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# Staff Papers Series

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IS THERE A FUTURE  
IN AGRICULTURE?

by

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## IS THERE A FUTURE IN AGRICULTURE?

Michael Boehlje\*

Clearly, farmers and the agricultural sector are facing stressful economic times, and some farmers will have to make major adjustments in their operations to survive. A number of farmers may have to obtain off-farm employment or leave the industry. The financial and human trauma associated with the current economic times cannot be ignored, but dwelling on the past, dwelling on the problems, is not very productive. Understanding history does provide a perspective for generating solutions, but it is time now to take a futuristic view of agriculture and the opportunities it will offer.

What are some of the positive dimensions of the current economic and financial stress in agriculture, and what do they suggest about the future of the farming and agribusiness sector? First, some lessons have been learned, although for some the tuition has been high. One of these lessons is the importance of efficiency and the fact that volume is not a good substitute for cost control and efficient production. Farmers are refocusing their attention on throughput rather than output - on getting more bushels per acre, more pigs per crate per year, and higher calving percentages and weaning weights rather than more acres, more stalls, or more cows. They are recognizing that the more efficient producers that followed a prudent expan-

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sion strategy are less vulnerable than those who expanded aggressively and hoped to offset less efficient production with higher volume.

The second lesson learned is the risk of borrowing money. During the 1970s, low interest rates combined with high rates of inflation suggested that debt-financed expansion was the best strategy and that there was little risk in borrowing. The painful lesson that there is a risk-reward ratio with borrowed money, and that with increased leverage the risks increase more rapidly than the rewards, is now apparent. Once the adjustments have occurred, farmers will use credit in a more judicious fashion. Farmers will not be able to eliminate the use of borrowed funds in their operation, but they will borrow smarter. They will recognize that credit is a valuable resource which can be either converted into debt or used as a reserve to handle difficult times. They will be more aware of repayment capacity and safe debt loans tied to income and cash flow generating ability rather than collateral and asset values.

A third lesson that has been learned is the necessity to become better marketing and financial managers. The focus on production technology of the 1950s and 1960s was appropriate because prices did not fluctuate dramatically, borrowed money was a relatively small part of the total capital base of agriculture, and interest rates were low. But we know "good farmers" by the standards of yesterday - efficient producers who adopted the latest technology - who are encountering severe economic and financial problems or have left the industry in recent years because they did not understand the

risk of the current economic and financial environment and utilize the best marketing and financial management techniques to counter or control those risks. The successful farmer of the future must have production skills, but in addition to those skills, he must also possess marketing and financial management skills.

Finally, we may have learned a few lessons about specialization and capital-labor substitution. Specialization that is accompanied by capital-intensive production results in increased risk, higher fixed costs, and less flexibility. It reduces the ability of the farmer to adjust to the changing economic times. This ability to adjust to change - to adapt - has been part of the historical success of agriculture and individual farmers and will become increasingly important in the agriculture of the future. Although specialization has its advantages, there are costs as well; we may have underestimated the costs in terms of the fundamental and essential ability of the industry to adjust to a changing environment.

A second positive result of the current economic and financial stress is the improved competitive position of U.S. agriculture. U.S. agriculture has become increasingly vulnerable to foreign competition in recent years - our cost structure has risen, eroding our competitive and comparative advantage. One of the major components of this cost increase has been the higher cost of farmland. With lower resource values - particularly lower land values - production costs will decline and the competitive position of the U.S. will improve. For individual producers, profit margins can be

increased through higher prices, increased efficiency, or lower costs of inputs. Lower land values and reduced capital costs per unit of output will result in lower costs of production. The capital and wealth losses for some cannot be ignored, but the competitive position of the industry will have improved once the adjustment takes place.

A third positive result of the current economic and financial stress in agriculture is the innovation that is occurring in the financial arrangements to alleviate financial stress and solve financial problems. Contracts are being renegotiated with new terms and arrangements including equity kickers, delayed principal payments, unpaid interest added to the principal outstanding, rental equivalent payments in lieu of principal and interest, etc. New lease agreements including flexible cash leases and even barter payments (providing services to the landlord in lieu of cash) are being negotiated. Lenders are taking back collateral in lieu of debt and leasing the assets back to the original owner, something which they claimed was impossible even as recently as a year ago. The innovations in arrangements and agreements in the financial markets are mind-boggling, and some of them will not work. But out of this "induced innovation" will come some new ideas on how to finance agriculture, and maybe even some new institutions. Institutional innovation is frequently a result of economic and financial stress. The opportunity to evaluate the potential of new leasing and tenure arrangements, new financing alternatives including the appropriate role of equity, debt and lease capital, and new ways of organizing production

including contracting should be exploited. Each of these innovations will have problems and costs, but we should clearly recognize that the traditional institutions and arrangements have costs as well. Now is the time to evaluate the costs and benefits of some of these new, compared to the traditional, approaches to organizing, financing and managing agriculture.

A fourth attribute of the current problems facing agriculture is the opportunity available to educate the public about the challenges, uniqueness and problems of the farming business and the agriculture sector.

Agriculture is in the limelight - the media from across the nation, as well as around the world, want to know what is happening "down on the farm." Our response can focus exclusively on the problems and tell the public how bad it is; or we can realistically and factually discuss the significant and for some traumatic adjustments that are and will occur in agriculture, the need for some assistance in making those adjustments, and the benefits of the orderly adjustment process and the "new industry" that will emerge. We can discuss the cost of reduced employment opportunities in agriculturally-related industries because of the recession in agriculture. But we should also take advantage of this media interest to discuss the inherent strengths in agriculture. Agriculture has contributed significantly to the economic and social well being of the United States. Agricultural producers, when receiving a fair return on their investment, add to the wealth of the national, state and local economies. They assure consumers worldwide of a safe and dependable food supply. They generate jobs; nationally one out of



every five jobs in the United States is dependent on agriculture, even though farmers represent less than three percent of the U.S. population. Major business firms derive a significant portion of their revenue from farmer purchases of inputs and the resulting sale and processing of raw food and fiber products. Countless communities are dependent on farmers and the firms that buy and sell to farmers because of the workers they hire, as well as their contributions to the local and state economies and tax bases. Agriculture has also contributed significantly to the balance of trade through large net exports. We have a unique opportunity to "tell people about agriculture;" it is essential that we seize it.

A fifth attribute of the current environment is that we are not in a "stable state" - an equilibrium, as economists would say. There is wide acceptance that interest rates in real and nominal terms are too high and that the dollar is overvalued. There is increasing concern about the inequities between the poor and the rich; about the strong recovery of the overall economy and the continued recession in agriculture. We are in an unstable situation and economic forces tend to move back to stability. Interest rates will decline and the dollar will weaken in time. A one percent decline in interest rates would result in an approximate two billion dollar increase in net farm income from reduced expenditures; this would increase net income for the farming sector by ten percent. This decline in interest rates would also result in a lower valued dollar, increased foreign

demand for agriculture commodities, and somewhat higher prices which would enhance farmers' incomes even more.

Most of the changes that will occur to move back to a stable state will be beneficial for agriculture. The timing of a recovery in agriculture is not predictable, but it will recover - there is a future. But make no mistake that for some the recovery will not come quick enough. The role of public policy can appropriately be to encourage that recovery (at least not discourage or impede it), and to assist those for whom the recovery comes too late to acquire the skills and the opportunity to have productive lives in other segments of our economy. It is important to recognize that we are not in a "stable state;" and although there are some pressures and government policies that might move us toward more instability, the much more likely scenario is a move to a more stable environment which would result in a healthier agriculture in the long run.

Finally, a significant positive dimension of the current financial problems of agriculture is the awareness and willingness to respond by both state and federal governments. As with the financial innovations between borrower and lender, some of the public sector responses will not work or may not be appropriate. But it is certainly not true that federal government or individual state governments "are not interested in agriculture." There may be debate about how much public sector intervention should occur and how effective the public can be in solving the problem, about how effective state programs can be to solve a national problem, about who will be

helped and who will pay the price of various public sector responses; but there is debate and that is significant in itself.

We in agriculture have a responsibility and an opportunity to provide the best set of information possible to help those participating in that debate to make the "right" choice. The questions are being asked - it is our responsibility to answer them in an objective way. To not do so would be to abdicate our responsibility. We have the opportunity to invest in agriculture in a way that has been infrequently given to us in the past - not in the form of machinery, equipment or even new technology, but in information that will provide a better understanding by both the policy maker and the citizenry of the agricultural sector and its challenges, contributions and opportunities.