CHOICES
The magazine of food, farm, and resource issues

A publication of the Agricultural & Applied Economics Association

Theme Overview: Agriculture in a Turbulent Economy—A New Era of Instability?

David B. Schweikhardt

"Despite its many ingredients, most of the farm problem boils down to issues affecting the level of farm income."

--Theodore W. Schultz
Agriculture in an Unstable Economy

The theme title is posed as a question rather than the descriptive statement generally used in past themes in *Choices*. The reason for this difference is based on the timing of this topic. World agriculture has recently passed through a brief period of extreme turbulence. Having passed through this period, it remains unclear whether the period is an outlier of long–term trends or a portent of things to come. In addition, this period is now being followed by an international financial and economic crisis that may yet result in extreme conditions of some other form. Thus, no definitive answer can be given about the question posed here.

Unlike the farm problem in Schultz' day, when the absolute level of farm income dominated the policy debate, today's policy issues frequently center on the variability of commodity prices and farm income. In addressing the question posed by this theme, two issues are relevant. First, is there a new era of instability in agriculture? It can be easily argued that it is too early to tell whether the events of the past decade signal the beginning of a new era or merely an outlier within past trends. Nevertheless, stakeholders and policymakers are likely to debate this question in the near future. Such a debate is more likely to reach a reasonable outcome if it is informed by economic analysis.

Second, are there new or larger portions of the ingredients that contribute to the instability of the agricultural sector and the food system at large? World agricultural markets, despite the continuing presence of trade barriers, have become highly integrated across national borders. After years of speculation about whether agriculture could be a significant supplier of energy, the development of the ethanol market as a major user of agricultural commodities is now a reality. The effects of macroeconomic conditions on agriculture are likely to be become increasingly evident as the global financial crisis unfolds. These and other ingredients pose the possibility that a new era of instability is emerging in agriculture.

The papers presented here examine these questions in the light of events over the past decade. The topics include consideration of whether agricultural commodity prices have reached a new plateau and whether the integration

Articles in this Theme:

of agricultural and energy markets exposes the agricultural sector to the instability of the energy sector. Other papers examine the role of national policy decisions, commodity market regulation, macroeconomic factors, and evolving credit markets as sources of farm income and asset price instability. Finally, the adequacy of existing risk management tools is examined.

In the first paper, Scott Irwin and Darrel Good examine recent changes in agricultural commodity prices through the lens of past episodes of increased prices. Comparing recent prices to the historical evidence, they reach the conclusion that a new era of agricultural price volatility has arrived with both a higher average price and wider variation in prices. Such an outlook, they conclude, could have far–reaching effects for virtually every market participant in the food system.

In the second paper, Andrew Muhammad and Ellene Kebede examine the question of whether the development of the ethanol market has resulted in the integration of oil and corn prices in such a manner that the agricultural sector is now importing instability from the oil sector. Based on an emerging body of literature on the subject, Muhammad and Kebede conclude that such integration has occurred. Such an unintended consequence could, of course, add a significant new ingredient to the instability of the farm sector by adding to the level and variability of commodity prices.

In the third paper, Joachim von Braun and Maximo Torero dissect the commodity price spike of 2007–2008 by examining the role of policy-induced instability in the price spike. In particular, they examine the role of changes in national trade policy—temporary erection of export barriers and reductions of import barriers—in adding upward pressure on commodity markets. Second, they examine the possibility that speculative activity contributed to the price spike. Both cases underscore the role of public policy in a market economy—every market operates within an institutional framework that determines the economic performance of that market. In that vein, von Braun and Torero then consider institutional innovations intended to increase the stability of commodity markets.

In the fourth paper, William Liefert and Mathew Shane examine the impact of the ongoing global financial crisis on the farm sector. Examining both the direct (credit availability) and indirect (economic growth and exchange rate) consequences of macroeconomic policy, they find that the indirect effects are likely to have a larger impact on the farm sector than the direct effect. If Liefert and Shane are correct in this assessment, the full impact of the financial crisis has not yet been felt by the agricultural sector.

In the fifth paper, Mitch Morehart considers the impact of macroeconomic policy on the value of farmers' largest asset—land. Examining alternative macroeconomic scenarios, Morehart finds that the outlook for land values can be highly sensitive to macroeconomic conditions. Such a finding is particularly important given the almost unprecedented uncertainty about macroeconomic conditions during and after the ongoing credit crisis. Again, the farm sector could be exposed to instability from a source outside the farm sector that is, in large part, a policy-induced creation.

In the sixth paper, Paul Ellinger examines the financial crisis from yet another dimension—that of the financial sector serving agriculture. As Ellinger notes, the initial shock waves of the financial crisis were centered in nonagricultural lending institutions. Thus, the initial impact of the financial crisis on agricultural lenders was minimal. As time has passed, however, the potential impact of the crisis on agricultural credit markets could be larger in the near future.

In the final paper, Keith Coble and Barry Barnett consider the issue of whether the farm sector's existing risk management tools are adequate for managing risk in a new era with greater volatility. They urge caution in concluding that agriculture has reached a new era of instability. Even if the recent years are simply an outlier of past trends, however, they conclude that the existing risk management tools are a patchwork, often designed in response to the political pressure arising from past farm income "crises." As a result, the issue of institutional innovation in risk management will continue to be a possibility in agriculture regardless of the answer to the question of whether we have entered a new era of instability.

As a collection, these papers underscore the complexity of understanding future economic conditions in the agricultural sector. Moreover, such complexity adds to the difficulty of anticipating the consequences of alternative policy institutions. Such is the nature of public policymaking, however, and the policy issues examined in these papers are likely to remain on the food policy agenda, in both national and international forums, for the foreseeable future.

David B. Schweikhardt (schweikh@msu.edu) is Professor, Department of Agricultural, Food, and Resource Economics, Michigan State University, East Lansing, Michigan.