Overshooting Agricultural Commodity Markets and Public Policy: Discussion

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The premise of this session, that monetary, fiscal, and other macroeconomic policies are now as important for U.S. agriculture as price support and other sector-specific microeconomic policies, is gaining widespread acceptance. These two papers, though very different in size and scope, are both welcome contributions.

Let us begin by considering the frictionless competitive world that the Andrews-Rausser (AR) paper calls the new classical paradigm and that the Rausser, Chalfant, Love, and Stamoulis (henceforth RCLS) paper calls the monetarist-neoclassical model. Such a model has two very strong implications for agriculture. First, macroeconomic policy has no systematic effect on real commodity prices, only on nominal prices. Second, there is no welfare justification for government intervention to help the farm sector. (Like RCLS, I am abstracting from nonmarket considerations like income distribution.)

It is more clear in the 1980s than previously that we do not live in such a world. Although prices of agricultural commodities are determined flexibly (in the absence of government intervention), prices of most goods and services in the Consumer Price Index (CPI) are sticky. For example, when the nominal money supply falls by one percent, the CPI is not free to fall proportionately, with the result that the real money supply falls as well. The result is large effects, at least in the short run, on real interest rates and real exchange rates. Real commodity prices are in turn sensitive to real interest rates and real exchange rates.

How can we be so sure that the sticky-price view of the world is more accurate than the frictionless one? Of the many possible pieces of evidence, I offer four here, one for each of the speakers in this session. First, the AR paper shows in table 1 that in the big cyclical downturns of the early 1930s and the early 1980s, prices fell more (and quantities fell less) in the agricultural sector than in any of nine other sectors. Second, the RCLS paper reports the finding that in regression equations for a farm price index, the money supply showed up as a relatively more important determinant and the lagged endogenous variable as less important, compared to regression equations for the CPI. Third, Cumby and Obstfeld, among others, have shown clearly that real interest rates vary significantly across countries, which refutes the old view that real interest rates are constant. The finding is undoubtedly related to the well-known finding that purchasing power parity does not hold, even approximately: exchange rate changes do not match changes in relative price levels.

A fourth piece of evidence comes from observed market reactions to the Federal Reserve's weekly money announcements. When the money supply turns out to be greater than expected, nominal interest rates tend to rise and prices of wheat, corn, and other basic commodities tend to fall. If the frictionless view were correct, then interest rates and commodity prices should either both rise (if the announcement causes the public to revise upward its expectations of future money growth) or else both fall (if the public revises downward its expectations of future money growth). The only hypothesis that explains the reactions in both the interest rate and commodity markets is that the increase in the nominal interest rate is also an increase in the real interest rate (presumably because the public anticipates the Fed will reverse the recent fluctuation in the money stock), which depresses the real prices of commodities.

Thus, the classical grounds for automatically prescribing laissez-faire are rejected. But this conclusion must not become an excuse for the government to intervene blindly in agricultural markets. The authors of both papers recognize that the policies that are actually adopted in practice are seldom well designed

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68, 2, May

as responses to macroeconomic instability or other sources of market failure. As AR hint, the policies are usually "captured" by the relevant special interest groups.

The important question is what are the right sort of agricultural policies to cope with macroeconomic instability? The RCLS model is well-suited to examine such questions of the interaction between macroeconomic and agricultural policies. It allows the specification of eight macroeconomic policy variables and nine agriculture policy variables. The authors use the model to produce some fascinating results: wheat growers are actually better off under their tax scenario (a negative macroeconomic environment) than under their subsidy scenario (a positive macroeconomic environment), because of the large direct subsidies to which they are entitled when wheat prices fall. I would like to see the authors use the model to evaluate the nine alternative ways of providing a given level of transfers to farmers (loan price support, land diversion, etc.) to see how they perform under conditions of macroeconomic instability.

One possibility is that none of the existing policy programs is well designed to cope with macroeconomic instability. Many aspects of government farm intervention subsidize risk taking and make things worse, for example encouraging the "overborrowing" and "overplanting" that occurred during the period of high inflation and low real interest rates in the 1970s. As for the high real interest rates and the high real dollar of the 1980s, agriculture is not the only sector to have suffered. Construction, capital goods, transportation equipment, steel, textiles, and copper also have been badly hurt. Regardless of whether one believes that the disinflation of the early 1980s was worth the cost in terms of lost output and inflation, it does not follow—taking the disinflation as given—that a particular sector's share of the burden should have been reduced. Regardless whether one believes that the government budget deficit in the mid-1980s is worth the cost in terms of the crowding out of the private economy, it again does not follow—taking the deficit as given—that any particular sector's share of the burden should be reduced. Indeed, agricultural support is one of the costliest programs in the government (as a ratio to the benefit to farmers) and necessarily must figure into any serious deficit-reduction plan, a point that is one of Rausser's "backward linkages."

The AR paper reminds us that the macroeconomic issue is not new. In the last part of the nineteenth century, the time of populism, real interest rates were high and real commodity prices low, like today. There is one striking difference. In the nineteenth century the centerpiece of the populist platform was the abandonment of the gold standard. One hundred years later a centerpiece of the populist platform is the return to the gold standard. At the recent Kemp-Bradley "U.S. Congressional Summit on Exchange Rates and the Dollar," Congressman Henry Reuss characterized Jack Kemp as the only populist in history to pick up the cross of gold and then run with it for a touchdown. I think that the explanation is that both in the nineteenth century and now the populists want looser monetary policy. One hundred years ago the gold standard was the obstacle to a looser monetary policy; today, in their view, the absence of a gold standard is the obstacle.

Recent appointments to the Federal Reserve Board support the claim that the administration is sympathetic to the Kemp view on monetary policy. Models of how special interest groups are able to pressure the government to get policies more favorable to them, which Andrews and Rausser point out are applicable to agricultural policies, may also be applicable to macroeconomic policies. In the past, the monetarists have emphasized the desirability of establishing a monetary regime that would be immune to political pressures and would yield a low and stable rate of money growth, a goal that they have inexplicably claimed would be more likely attained if the Fed were brought more closely under the control of the Treasury or Congress. In recent years the monetarists, both within the administration and without, have been put in the most untenable of positions by the Treasury supply siders who have pushed for easier money at the same time that the money growth rate has been so rapid as to produce dire monetarist warnings of renewed inflation.

References

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