Parity Prices Policy Brief

Context:

Parity refers to a state of equality or balance. In agriculture, it means ensuring farmers receive prices for their products that maintain their purchasing power and standard of living, similar to a previous, more stable time.

The concept emerged in the early 1920s in response to the agricultural depression after World War I. When the frontier was settled in the early 1900s, American farms expanded. WWI caused high farm prices and production, but post-war mechanization slowed demand. Continued overproduction led to low prices, resulting in lower incomes for farmers.

Parity developed to address the economic crisis of the early 1900s, marked by a "severe and increasing disparity between agricultural and other commodity prices." The national credit system depended on farmers having strong purchasing power, which was eroded by rising non-agricultural prices and falling agricultural prices after WWI.

The Agricultural Adjustment Act of 1933 sought to restore farm income to parity levels, which had declined during the Great Depression. By controlling production and stabilizing prices, the act aimed to align agricultural prices with parity.

Rationale:

Parity pricing aims to correct the market failures in agriculture by providing a safety net for farmers, encouraging sustainable practices, and fostering a more stable agricultural economy. This benefits not only farmers but also the wider community by promoting food security and environmental stewardship. The market failures pertaining to parity prices are periods where farmers receive abnormally low prices for their commodities in relation to high cost of living. A market failure in this context would be farmers not being able to receive a socially optimal standard of living.

Explanation:

Parity pricing originated during the Great Depression as a response to plummeting farm incomes and is based on the ideas that farmers should earn enough to cover their costs and sustain their livelihoods. The government often intervenes during a market failure (farmers not being able to sustain their livelihoods) to establish parity prices through subsidies or production controls, aiming to stabilize agricultural markets and protect farmers.

The goal of parity pricing is to create a more equitable agricultural system, ensuring that farmers are compensated fairly for their contributions to the economy. Parity pricing ensures that farmers receive a fair price for their products, allowing them to maintain their purchasing power and standard of living compared to a historical baseline.

Parity prices are based on the period between January 1910 – December 1914. This era was deemed to be a time of economic stability of prices for 'articles and services that farmers buy, wages paid hired farm labor, interest on farm indebtedness secured by farm real estate, and taxes on farm real estate (the parity index). The adjusted base price (the average of the prices received by farmers for such commodity, at such times as the Secretary may select during each year of the ten-year period ending on the 31st of December last before such date, or during each marketing season beginning in such period if the Secretary determines use of a calendar year basis (USDA)).

Tradeoffs/Research Findings

Farmers are affected by parity prices in various ways. Parity prices attempt to equal the playing field for farmers by bringing up the prices farmers receive for their commodities. Farmers directly benefit from parity prices because they receive compensation for their commodities that allows them to receive a stable source of income. This helps them cover production costs, invest in their operations, and sustain their livelihoods. With adequate pricing, farmers are more likely to invest in sustainable farming techniques which allow them to focus on the long-term health and sustainability of their operations. However, parity prices are often above the current market price, so it will not always be the ‘fix’ that farmers and the government are looking for. If the government was to utilize parity prices, there would be instances of large amounts of surplus and goods in government storage. With parity pricing, producers may begin to produce more goods as they would be receiving above market value payment for them. The government would buy the goods or give compensation to the producers, but there is now a surplus in the market. The market takes time to recover from surpluses or excessive amounts of storage and return to ‘normal.’ This is one of the larger tradeoffs of utilizing parity prices; it helps for a little while, but the market needs to time to return to normal.

Consumers are affected by parity pricing because it helps ensure a steady and stable supply of agricultural goods. When farmers feel more stable and financially well-off, there is stability in the agricultural market. However, parity prices can lead to increased food prices for consumers in the short term.

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NAFTA vs USMCA

Introduction/Context

This policy brief examines and compares the two major trade agreements between the United States, Mexico, and Canada: the North American Free Trade Agreement (NAFTA) and its successor the United States-Mexico-Canada Agreement (USMCA).

NAFTA was a trilateral agreement implemented in 1994 under the Clinton administration. This agreement aimed at reducing trade barriers and increasing economic cooperation between the three countries. Nafta immediately lifted tariffs on the majority of goods produced by the three nations and called for the gradual elimination (over 15 years) of most of the remaining barriers to cross-border investment and the movement of goods and services among the countries.

The USMCA replaced NAFTA in 2020 under the Trump administration. This agreement aimed at modernizing its predecessor (NAFTA) and builds on many of the same principles, but with significant updates. One of the key differences of the USMCA compared to NAFTA is that the agreement expires in 16 years and requires a review of the trade deal every 6 years to amend/re-authorize the agreement.

Rationale

The primary rationale behind NAFTA and the USMCA is to foster economic growth in all three countries by reducing barriers to trade. This was particularly important for the agricultural where economies of scale and expanded markets can lead to lower prices for consumers and increased profit for producers. Government creation/involvement in trade policies such as NAFTA and the USMCA is justified by the need to correct market failures such as externalities like the negative economic impact of trade barriers and tariffs. Correcting this market failure is especially important to the agriculture industries in all three countries where farmers faced unfair market competition from foreign subsidized goods and/or were not able to access larger markets.

Explanation

NAFTA was created with the goal of removing tariffs, reducing non-tariff barriers, and increasing cross-border trade between the United States, Mexico, and Canada. The goal was to create a trade bloc between the three countries that would stimulate economic growth, enhance competitiveness, and create job opportunities across the board. It succeeded in expanding trade, especially in agriculture. Under NAFTA, both Canada and Mexico saw an increase in agricultural exports to the United States and United States exports to Mexico grew significantly, especially with agricultural commodities such as corn and wheat.

Some of the key elements of NAFTA were the reduction and eventual elimination of tariffs on goods traded between the three nations. Over a period of 15 years, most tariffs on goods were removed, which boosted trade. NAFTA also aimed to open the service sector by allowing companies from each country to operate more freely in each others' markets. NAFTA opened up markets for crops like corn, wheat, and dairy products by eliminating tariffs and quotas on these products. The agreements also included other agreements on labor and environmental protections, but those were not as enforceable or comprehensive as other provisions. All of these elements aimed to the deepen the economic integration in North America.

The USMCA is designed to address the shortcoming of NAFTA and modernize the agreements to reflect current trade practices. The USMCA offers expanded market access in the agricultural sector. It eliminated Canada's milk pricing policies and expands the market for U.S>. dairy, poultry, and eggs into Canada. Mexico also gains improved access to U.S. corn, wheat, and other agricultural products. The USMCA also introduces stricter labor standards, including requirements for Mexican labor reforms and wage increases to reduce the incentive for off shorting jobs. Certain environmental standards are also included to address cross-border pollution and sustainable agricultural prices. The automobile sector is a major aspect of the USMCA, which includes rules of origin that mandate a higher percentage of a vehicle's contents be sourced form the region to qualify for tariff-free trade.

Trade Offs/Research Findings

The USMCA and NAFTA both have distinct winners and losers across various sectors:

- Producers: U.S. agricultural producers, particularly in the dairy, poultry, and grain sectors, stand to gain from the expanded market access to Mexico and Canada. However, Canadian dairy farmers face increased competition from U.S. producers, and Mexican farmers may experience challenges from U.S. agricultural subsidies.
- Consumers: Consumers benefit from the reduction in tariffs and increased competition, which leads to lower prices for goods like automobiles, agricultural products, and electronics. However, in sectors where protectionism still exists (such as certain dairy products in Canada), consumers may face higher prices or limited access.
- Taxpayers: The agreement shifts some costs to taxpayers, especially in the form of enforcement of intellectual property and labor standards. Additionally, there may be fiscal implications for governments seeking to implement the provisions of the agreement, particularly in enforcing environmental regulations and labor laws.

Studies comparing the effects of NAFTA and USMCA indicate mixed results. While the overall economic growth under NAFTA was generally positive, particularly in trade volumes, there were significant concerns about the redistribution of benefits. For instance, many low-income U.S. workers, particularly in manufacturing sectors, experienced job losses due to offshoring to Mexico. Research also suggests that while USMCA addresses some of these issues, it remains to be seen whether the new labor and environmental provisions will substantially benefit U.S. workers without imposing higher costs on businesses.

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