

Managing Risks and Profits with Market Power

By Richard A. Levins

Every spring semester, I lead 100 or so undergraduates on their first encounter with the dismal science. The text I use, that of Samuelson and Nordhaus, has enjoyed near biblical status among economists for the past half-century. We spend the first half of the semester studying perfect competition and free market economies, go on spring break, then come back to face Chapter Nine and the concept of imperfect markets. The chapter begins by listing virtually every conceivable industry, from aluminum to software to chewing gum. A remarkable statement follows: only wheat farming “falls within our strict definition of perfect competition”, each of the others “fails the competitive test”.

Inquisitive undergraduates often ask the obvious question of why, then, did we spend so much time studying a world that the text cannot find? What about the world that they will inherit and in which they will seek their fortunes? It’s a good question, especially in light of the outrage over Enron, WorldCom, and their kin. Employees sent packing by the thousands, billions of dollars tucked away in places not frequented by auditors, and pension plans up in smoke could not have been imagined by Adam Smith as he put his trust in an invisible hand over 200 years ago.

The question my students ask is a good one for us to think about, too, as we consider the risks and profits of agriculture. In my book Willard Cochrane and the American Family Farm, I said: “I have sometimes thought that the shortest possible economic history of U. S. agriculture would be this: nonfarmers learning how to make money from farming”. (p. 8) As I look back, the biggest change in agriculture during the past 20 years didn’t happen on the farm at all. It happened off the farm. Mergers, acquisitions, and globalization have so changed the farming world that what has, and has not, worked in the past must be reevaluated.

Are our traditional approaches to risk management and staying profitable still relevant? I think so, for the most part. But I also think that the years ahead will challenge us to consider market power more than we have in the past. We must think not only of how profits are made, but of how they are distributed in the modern agricultural economy.

The Agricultural Stock Market

The stock market has been so much in the news lately that I would like to begin by talking about agriculture’s own stock market, the market for farmland. Economists generally believe that land costs are determined by the current value of the products produced on that land. Because of this, the market for farmland is not all that different than that for stock in Deere and Company, the world’s leading manufacturer of farm equipment. Both Deere shares and land values are generally more valuable when the farm economy is doing well, and less valuable when it is struggling. A share of Deere and Company entitles its owner to a share of the company’s profits. Likewise, an acre of cropland serves as a share of stock in our farm economy. The owner of such a share is

entitled to some portion of the financial bounty generated by U.S. agriculture. The dividends from those shares are paid out as rental rates on farmland.

Nationally, over 40 percent of our farmland is rented rather than owned by the person farming the land. The percentage is almost 60 for Iowa. There is a natural tension between absentee landlords and farmers who rent land. Both want as large a section of the farm profit pie as they can get. Most agricultural economists would agree that landlords have the upper hand and generally make more than the farmer. There is only so much land to go around and there are always farmers willing to bid up the price of that land whenever the farm economy is doing well. The value of farmland in the United States is close to one trillion dollars. High land values provide retirement incomes for farmers and their heirs, a source of revenue for rural economies through property taxes, and collateral for many loans made by rural banks.

Farming has become increasingly productive in the last several decades. As a result, farmers have come to rely on export markets for much of what they grow. Private grain companies buy products from U. S. farmers, transport them to distant shores, and sell the products in foreign markets. The National Farmers Union recently updated its series of reports on agribusiness concentration (www.nfu.org). The study showed “the incredibly high level of control by the top 3 companies in corn and soybean exports”. One of those three was determined to be of relatively minor importance, leaving “only Cargill and ADM with the real control of all U. S. corn and soybean exports”.

Grain companies do not farm or own farmland. They do, however, decide where they will buy grain, how they will move it, and where they will sell it. They also decide where they will make investments in export terminals that are necessary for the

movement of grain in world markets. The principal competition for Corn Belt farmers comes from South America. Cargill and Archer-Daniels-Midland have chosen to make substantial investments in South America as well as in the United States. Because of these management decisions, the grain companies are in perfect position to keep the price they pay to buy grain low by playing farmers in one country against those in another.

Some economists are now beginning to talk about the way relatively high land costs in the United States are limiting our participation in valuable export markets. No politician wants to see the problems that falling land values would cause. Rural communities depend on property taxes from farmland and rural banks use farmland as collateral for many of their loans. Nonetheless, the legislative response has not been one that addresses the basic problem of low farm prices. Rather, we continue to spend billions upon billions in payments that do nothing but get us to the next year of problems. Without those payments, agricultural economists agree that land prices would fall dramatically. For example, a recent USDA study ([Agricultural Outlook](#), November 2001) found that “the current set of farm commodity program payments has added nearly \$62 billion to U. S. farmland values”. That even more of our farmers would be forced out in the absence of program payments goes without saying.

Globalization and Economic Power

The threat to both farm income and land values has at least two principal causes. One of those is globalization, and the other is a shift of power away from farmers and owners and into the hands of those that manage the global economy.

The term “globalization” is sometimes confused with trade among nations. Nations have traded products for centuries, and the economist David Ricardo provided an

enduring story of how everyone can benefit from international trade over two hundred years ago. International trade, it is said, can make everyone better off. Farmers will earn more because they are producing products in which they have a comparative advantage, and landowners will make more because their productive resources are being used with greater efficiency.

The international trade story brought to us by Ricardo may or may not be true. The important point here is that it is irrelevant. We have moved beyond international trade and into an age of pure globalization. Nations don't trade in the way they once did. Instead, transnational corporations move capital across borders with ease, deciding today to make shirts in southeast Asia and tomorrow to make automobiles in Mexico. This is no longer a story about countries acting in their mutual interests. Rather, it is one of multinational corporations searching the globe for cheap labor and the least restrictive environmental and social regulations.

In the world of most economics texts, power is shared by the workings of a competitive market and by a powerful government that regulates that market. But to be truly global, a corporation must be very large. That very size gives the multinational corporation the power to compromise the authority of both government and competition. Managers of very large corporations can bring far more cash to bear on the political process than any single farmer or landowner could imagine spending. As corporations become global, we also see threats to competition. It is often said that a free market economy is driven by personal self-interest, but regulated by competition. The discipline of competition plays a large part in determining how much of the economic pie will go to labor, to ownership, and to management. As corporations approach the size of countries,

however, there are so few players in the economic system that competition cannot exercise the control it once did.

The new economic order appears to be one in which farmers increasingly depend upon public subsidies for much of their income. And the experience of Wall Street investors shows us that ownership provides no watertight guarantee of wealth. We are beginning to see that full participation in a global economy is at odds with a goal of maintaining wealth in the hands of farmers and landowners. The question is, “what do we do about it?”

Some New Directions

Neither globalization nor the loss of economic power to global corporations are addressed very well by traditional farm management practices and government programs. Rather, we try to make the best of bad situations and to seek the highest of relatively low prices. Failing that, we try to give farmers enough cash to compensate for the losses the new economy has brought them. The present structure of the agricultural economy challenges us to do more.

In January of 2000, the Federal Reserve Bank of Minneapolis reported that: “In a recent poll of 680 North Dakota farmers, 70 percent said agribusiness concentration was a major cause of the current farm recession, and 20 percent said it was a minor cause”. Since then, I have done several smaller surveys myself in Minnesota, and each confirms the central message of the North Dakota survey. Farmers are ever more inclined to think that their financial difficulties result from lack of competition among buyers of their products and a general lack of bargaining power that they have in a world of agribusiness giants.

This has significant implications for farmers throughout our hemisphere. Farmers on the one hand must deal with multinational firms to sell their products and buy many of their inputs. But farmers continue to identify themselves as being from one country or another, and to see salvation either in competition with their domestic farm neighbors or with farmers from other countries. This may have worked in the past, but it will not work in the future.

We must all work together to think of strategies that rely on global cooperation, not competition, to be successful in global economy. Farmers must act together, not against each other, to build the economic power so necessary to insure that rules of the economic game are favorable to their interests. Is the prospect of a global farmer network that builds economic power, rather than global competition that reduces that power, anything more than a dream? Perhaps so, but I am encouraged that much of my recent writing on collective action, and particularly collective bargaining, has found a wide audience among farmers.

Our current strategies for dealing with a twentieth century farm economy took many years and many creative minds to forge. The search for effective strategies for the new century will likewise challenge all of us for years to come. I am confident that as we develop those strategies, we will not hear the words “efficiency” and “competition” as often as we have heard them in the past. In their place, we will hear of cooperation, of collective bargaining, and of farmers reclaiming their market power.

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This paper was presented by Dr. Levins as the keynote address at the Risk and Profit 2002 conference in Manhattan, Kansas, on August 15, 2002.

Dr. Levins has also written "An Essay on Farm Income" that presents his ideas on farmer collective bargaining in more detail. The essay is available at no charge at: <http://agecon.lib.umn.edu> or by calling Waite Library at 612-625-1705.