The Dollar: Political Economy Down On The Farm

The Bush administration is starting to mix and match some of the worst economic policies from previous Republican administrations (your loyal correspondent is a Libertarian, neither a Democrat nor a Republican). First, we have a Nixon-like backslide toward protectionism in steel, as in the case of restrictions on steel imports designed to help firms such as Weirton Steel in politically sensitive states such as West Virginia. Next, we have another Nixon-like success story emerging with electricity price caps in California. Third, we have Ford-like synthetic fuel boondoggles for ethanol production that will help corn processors, Archer-Daniels-Midland in particular. Finally, we have a Reagan-like receptive ear being lent to calls for an end to the strong dollar policy; these pleas were heard last week by corporations such as International Paper and echoed by business groups such as the National Association of Manufacturers.

In a floating exchange rate system, the dollar can be neither too strong nor too weak for all segments of the economy simultaneously. Whatever the present level and trend of the USD, winners and losers will be created. The present strength of the USD is producing the following effects, among others:

1. A higher current account deficit than would exist otherwise in a weakening economy;
2. A proportionally higher capital account surplus, which is support U.S. financial markets;
3. Downward pressure on personal savings as consumers exchange their strong currency for goods and services;
4. Deflationary price pressure from cheaper imports, and commensurately lower interest rates;
5. The capacity for the Federal Reserve to continue lowering interest rates without immediate inflationary effects; and
6. Political rewards for importers and creditors, as opposed to exporters and debtors.

This last point is crucial for the topic at hand, economic pressure on the U.S. agricultural sector, as farmers are both export-dependent and highly leveraged. Not only have prices for grains, livestock, and cotton been declining on both a nominal and real dollar basis, but the strong USD has removed much of the price advantage for U.S. farmers in global markets as well. Parenthetically, the spike in grain prices seen during the 1995-1996 period didn't benefit most farmers; these price increases were for so-called old crop grain being carried forward from 1995 to 1996; the new crop prices for delivery in the 1996 harvest were far lower.

Currency Effect On Grain Prices

A Return To Prairie Populism?

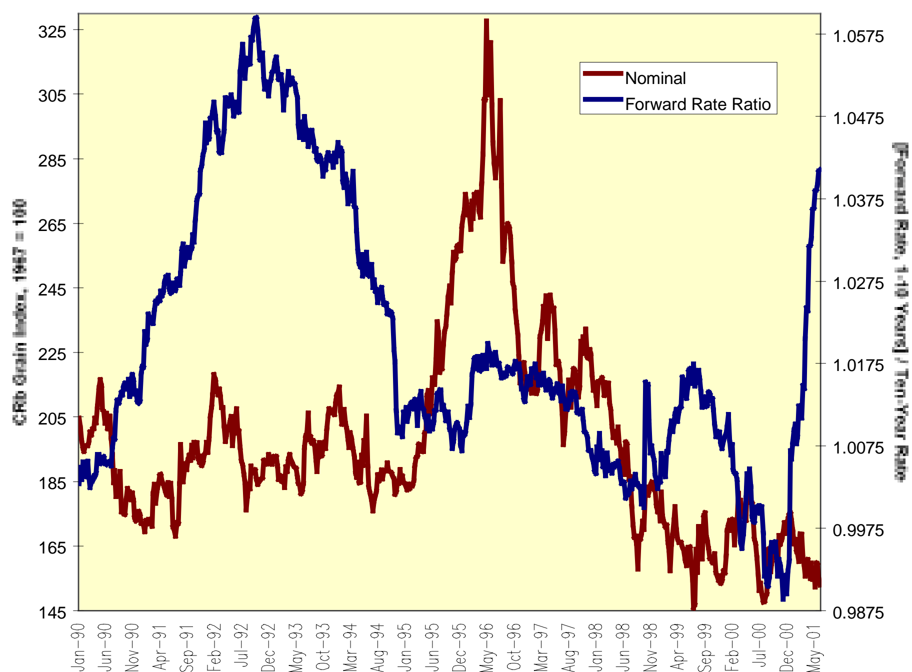
The agricultural sector occupies a special place in our national psyche, and electoral mathematics insures it occupies a special place in our national politics. Previous periods of prolonged decline in grain prices occurred in the 1870s, when transcontinental railroads opened the West, in the 1920s, when farm mechanization and the introduction of cheap ammonia-based fertilizers increased yields, and in the 1950s, when cheap pesticides and herbicides and specially-bred hybrids boosted yields even further.

Each of these periods produced a political flight from free markets. The 1870s, with Republican presidents Grant and Hayes, saw the growth of the Greenback and Populist parties, both of which championed inflation as a form of debt relief. The 1920s, with Republican presidents Harding, Coolidge, and Hoover, saw growing support for the notions of price supports and export subsidies, which later flowered during the New Deal. The 1950s, with Republican president Eisenhower, witnessed the massive extension of these agricultural price supports and the passage of Public Law 480, which championed export subsidies for surplus grain. All of these policies produced a form of welfare dependency in the agricultural sector and predictably helped accelerate the flight of farm families, those cherished political icons, off the land.

If you want to destroy an industry, get the government involved therein. The steel industry, under protection from trade barriers, lost its incentive to become more efficient. The U.S. auto industry, another recipient of trade protection, is now just a part, and not the undisputed leader, of the world auto industry. The U.S. petroleum industry has seen the demise, mostly through merger, of Arco, Amoco, Gulf, Mobil, and now Texaco, amongst others, over the past twenty years. The move toward re-regulation of the electric utility, led by Gov. Gray Davis of California, is likely to cripple the U.S. electricity industry for a generation; it's certainly done wonders for AES, Enron, and Calpine, down 25.8%, 46.0%, and 16.3%, respectively, so far in 2001.

The agricultural sector and its advocates will demand, and no doubt receive, further subsidization; farmers live in the red states from the November 2000 election. Farmers live with two illusions: That the current price, no matter what it is, is too low, and that inflation and a weak dollar are desirable. Neither has any basis in fact. We can measure inflationary expectations from the yield curve. If we calculate the forward rate from one to ten years, the rate at which you can borrow, starting one year from now, for the next nine years, and compare it to ten-year rates themselves, no discernible causal relationship with grain prices can be found at any lag. Put simply, the present aggressive monetary policies won't bail out farmers any more now than they did during 1930-1931.

No Monetary Rescue For Grains



Are food processors, the expected beneficiaries of lower commodity prices, benefiting from this trend? Hardly. While broader comparisons are difficult due to special considerations for firms such as IBP, Smithfield, and Kraft-General Foods, major grain purchasers such as ConAgra and Tyson Foods are down 21.0% and 27.5%, respectively, so far in 2001. Have we as a society decided to stop eating? Doubtful; as one Hoover-era ditty put it, "Let's have another cup of coffee, let's have another piece of pie."