

Alan E. States

I have led a flawed life. I earned a degree in economics, fought in a war in Vietnam, grew wheat for a living and bought a bank. In that process I have made one consistent mistake. I will get back to that later.

In the last year the United States passed a new farm bill. I am not here to defend it. The 2002 bill is what happens when a group of Populists from the Dakotas team up with the Protectionists of the South and the Dairy Northeast. It was a small step backward, but not always for the reasons commonly assumed.

First of all, the Counter Cyclical Payments are not an incentive to produce. The farmers will get them regardless of whether or not they plant the crop. This is not your father's Target Price Program. These payments are decoupled from actual production. For technical reasons they may be put in the amber box, but for all practical purposes they are green.

I am amazed that some individuals in policy making roles do not understand the importance of decoupling. If it is decoupled it is not a trade distorting incentive to produce. In fact I would welcome increased decoupled payments to my competitors from the EU. If they paid them 2,000 Euros per hectare I would make more money as a Kansas farmer.

In Kansas we hunt pheasants. For sixty years we have shot all the pheasants that flew. Only the runners were allowed to breed back. Therefore we are left with only pheasants that run.

The real problem is that the 2002 Bill allowed for the updating of bases and yields. Farmers have two rules when complying with the farm programs. Rule 1. When there is a farm program, protect your payments, that is, protect your program bases and yields. Rule 2. If there is no restrictive farm program remember that there will be, so build your bases and yields. That means that the farmer must plant fencerow to fencerow program crops.

After the 1996 farm bill farmers were allowed to fly. They could plant alfalfa, or other innovative and profitable crops. They could actually make money in the market. Those farmers that did were punished by the 2002 Bill.

It rewarded those that did not innovate but planted wall to wall program crops. We again shot the flyers and let the runners breed back. Never again should we allow the updating of bases and yields. That is a trade distorting incentive to produce.

Today I have heard a lot of misguided talk about the distorting effects of the Counter Cyclical Payments. What the academics are actually measuring is the immeasurable propensity of Congress to allow the updating of crop basis and yield and the probability that new crops will be added to the safety net.

Loan rates are trade distorting. If they are low enough the effect is minimized. Never in their wildest dreams did the legislators think that prices would fall below the loan rates set in the 1996 farm bill. The economies of the Pacific Rim collapsed and the dollar soared. Grain and oilseed prices fell below loan. Program crops then became safe crops to plant. Loans are trade distorting and should be phased out. They were rationalized in the 2002 bill. That means that political negotiating skills were demonstrated. Soybean producers realized that they made mistake decades earlier when they didn't play the target price game. They are now playing and the tradeoff was a lower oilseed loan rate. They won.

As a farmer one of the biggest problems with the 2002 bill is that it makes me less competitive on the world market. I not only have to compete with my neighbors but with the Magi family in Brazil. Income guarantees are capitalized into the value of the farm land. If land prices are high then rents and land ownership costs are high. If all else is the same then my neighbor just across the border in Canada has a competitive advantage due to his lower land costs. That is why I would like to see my European friends paid €1,000 per hectare in decoupled payments. His land prices will go up to the point that he will not be able to compete. If he is paid a subsidized price or an export subsidy I will be an unhappy camper, because coupled subsidies are a trade distorting incentive to produce. I can compete with the farmers of the world; I can not compete with the treasuries of the world.

Now the banker bit. As an aside, land prices are climbing not only because of subsidized farm income, but because of negative real interest rates. Farmers can finance land at 3.3 percent which gives an after tax rate as low as 1.8 percent. If inflation is greater than 1.8 percent real interest rates are negative. Banks are buried in cash. Banking is a mature and competitive business in the United States. If a farmer is credit worthy, he can get a loan.

Why are real interest rates negative? The world economy is close to deflation. Every day computers, cars and corn are cheaper in real terms. Now even unions in the airline industry are taking pay cuts. I mention this because, with the exception of Japan, the world has not seen serious deflation for over seventy years. It relates to NAFTA because deflation fuels protectionism. Protectionism leads to less trade and lower living standards and more deflation and more protection. We do not want to go there.

We still have protectionism. There are sugar and dairy programs in the United States that are very protectionist. But they are equaled by the Canadian dairy program and the State Trading Organization that control Canadian wheat. Only when I can take a truck or train load of wheat into Winnipeg for milling and sale without question or quota will free trade exist on the North American continent. I say that knowing full well the elimination of the STO in Canada will mean that the better Canadian farmers will be better able to compete with U.S. farmers. The Canadian Wheat Board is an impediment to free trade but its elimination will help Canadian farmers more than it will help U.S. farmers. But if we have a common philosophy the CWB must go or at least lose its monopoly powers.

Country of origin labels are clearly protectionist.

Protectionism limits change. In the internet and information age the world is changing fast. Banks are being disintermediated. There is so much information that the middlemen are being cut out. If a farmer can borrow money outside the banking system for 3.3 percent for land and at similar of lower rates from farm input suppliers such as Pioneer and John Deere, why do agricultural banks exist?

Change is driven by technology. Protected industries are slow to adapt and when the tipping point occurs that forces change, the dam breaks and the torrent is catastrophic. Sweeteners into the U.S. and corn into Mexico are two prime examples that come to mind. It is better to let change occur at its natural pace even if it is uncomfortably rapid than let the pressures build until they can no longer be held back.

We need to accelerate the elimination of trade barriers. Tariffs should be phased out. Trade distorting incentives to produce, coupled subsidies, need to be eliminated. Finally non-tariff barriers must go. All barriers need to be:

Quantified
Monetized
Decoupled
Phased out

We have heard a lot of talk about harmonization. The Canola industry has taken an active role in this effort. We are making some progress.

Earlier I told you that throughout my business career I have made one consistent mistake. I never thought big enough. Whenever I set a goal, I made a plan. When I executed the plan the goal was achieved. And then I floundered until I consolidated my position and set my sites higher.

NAFTA has been a remarkable success but does not set its sites high enough. It can achieve more. It is flawed because it is a collection of bilateral trade agreements. When additional members enter, the number of permutations and combinations will become incomprehensible and unmanageable. Convergence of policy is the goal.

The goal needs to be set higher. The Trade Association should set a common policy for health and safety standards. It, by definition, must be supreme authority for the organization. If any nation wishes to gain accession into the Association it must allow free and unfettered trade in any good that meets the health and safety standards of the Association. If no standard exists then no restriction should apply. Bluntly this means that it would supercede the FDA, EPA and the DOT in the United States and their counterparts in the other countries. It is a lofty and worthwhile goal. Free and unfettered trade, the elimination of non trade barriers will increase the well being of the citizens of the continent, the hemisphere and the world. It will also lessen the ability of protectionist winds to drive the world economy onto the shoals of deflation. I think that it is time to take on the challenge and set the higher goal. Our grandchildren will thank us.

Thank you. I have saved time for questions.