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The Outlook for U.S. Agriculture and Agribusiness

Clayton K. Yeutter

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By
Dr. Clayton Yeutter
President and Chief Executive Officer
Chicago Mercantile Exchange

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I. Introduction

Not since the 1930s have I been as concerned for the short term future of American agriculture as I am now. Last year's net farm income is estimated at only about $15.5 billion. In the aggregate, and in real terms, that is the lowest it has been in decades. Fortunately, on a per capita or per farm basis the numbers are less depressing and, fortunately, they will begin to trend upward again in 1984. But it looks as if export tonnages will decline for the fourth year in a row, and farm land values may also decline for the fourth year in a row, not a happy trend for any of us.

It is ironic that at the very time our economy as a whole is enjoying a dramatic and healthy recovery, its largest industry - agriculture - must struggle mightily to survive. It is especially ironic when one considers that agriculture may be this nation's most efficient industry. A further irony is that agriculture's fortunes could change so quickly - from more than $30 billion in net income a decade ago to half that in 1983.

What happened? And, more importantly, what can we do through the policy making process to reverse these disturbing trends and improve agriculture's financial outlook?

II. What Happened

First, to put all this in perspective, let's deal with what happened. The answer is, a lot, and most of it was our own doing. But we did not worry about it much until recently because inflation subsumed our underlying problems.

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*President and Chief Executive Officer, Chicago Mercantile Exchange; former Deputy Special Trade Representative and former Assistant Secretary of Agriculture.

Putting it another way, we shot ourselves in the foot a number of times in recent years but to avoid embarrassment we bandaged the foot very quickly. Now the bandages have become unraveled, and agriculture's financial wounds are fully exposed. In addition, the corrective surgery that may now be required is likely to be much more painful, and conceivably more expensive, than prompt and immediate treatment would have been.

Let's spend a moment in soul searching, not for the purpose of assessing blame for our mistakes - for that is a fruitless endeavor - but as a reminder, and as a learning experience.

First, we embargoed our agricultural products. We deliberately constrained their exportation, perhaps for legitimate political reasons though even that is a dubious proposition, and forced importers to turn elsewhere for major portions of their food needs. We not only became an undependable supplier, we essentially forced our customers to make us a residual supplier! After fighting for years to extricate ourselves from the residual supplier category, we purposefully put our foot back into that grave. Not only did we do it once, we did it several times - under both Democratic and Republican administrations. Quick learners we are not!

Second, for many years we have been remarkably tolerant of the unfair trade practices of other nations. We have permitted the European Community in particular, but other export competitors as well, to use export subsidies - almost at will - to undercut us in third country markets. Not surprisingly, our market share in the affected products has declined; that of other countries, far less efficient producers than we, has increased.

We have also been remarkably tolerant of the import restrictions of other nations, i.e., their efforts to keep our agricultural products out. We have not leaned on the Japanese very hard even though their efforts to be more self sufficient in food production are ludicrously expensive. Were they to grow less rice, we could sell them considerably more wheat, and their food bill would be a whole lot lower.

With the exception of beef and citrus, we have not leaned on them much for their import quotas on food products either, even though each of those quotas is illegal under the General Agreement on Tariffs & Trade (the GATT). Nor have we leaned on the lesser developed countries very much when they follow trade practices that are damaging to us, and often not even in their own best interests.

We have also priced ourselves out of the world market much too frequently. This occurs when our support levels are above global prices, making us the supplier of last resort. Our competitors love this situation, and they are the first to advocate that we boost our support levels still higher. As intelligent marketers, we should understand that what is in the best interest of our competitors is not necessarily in our best interest.

We have also taken unilateral actions from time to time that may have been helpful to U.S. farmers in the short run, but damaging in the long run. Unilateral establishment of the grain reserve program is one example. There is some value to a grain reserve, of course, in that it provides a stabilizing force in the marketplace. But all exporters and importers benefit from that increased stability, not just the U.S. Yet with a unilaterally established reserve program, we Americans pick up the tab, and everyone else gets off scot free!

We have also unilaterally cut back on production, the classic case being the PIK program of a year ago though we have taken similar actions on numerous occasions in the past. That simply hands market share to our competitors on a silver platter, and the American taxpayer absorbs the cost. The best of all worlds for our competitors; the worst of all worlds for us!

Finally, American agriculture has been buffeted by an array of economic phenomena essentially, if not entirely, outside its control. With farmers being heavy borrowers in what has become a capital intensive industry, high real interest rates have been devastating recently. The leveling off of inflation, due primarily to changes in monetary policy, has been healthy for the economy as a whole, but traumatic for farmers who are highly leveraged. These include some of our very best young producers who expanded in the '70s, expecting to pay off their loans with inflated dollars. Those business decisions were wrong, but they were not irrational when made. It is monetary policy that has changed over the last few years, not the managerial capabilities of those farmers. They are probably better operators than they were five or 10 years ago, though their net worth may be a fraction of what it was then.

Fiscal policy has been a wild card too. Who could have predicted $200 billion annual deficits for the mid-1980s, coupled with monetary policies and global uncertainties that in combination have driven the dollar upward to unprecedented levels. This scenario has put tremendous presure on all American exporters, agricultural and non-agricultural. It is truly amazing that our farm exports have held up so well under the circumstances.

We have also had terrific weather in most of the world during the past couple of years. In a market characterized by inelastic supply and demand curves, that can have a precipitous impact on price, and it has. The bears have carried the day in most commodity markets recently.

Finally, we might lump the energy crisis of a decade ago and the more recent global recession together as examples of constraints on the demand side. Oil importers had to choose, at the margin, between energy and food a few years ago and greater expenditures for energy meant lower expenditures for food. We felt the impact of that phenomenon, as did all other agricultural exporters.

Just as that crisis began to ease a bit cyclical and other economic factors brought the world nearly to its knees in a recession of major proportions. Debt burdens skyrocketed in the lesser developed nations, and the entire world monetary system was jeopardized. That too was devastating to American agriculture because the LDCs were our fastest growing customers.

After all this, is it any wonder that U.S. farm income began to fall!

III. <u>The Outlook</u>

Enough of the past; let's turn now to the future and see if there are any bright spots in this rather bleak picture. They are hard to discern in 1984, but I am cautiously optimistic about 1985 and beyond.

The one immediate shining light is the global economic recovery. There should no longer be any doubt about the strength of the U.S. recovery, though the media is unlikely ever to give Reaganomics credit for it! We have more people working than ever before, and they have money to spend. Consumer confidence is high, and that will be reflected in the demand for all products, including food, in the coming months. The rest of the world trails in the recovery process, but growth estimates for 1985 are optimistic almost everywhere. Demand will certainly rise next year in most developed countries, and even the developing world is recovering except where the debt load is unbearable (primarily Latin America).

Notwithstanding that bit of good news, we will not get much help on the exchange rate front. The dollar may slip a bit in the coming year, but not much. Interest rates may decline somewhat too, but not much. My judgment is that the probabilities for an increase in the value of the dollar and in short and long term interest rates are about as great as the probabilities for a decline. Furthermore, I see little likelihood of a major movement in either before 1985.

Farm land values may have bottomed out earlier this year, but I doubt it. I suspect we are in for a modest price decline this coming winter, hopefully our last deflationary gasp! Should that not be the case, we are going to lose a lot of quality farmers over the next two or three years. Lenders just cannot tolerate much more deterioration in net worth statements.

For producers, the short run outlook is at least mildly optimistic for products aimed primarily at the domestic market, which is recovering rapidly. Outlook is bleakest for products which are heavily export dependent, since that segment of demand is still lagging. This situation should reverse itself in the longer run, but farmers must find ways to survive the short run before savoring the long run taste of export expansion!

IV. Where Now

Everyone in this room has an interest in agricultural policy. It is from you that we must generate creative ideas for dealing with the financial challenges of American agriculture. The old policy prescriptions are unresponsive and obsolete, made irrelevant by the global nature of the marketplace in which U.S. farmers must compete. Therefore, if we are to provide income protection for our agricultural producers (a proposition that will be fiercely debated in the future), we must find non-traditional ways to do so. If we cannot develop economically sound policies for rationalizing U.S. agriculture, radical solutions will inevitably come to the fore. Some have surfaced already, and we are likely to see a lot more by next year.

What then should we do?

First, "farm programs" as we have known them need to be placed in their proper perspective. They are not, and will not be, a panacea for our farm income woes. The days of $30 billion PIK programs are over. That kind of economic rescue effort is unlikely ever again to be mounted by any U.S.

administration, irrespective of political persuasion. There are just too many competing priorities for limited taxpayer dollars. In addition, the U.S. populace has clearly become more conservative in recent years. Our people are just not in the mood to spend billions of dollars on farm subsidies, no matter how the program is couched, and notwithstanding the great affection they feel for farm people. Huge farm programs are just not in the cards politically.

But let us not despair. If there be answers to the omnipresent "farm problem," we just might discover that they are located outside the "farm program" sphere anyway. Government intrusion into agriculture obviously has not worked terribly well; were it otherwise, we would not still be at the drawing boards after 50 years of farm legislation. On many occasions during the past half century, American agriculture would have been better off if government had simply stepped aside and permitted our efficient farmers to do their thing.

Nevertheless, there are macroeconomic steps that can be taken by our government, the impact of which will be positive indeed for agriculture. (And, as agricultural economists, we should never ignore or minimize the importance of microeconomic steps that can be taken by producers themselves.) Let's start with what I would consider the top priority. Nothing would help American farmers more than a diligent, concerted, <u>successful</u> effort by Congress and the Administration to reduce dramatically our $200 billion federal deficit. Doing so would have a bullish impact on U.S. financial markets, and would almost certainly bring interest rates down. Were the magnitude of federal borrowing to recede, the Federal Reserve would also be more inclined to loosen monetary policy. Inflationary expectations would be reduced as our government began to get its fiscal house in order, and that would provide a higher comfort level to monetary policymakers. In other words, Paul Volcker and his colleagues at the Federal Reserve could relax a bit if they no longer had to shoulder the entire burden of inflation control.

The fiscal and monetary adjustments just outlined would assuredly have an impact on our exchange rate, where high real rates of interest have siphoned enormous quantities of capital to the U.S. from other countries. Once that siphon is reversed, the dollar will fall, perhaps appreciably. With the relative success we have had exporting agricultural products in the face of a strong dollar, we ought to be gangbusters if the dollar declines in a major way!

I would then add trade policy to this picture, emphasizing that it is imperative to have another round of GATT negotiations soon with agriculture being one of the centerpieces. In the past, agriculture has had short shrift in GATT negotiations, due primarily to the resistance of the European Community. Stating it less elegantly, we have simply been out-negotiated. It is time that we insist on improved rules for international trade in agriculture by informing our trading partners that we will otherwise be much less magnanimous in future trade disputes. We should be prepared to aggressively protect our own agricultural trade interests on a case by case basis if and when the GATT rules prove to be ineffective. We have operated with kid gloves in this area for much too long.

I submit to you that if we, the United States, do our job right in <u>fiscal</u>, <u>monetary</u>, and <u>trade</u> policy over the next few years, farm incomes will rise substantially. (We will have a healthier overall economy too.) And I further submit that what we do in fiscal, monetary and trade policy is infinitely more important than anything we can or will do through traditional "farm programs." The latter are still important, but I rate them as the fourth and least important of the legs on this policy stool. Most farm organizations traditionally expend most of their lobbying efforts on farm programs, and little in these other areas. That has to change if they are to properly represent their farm constituents. (The same applies to government appointments, where agricultural organizations have generally paid little attention to positions outside the Department of Agriculture.)

V. The Farm Policy Leg

In basic farm policy our primary objective should be to avoid repeating past errors. That costs us nothing, and it could gain us a great deal. Foremost on our list should be the need to avoid export restraints. Government officials keep making commitments in this area, but those commitments do not always seem sincere. The benefit-cost ratio of agricultural export restrictions is negative, and will remain so. As a consequence, we should decisively, and with finality, remove them as a policy option. If we continue to be challenged geopolitically, as is probable, we should meet those challenges in another way and with a strategy that has at least a chance to succeed!

Our principal export objective should be to increase market share. For that we should not apologize to anyone. On the contrary, we should be candid with our export competitors, telling them that we are no longer willing to accept a share of the world market that does not properly reflect the competitiveness of American agriculture. If we must use credit programs, long term agreements or other market development efforts in order to achieve the market share that would be ours through free competition, then we should pursue those efforts. We ought to have even an export subsidy arrow in our quiver, though I hope it need not be used.

We are superb producers; we now need to become comparably proficient as international marketers.

We have long used loan levels as the basic safety net for our farmers. Unfortunately, doing so stimulates irresistible political pressures to raise loan rates during difficult economic times. That in turn jeopardizes our international competitiveness, costing us export markets that we would otherwise dominate. We must learn to keep loan levels below global market prices and, if we need a safety net, provide it in other ways.

Under our present system target prices are a more appropriate income protection device. But farmers feel squeamish about getting deficiency payment checks from the Federal government. They would rather deliver their crops under a non-recourse loan program. This reaction is understandable for no one likes to be palpably on the federal dole. But it is not defensible from a policy standpoint. If the American taxpayer is to foot the bill for agriculture's safety net, that bill ought to be visible. The taxpayer has a right to know what a farm program (or food stamps, social security or any other safety net, for that matter) truly costs. We who are committed to a strong, healthy agriculture should be able to defend the level of target prices, or whatever alternative safety net we advocate. If we cannot do so, openly and with candor, we are not entitled to that income protection. The burden of persuasion is on us.

If the budget for traditional farm programs is destined to decline, as I believe it is, we must also search for ways to get more "bang for the buck" in our income protection programs. Perhaps we should consider abandoning the use of support loans, target prices, or any other safety net mechanism for farms that are really not farms, i.e., for those people who earn their basic living off farms and for whom agricultural income is only supplementary. Defining and delineating such a group would be difficult, of course. And, at the other end of the spectrum, perhaps we should also consider abandoning such programs for large scale operations where net income is typically such that a safety net is unnecessary. Defining and delineating that group would obviously also be difficult. I am not advocating this course, but only suggesting that we must somehow use our farm program dollars more efficiently. With a severely constrained budget, as seems likely for the future, USDA will have to find ways to pinpoint its programs with greater precision. We have often used a shotgun approach to farm policy in the past, sometimes effective but always inefficient. It would now seem imperative to find rifles, if we can, to do the assigned job at much less cost.

The agricultural economists in this audience today can probably do more to contribute to imaginative farm policy than anyone I know. And you certainly have a role to play in the important areas of fiscal, monetary and trade policy. I hope you will provide ample input between now and next spring, for 1985 may be one of the most critical policymaking years in the history of U.S. agriculture.