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THE STATE OF AMERICAN AGRICULTURE — A VETERAN'S JUDGMENT

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"Watchman, tell me of the night!" must be the world's oldest entreaty. Understanding of the present and foreknowledge of the future are the most sought-after kinds of intelligence. Everyone wants to know what is going on now and likely to come next. On radio and TV, more program time is given to weather forecasts than even to salacious serials.

Almost as popular as weather forecasting is crystal-ball gazing about our economic and political future. In agriculture the economic outlook gets a lot of attention, not only because agriculture is still a major part of the economy but also because farming is an exercise in futurity. Everything in agriculture is done in anticipation of a later day. (Wags would say that farming is also an exercise in futility. The quip is not really true. Sometimes agriculture is highly fulfilling.)

Anyone venturesome or foolhardy enough to address the topic of the state of agriculture, my assignment here, has to be self conscious about his credentials. My first one is undeniable; it is veteran status. How much one's insight is improved by having been on the scene since McNary-Haugen days may be questioned. I declare only two principles that I believe years of observation have validated. The first is that conditions in agriculture are hostage to what happens outside its borders to greater degree than farmers like to admit. Most people know better, but they prefer a delusion that agriculture is in charge of its destiny. It isn't!

The second observation borne of 60 years of watching is that conditions in agriculture are implicity unstable. They are constantly changing. In economists' language, the future for agriculture is not an extrapolation of the present. No one can know for certain what the future will bring but it definitely will not be a replication of the present.

I add a second credential that bears on what I will say. I am an extension economist, and try to be faithful to the extension tradition of being as factual and as forthright as one can be.

This quality is rarer than might be supposed. Much economic reporting nowadays is colored by the interests of groups that have something at stake. Indeed, advocacy in the guise of scholarship is one of the phenomena of our time.

In the same vein, I am a countryman's common-sense economist. The trend just now is to convert economics to building conceptual models, abstract and abstruse, which are then "solved" by using the magic of computers. I do not

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object to formal mathematical analysis. It is needed. But I am apprehensive about the Pygmalion complex, in which the model builder falls in love with his creation and believes it is the real thing.

The State of the World

More than ever before, agriculture today is buffeted, shaped, and guided by events external to it, even worldwide events. At a national symposium on farm policy held at Kansas City in March, all speakers did a drum roll on this theme. Farmers and others attending did not disagree but they were nonplussed. They also were tongue-tied: they did not know how to phrase their uncertainties about monetary exchange ratios, third-world countries' default on international debt, or the European Community's variable import levies.

Economists too are less than comfortable. Like everyone, we learn from experience, but our nation has not had much experience that bears on what is happening in the 1980s. We all ought to be cautious about what we say, as the farmers were at Kansas City. Unfortunately, the situation invites loose talk and self-declared expertise. I will mention later a few of the ideas being circulated now that I believe to be wrong.

I offer first my interpretation of economic trends of the last decade. The world economy has been slowing down. We in the United States are most concerned for visible retardation in the Western World, that is to say, in the developed countries of Western Europe, North America, Japan, and Oceania. Throughout that region economic growth has slowed or stopped. In my judgment a growing pressure of population on resources lies at the root but the slowdown was triggered by OPEC's sudden boost in price of petroleum a decade ago. Whole economies that had been built on cheap energy could only go into shock when oil prices advanced from $2.00 a barrel to $8.00 and $12.00 and eventually $34.00. Even now the price is still around $28.00.

I suggest that reactions to the shock of 10 years ago are an exhibit in global socio-psychology. In the United States we quickly dropped into the depression of the mid-1970s. We goaded our economy with tax incentives and low interest rates. Interest groups scrambled to protect themselves by whatever economic or political power they possessed. Citizens began to squeeze the public sector hard, in order to protect their private spending. The 1970s will go down in history as a hectic period. Yet what did we get from all that scurrying? The outcome is summarized in the single word spoken so often then, stagflation; that is, rising prices without much increase in production.

Mark Hibbs has pointed out that in the decade of the 1970s the "real median family income" — buying power for the average family — increased only 6.7 percent. In the 1950s the gain had been 37.6 percent and in the 1960s, 33.9 percent. [1] Moreover, in the last few years the average employed wage worker has done well just to stay even. For the unemployed, income has gone down.

During the 1970s, we dashed hither and thither politically. We changed Presidents fast. We invented catch-word economic policies such as new

[1] Mark Hibbs, Challenge, March/April 1983, p. 62.

industrialism, rational expectations, monetarism, and supply side economics. In my opinion we became more internally divided. We made contradictory moves. We told ourselves we wanted less government but turned to more political action than ever before, especially in the tax arena. We said we believed in grass roots democracy but the new Political Action Committees are the most extravagantly financed pressure groups we have ever had. As everyone knows, we have seen the anomaly wherein an Administration normally tagged as fiscally conservative not only unbalances the federal budget as never before but refuses to take corrective steps. The same irony appears in agriculture, where an announced policy of minimum government led to the most costly farm program ever engaged in, namely, PIK.

Lest his sound too harsh, I credit the Executive and Legislative Branches with reflecting the wishes of citizens. Thus I sense that American people are puzzled, divided, probably more selfishly defensive of private interests than in previous happier years, and highly uncertain about where we are headed as a nation.

I have already said that our economic dilemma is not confined to our shores. All developed nations are going through similar throes. They too are darting this way and that politically, without a pattern. Consider Mitterrand in France alongside Thatcher in England, for example. More significant to us is the imbroglio that is underway in international trade. Countries are trying to kill off each other by competitive protectionism, even as international financing of trade is in virtual chaos.

Misunderstandings of Our Day

I have suggested that our citizens are groping for ways out of our common troubles. In the process we wrestle with a variety of broadly sweeping ideas. I touch on a few, briefly, treating them as a true-false test.

Idea number 1: in looking at our economy we are caught up in a numbers game when what really counts is not dollar values but the quantity of goods and services produced.

Absolutely true. Dollar values can mislead. I add only that data on number of persons employed and on income distribution count too. Conceivably, half the economy could be doing well, even as a fringe of 10 percent of workers stay unemployed and another 10 percent, though working, get below-poverty-line income. In my glummest moments I worry that we might be headed for such a stalemate.

Idea number 2: the economy can be visualized as one big market place, a huge oriental bazaar where millions of transactions are completed.

Absolutely false. Only in selling wheat and in a few personal services is this true. Ours is essentially a negotiated, contractual economy. Moreover, it operates primarily by obligations for the future — business borrowing, retirement plans, actuarial arrangements of a hundred kinds. Moreover, valuation of fixed assets is simply a guessing game about future earnings.

What moral do I draw? One, holders of promises to pay, including all pensioners, are the nation's largest economic interest group. Second, the rate of interest is the most devastatingly powerful integer in the economy. It makes me shudder to think about how it is managaed by a small body of Federal Reserve Board Governors who hold virtual economic life and death power over businesses and people.

A second moral is that the debts that drive the economy are not, by and large, repayable. This definitely is true of the so-called national debt, the obligations of our federal government toward its citizens. Dreams of tightening our belts and paying ourselves off are pure fantasy.

But the most dramatic instance lies in international finance. Third world countries are in debt internationally to the tune of $600 to $700 billion. Not by any stretch of the imagination can they repay. Private banks have made almost half the loans. Nine U. S. banks have made such loans to the tune of $60 billion, an amount two and one-fourth times their capital assets.[2]

Idea number 3: the economy can be kept on an even keel by managing the money supply. Doubly false. It's not possible to keep the economy on an even keel, by any means. All that is possible is to smooth the roughest spots. The idea of a "money supply" is a delusion. Money is not a hoard of gold or greenbacks; it is a record of transactions.

If instead we say that interest rates can be kept high enough to stop inflation, this is true. It will also dry up the economy and enrich lenders at the expense of borrowers everywhere.

Idea number 4 is heard often now as officials who unbalanced the federal budget wring their hands over it: a budget deficit discourages investment, stymies business activity, and adds to inflation.

Answer: true during boom times, false during severe recession. I have said often that our present budget deficit is inexcusable and a sign of irresponsibility. But it is keeping unemployment from being even worse. And when the economy is as slack as it is now, government-financed activity robs no one of materials or workers.

Moreover, in times such as these government borrowing does not divert investment funds from private borrowers. Investment funds are not a stock, a hoard, any more than money is a big bag of gold. Banks have the miracle power of expanding the currency; they lend on the basis of the soundness of the borrower. They have been conservative in the last few years not because they lack lending capacity but because they distrust the soundness of borrowers.

Prospects

Question next arises as to what may be foreseen for the future. My judgment can be summarized briefly. It is also almost a consensus judgment. Except for a few incurable or strategic optimists, the futurist school comes out somewhere close to my prognosis, which is that our economy will waver and fluctuate without embarking on any clear trend, either up or down.

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[2] Paul A. Volcker, "How Serious is U. S. Bank Exposure?" Challenge, May/June 1983, pp. 11-19.

My reasoning has perhaps been implied in the above remarks. It begins with our national uncertainty. By no means has our nation chosen clear signals as to how we hope to establish national economic policy. It extends to the consideration of basic resources. I am convinced that our nation will have to adjust to somewhat scarcer and more costly raw materials than in earlier years of vibrant economic growth. We are not prepared to adjust smoothly.

Obviously, whole sectors of the economy are certain to be smaller and it will be difficult to re-employ all the displaced workers of the industrial midwest and northeast. This observation has been made many times and I need not elaborate.

My fear, though, is that we will bog down into a stalemate. Unemployment might stay in the range between 9 and 12 percent. In a few summary words, for a generation or two we tooled our policies, both private and public, for a growth economy. We are not ready for relative stability. Yet that is what I believe to lie ahead.

My crystal ball shows one likely development that may be of interest. When Americans stop going off on ideological forays and decide to work together to resolve our problems, I believe the harsh adversary relationship among government, business, and wage workers will be softened. I am impressed by how much attention is being given to the Japanese model, which may be more patriarchal than we like but is less abrasive. I have predicted such a new direction in national affairs for a long time.

Everyone wants to know about interest rates. Just about everyone is quick to offer his forecast. I get into the act too, but with a low confidence level. I continue to believe interest rates are too high. The old rule that the rate of interest should be three or four percent above the inflation rate is fundamentally sound. To siphon income from the rest of the population to lenders is ultimately suicidal for an economy. But having said that I add fast that the income tax code enters in. To borrowers who deduct interest cost from tax obligations the net interest is less than the nominal rate. The syndicated columnist Eliot Janeway observed recently that "our tax code invites borrowers to deduct their interest bills from taxable income but forces them to pay income tax on the dollars they earn to pay the principal on their borrowings."[3] It's a strangely perplexing arrangement.

My guess is that it will be politically necessary to hold interest rates down.

Will we go off on another round of inflation? We invite that, to be sure, and not primarily through deficit financing of government. For years I have insisted that the key consideration in inflation is not an increasing price of raw materials or consumer goods, but of fixed assets. The worst feature of the inflation of the 1970s was the boom in prices of land and similar assets. We invite renewed inflation of that kind as we tax-subsidize borrowing, then apply low tax rates to capital gains income. We veritably subsidize inflation. We may get it.

[3] Quoted in Sucessful Farming, May 1983, p. 12.

Agriculture's Supply-Demand Imbalance

Agriculture will be beneficiary or victim to whatever happens in the economy as a whole. Let me remind that three fourths of agriculture's market is domestic — U. S. consumers who buy beef, pork, milk, poultry and eggs, fruits and vegetables, and cereal and oil products. Their ability to buy is still the foremost influence over the prosperity of agriculture. In years of ecstasy over exports this fact of economic life was lost sight of.

Agriculture has been hurt severely by the recent depression. (Professor Stigler is correct in calling it a depression, not a recession.) Cattle and hog producers have felt the pangs. The hog people responded by cutting back on output. Cattlemen find it hard to adjust as fast. It overstates only a little to say that for a number of years the farmer-rancher cattleman lived off inflation in value of rangeland. The outside investor-cattleman was helped by tax rules. Both are in trouble now. I do not see good times for the cattle industry until the economy recovers strongly.

Agriculture is hurt likewise by the combination of higher interest rates and deflation in asset values. Only a minor fraction of all farmers are heavily in debt and therefore barely hanging on, but a great many farmers depend to some extent on borrowed money — especially when they farm all their land instead of putting part in PIK.

In my list of popular ideas about the economy that I listed above I did not include one adage about agriculture, namely, that these tight times sort out the good farmers from the poor. That is false. These times separate the high equity farmers from the low equity ones. Among the mail-in-record farmers of Missouri in 1981, the difference between those who made and those who lost money was accounted for entirely by their debt situation and interest payments. Those who showed losses actually had better operating records (as in yield per acre) than those who could report a positive net income.

This situation whereby terms of financing have such a bearing on the position of individual farmers has its own message. It is that for debt-burdened farmers the future will be shaped mainly by interest rates and any re-flation of agricultural assets. It could also be influenced by any national policy to ease their burden. I was surprised to find that in our recent opinion poll, two-thirds of Missouri's leading farmers favored granting some degree of debt relief.

Even though only a fourth of our agricultural production is sold into export, the export market is vitally important to several crops and bears heavily on total farm income. The drop-off in export movement the last couple of years was unexpected and has been painful. I do not join the critics who say our political actions, including past embargoes, are the principal cause of shrinking exports. The primary reasons our export volume is down, particularly in dollar value, are that (1) the whole world is in recession and our potential buyers are strapped for money; and (2) the relatively high exchange rate for the U. S. dollar has overpriced our products. To what extent the exchange rate, in turn, has been engineered by the Federal Reserve Board's tight money policy, versus its origin in worldwide speculative demand for the U. S. dollar as a haven, is an unanswered question.

Is the agricultural plant basically overexpanded?

Probably not.

Three years ago we worried that the world was running out of capacity to produce food. The United States as one of the few suppliers was seen as in a privileged position. Now we hear that agricultural production capacity is in chronic surplus.

At the Kansas City symposium to which I have referred, Professor Luther Tweeten of Oklahoma State University suggested that our agriculture will continue to fluctuate between oversupply and some degree of scarcity, and the up and down swings will overshadow any continuing trend. I am inclined to concur.

Tweeten told his audience that his data showed the growing season of 1982 to have been truly extraordinary. His advice was that we not base our guesses for the future on such an exceptional occurrence.

Agricultural policy has as its goal the smoothing of short run fluctuations in price and income. Too often, though, we fail to write or administer our farm laws accordingly. For example, the farm program of 1982, with its attractive, lid-less farmer-held reserve, could have worked smoothly only if crops were small and demand strong. As neither materialized, we now have PIK.

PIK is too costly to be the prototype for farm programs of the future. Yet farmers and their leaders are unsure what course to follow henceforth. In the opinion poll of leading Missouri farmers we found that for the first time in a decade fewer than half the farmers endorse the current voluntary program as their first preference. To the surprise of some of us, a third favor stricter production control.

Soil Conservation

As one further note on farm programs of the future, they will eventually contain a provision of some kind relative to soil conservation. I mean a mandatory provision, one with clout. Unless I misread the temper of the countryside and of urban people too, something of that nature is certain to come. A sizable number of Missouri farmers favor "cross compliance," which would require that in order to qualify for price support, a farmer would have to meet minimum requirements in soil conservation. Resistance is growing to subsidizing a farmer to produce crops, themselves in surplus, on steep slopes that ought to be in grass.

Biomass

Quickly in passing I flag the question of whether more of the products of agriculture will go into energy and other industrial uses. I continue to believe that biomass, the use of organic materials for energy, offers potential and is a part of the wave of the future. But it is the distant future. Enthusiasts who look for major developments soon are mistaken, in my opinion. I also believe that the materials used will not be foodstuffs such as the grains but cruder, coarser crops bred for the purpose.

A Less Capital-Intensive Agriculture?

I touch now on the question of whether farming of the future will be as gung-ho in capital intensive technology as it has been in the recent past. Will the trend toward more capital and less labor that has been so pronounced since World War II continue in the future? Mine may be a minority vote but I think the trend will not continue without some slowdown. Rising costs of industrial inputs, and even of transportation, will at least retard the earlier trend. Already we are seeing interest in practices that conserve soil resources and reduce costs, some of them associated with the term "organic farming," which itself has become respectable.

International Issues

Not least perplexing among issues of the future is how international trade will fare and be conducted. At the Kansas City symposium several speakers warned that surging exports will not bail agriculture out of all its oversupply problems. In a world in which the terms of trade in farm products are increasingly being politicized, and in which export and import policy is often subordinate to internal agricultural policy, international trade presents one of the major uncertainties.

One possible route for the United States is to move toward negotiating terms of trade bilaterally, country by country. Many of us are reluctant to endorse so clumsy a course. On the other hand, I think it likely that a connection between our export policy and commodity price supports will be drawn up more explicitly in the future.

As I have been pretty glum on several matters, I am glad to end with an expression of confidence in our farm export trade. The world still needs our food and other products of agriculture. We need to sell those products. Somehow a way will be found.

We may have to offer concessionary prices to some buyers. But food is very nearly our greatest resource in relations with many countries. My confidence does not reach to exports' fueling a speculative boom in farm land similar to that of the 1970s. But that boom had harmful aftereffects that we do not want to repeat.

On the whole we may have a quieter agricultural economy in the rest of the 1980s, one bolstered by some recovery in exports and stabilized by more prudent farm policies than those of the recent past. This may not be an exciting outlook, but it could at least be interesting.