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.

Sources

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Chapter Four. Parity Prices, Parity Ratio, and Feed Price Ratios.

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