm act, while cotton exports have mostly been lower (Figure 2c).

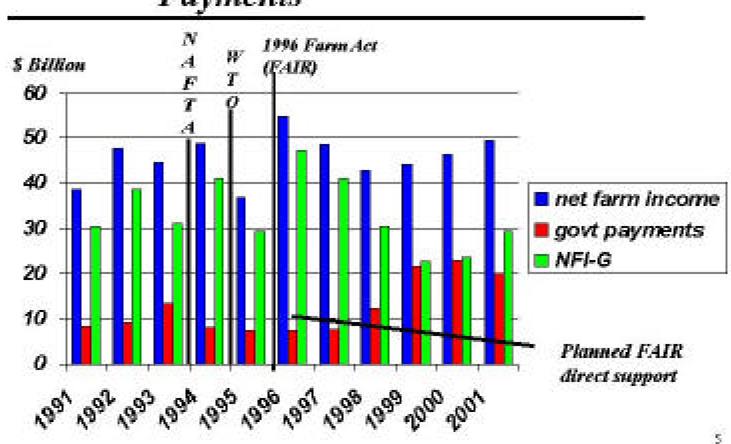
Figure 2c. US Cotton price & exports, 1992-2002



Cotton exports are expected to be up significantly this year (2002), apparently responding to very low prices.

<u>Net Farm Income.</u> An examination of net farm income (Figure 3) suggests these two points as obvious: (1) government support has greatly increased; and, (2) the market contribution to net farm income has declined.

Figure 3. Net Farm Income & Government Payments



My recollections of many well-intentioned academic and industry analysts' forecasts are to the contrary: (1) government support would decline; and (2) the market would more than compensate for the loss of government support; and (3) with reduced government intervention, efficiencies would be captured by the industry.

Distributional Issues. A closer review of government support, however, shows there has been an elevated interest in the apparent distributional inequity of payments to participants (EWG). First, there is the obvious fact that only farms engaged in production of program commodities get all or most of the direct payments. Then, we have found that 10% of farms get about two-thirds of the government payments. So, when about $25 billion was given to participating producers from federal commodity and related programs in 2000, that suggests that about 10% of participating producers received $15-16 billion, while the remaining 90% received $9-10 billion. And, now we see the rent-seeking frenzy surrounding the new farm bill debate, where the more conservative farm and commodity organizations, agribusiness, and larger-producing, bigger farms tend to support expanding government spending for the next 10 years, while maintaining the existing distribution system. Is it any wonder there is a populist backlash against such policies?

If we look at market structure and the composition of productivity and sales, we see that about 10-20% of farms account for 80-90% of sales. In raw numbers that means that 200,000 to 300,000 farms account for most of the commercial production in the US. More detailed examinations such as in

Oklahoma have shown that many of those remaining farms are, in fact, operating in the red (Figure 4).

Figure 4. 1999 Net Farm Income by Sales Class

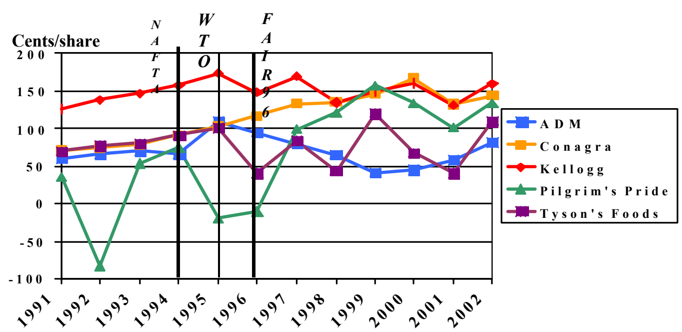
	$/ac. Operated	% total NFI	% farms
<$2500	-31.79	-2.4	11
$2500-4999	-20.82	-3.1	12
$5000-9999	- 8.78	-2.2	15
$10000-24999	- 2.15	-1.6	22
$25000-49999	7.02	4.8	12
$50000-99999	13.42	10.7	11
$100000-249999	21.33	24.7	11
$250000-499999	40.58	22.5	3
$500000-999999	52.12	20.9	2
>$1 million	49.85	25.7	1
State	18.79	100	100

So, while agricultural trade and the value of agricultural trade has certainly increased, there is no direct indication that this has improved net farm income, in total or on average. Any improvement in net farm income appears to have come from government payments, and has probably benefited larger operations more than smaller farms.

Agribusiness Status. Another place to look when examining the question of who benefits with trade is the agribusiness sector. A partial list of some of the more significant names in the industry includes ADM, Conagra, Kellogg, Pilgrim's Pride and Tyson's Foods. ADM is "one of the world's largest processors of oilseeds, corn and wheat", and foreign sales accounted for 35% of total sales in fiscal year 2000. Conagra is "the nation's second largest food processor". Kellogg is the "world's largest manufacturer of ready-to-eat cereals", and foreign operations accounted for 41% of sales in 2000 and 35% of operating profit. Pilgrim's Pride is "one of the largest producers of prepared and fresh chicken in North America, ranking second in the United States, and second in Mexico", and foreign sales accounted for about 14.8% of total sales in fiscal 2001. Tyson's Foods "is the world's largest processor and marketer of beef, chicken, and pork products", with exports accounting for 11.2% of total sales in fiscal year 2001 (Value Line).

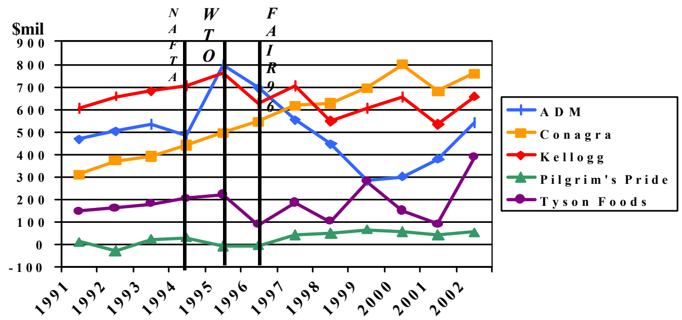
Three indicators of corporate financial status include earnings per share, net profit and dividends. Earnings per share of these selected agribusinesses are shown in Figure 5.

Figure 5. Food Industry Financial Indicators, selected crops, 1991-2002: Earnings/share (cents/share)



While earnings vary by company and by year, each of the companies has improved earnings since 1991, and all but ADM are up since 1996. Net profit for these selected agribusinesses are shown in Figure 6.

Figure 6. Food Industry Financial Indicators, selected crops, 1991-2002: Net Profit ($mil)



Net profits per year for all these companies has i increased since 1991, some substantially. Again, all but ADM show higher net profits in 2002 than in 1996.

Another possible indicator of the financial status could be dividends paid by each of these companies. Annual dividend rates for the past 10 years are ADM 19%, Conagra 15%, Kellogg 8.5%, Pilgrim's Pride 3%, Tyson's Foods 31%. Annual dividend rates for the past 5 years are ADM 18%, Conagra 14%, Kellogg 6.5%, Pilgrim's Pride 6.5%, and Tyson's Foods 22.5%. So, each of these companies have shown relatively healthy dividend rates. While one must be cautious in interpretation of these three indicators for these 5 companies, it appears they have done generally well compared to the agricultural production sector as reflected in net farm income without government payments.

<u>Concentration Issues.</u> Another aspect that may, in part, be related to increasing global competition is the trend toward consolidation or concentration. This statement is excerpted from a USDA study:

The level of concentration is historically high and growing higher in many areas of the agricultural economy, including meat packing, as well as in several food industries. The merger movement of the past decade has contributed to the increasing concentration throughout the agricultural economy. This concentration provides the opportunity to both use and abuse market power.
In meatpacking alone, concentration has risen to the point at which four firms account for over 80 percent of all cattle slaughtered.
In the lamb industry, three firms currently control approximately 70-75 percent of the market, with no clear fourth-place firm. The trends of high concentration exist not only at the packer level, but also at the processing (or breaking) level. This trend of concentration has never been thoroughly evaluated, nor is it clear how the interrelationships--from the lamb packer to the breaker--are established anymore. In 1995, the largest lamb packer ceased operation of its fabrication floor. Within 2 weeks, the largest lamb breaker established operation at the plant. Currently, both the packer and the breaker claim little actual input into the other's operation.
–Concentration In Agriculture, chapter 3.

Other generally available information indicates that concentration is now the norm in many input sectors of agriculture. The Grain Seed top 4 companies control 36-97% biotech seed market. The Fertilizer top 10 companies controlled 50% in 1980, while the top 4 companies control 50% in 2000. In Nitrogen 17 companies controlled 70% in 1980, while 8 companies control 70% in 2000. In the product markets, Grain Processing top 4 businesses control 62-83% milling/malting. In Meatpacking, the top 4 businesses control 54% of hogs, while the top 4 control 78% of steers/heifers. Whether consolidation is a result of global competition or other factors is a research question. That trade agreements has not reduced the trend toward concentration makes a loud statement. Consolidation/concentration may improve efficiency, but often means fewer farms and firms own or control more of the resources. That result, coupled with reduced net farm income from the market suggests some of the reasons so many rural farm economies are not healthy.

Rent-seeking, Efficiency and Agricultural Policy. The most recent challenge to claims that free markets are good, especially for agriculture come with the demise of the 1996 farm act (FAIR). Most of the farm organizations that assumed leadership in the market-oriented, government support- reducing "Freedom to Farm" act have led the charge to successfully invigorate agricultural policy with significant increases in federal support. The just-signed Farm Security and Rural Investment Act of 2002 allows for $80-$90 billion in new federal funds for agriculture over the next 10 years. In fact, spending could be higher. CBO was increasing its cost impacts during the votes in the House and Senate.

The irony is the conclusion from this massively successful example of rent-seeking. Some staunch defenders of free markets had been facing the adverse impacts of trade agreements and the '96 act with the response: "Yes, it is sad that some farms and agribusinesses have to go out of business. However that's what it means for the sector to have a more efficient allocation of resources–some firms and farms will get more efficient and be more profitable, while some will be forced out because they are innefficient." Now, it is much more difficult to defend pursuit of a so-called free market when the so-called efficient farms will be receiving so much federal support. With 200,000 to 300,000 farms participating in commodity programs, then 20,000 to 30,000 farms can expect to receive about $11-12.35 billion over the next 10 years from the federal government. The fights in the debates over a packer ownership ban and country-of-origin labeling offer other insights, but are left for another paper.

Tentative Data Conclusions. So, while this story is still evolving and the questions beg for answers, to date it seems the following are reasonable, if partial and tentative, conclusions:

1. Trade has improved since the trade agreements of the 1990s, with both imports and exports trending up.
2. Net Farm Income has not been improved with the trade and trade agreements of the past decade.
3. Distributional inequity has not diminished with trade and trade agreements, nor with the farm act, and a cursory review of the data suggests trade, trade agreements and the farm act are not size-neutral nor distribution-neutral, but favor larger farms and firms.
4. Major agribusinesses with significant domestic and international activity have done relatively well during the past years, and there is no clear evidence that trade, trade agreements and the farm act have harmed them. In fact, improvements in selected financial indicators for most of the selected firms is coincident with the trade agreements and farm legislation of the 1990s.
5. Concentration in agriculture and agribusiness has continued and perhaps accelerated during the time of expanded trade and new trade

agreements.

6. Rent-seeking and resulting federal support for agriculture are at some of the highest levels ever, begging further questions about the meaning of efficiency and government contributions to the sector.

Is it then unreasonable for populists to conclude that trade, trade agreements and federal support for farms as currently distributed are not helping most farmers, but instead are helping the larger farms get larger, helping the top agribusiness firms get richer and harder to deal with in a fair way in the market, are contributing to rural farm communities economic woes, and contributing to the worsening of local farm economics in developing countries? These are, perhaps, overly simplistic conclusions to very complex conditions, and trade and trade agreements, if deserving of any blame, may deserve only partial blame. However, the review above does seem to suggest they merit further study, rather that being dismissed out of hand simply because they fly in the face of economic rhetoric.

CONCLUSION

. . . Getting government off the back of business simply means putting business on the back of government. . . . Historically it is the national government that has served as the protector of the powerless.

. . . Democratic capitalism has triumphed because of the long campaign of reformers . . . To use the national government to humanize the industrial order, to cushion the operations of the economic system, to

strengthen the bargaining position of workers and farmers and consumers, to regulate wages and hours, the quality of products and the sale of securities, to insure against recurrent depression by built-in economic stabilizers, . . . To combine individual opportunity with social responsibility . . .
--Arthur Schlesinger, Jr. (1995)

Because I have spent most of my career being a public policy specialist, I have been committed to maintaining objectivity and balance and refusing to advocate. Given the direction of economic forces and policy, I think it is time to at least stop kidding ourselves that the efficiency model of the free market is objective. It is neither objective nor harmless. With more candor, we may still decide it has some utility. But to tout it in the face of the aggressive trend of consolidation, where the characteristic of many sellers and free information do not exist, and the acceleration of market power is real, is irresponsible.

Let us be straightforward and say that accepting the inevitability of the current trends for competitive consolidation may also include acceptance of certain inevitabilities such as the following.

1. Free markets, if defined as self-regulating markets, are a myth.
2. Market power is a fact.
3. Trade agreements are a form of government intervention.
4. Market capitalism endorsed and supported by democracy is a government-supported program.
5. As trade agreements reduce protection (or, perhaps, shift protection),

many firms and farms will be driven out of business, or at least forced to drastically alter their practices and structure, which will be protective responses that further prevent self-regulating markets.

6. Those who survive will continue to seek rents from the government in the form of subsidies and protective measures, and will have periods of profitability that are a result of this anti-free-market government support.
7. Government will continue to be responsive to these rent-seeking requests.
8. Rural communities where agriculture is a significant contributor to the economy will continue to face cyclical pressures: smaller farms and firms are forced to sell out or consolidate, depopulating the rural areas and reducing the need to purchase inputs locally; weakened commodity prices will contribute to reductions in land values and tax bases, unless compensated by capitalized government subsidies.
9. Rural economic diversification or economic malaise are the stark choices for rural farming communities. The protective response of seeking government support may enhance the survival rate of some of these communities.
10. Off-farm employment, alternative education and training programs, entrepreneurial creativity, and relocation to urban centers are the stark choices for farm families and farm labor declared as excess as this transition to consolidation occurs.

11. Consumers will benefit with respect to relatively cheap food and fiber, varied and convenient food choices, more simplified one or two-stop shopping experiences, and as much labeling information as they demand. However, the concentration of food sources may only be realized as a problem after it too late to do much about it.

12. Consumers will lose with respect to having a sense of community which supports local food production, losing locally rich markets because of the power of large chains, greater challenges in getting the market to be responsive to concerns about food safety.

13. While agricultural producers continue to gain more so-called flexibility in government farm programs, they face relatively less flexibility in a market of contract agriculture and restriction-laden biotechnology seeds and evolving restrictions on segregation and transportation of product from such operations.

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