U.S. Farm Policy and Prospects

for Agricultural Exports

Robert L. Thompson,

Assistant Secretary for Economics,
U.S. Department of Agriculture.

ABSTRACT

The current prospects for U.S. agriculture, particularly for its export sector, are examined in the light of the new 1985 Farm Bill. After having taken stock of the situation in the 1970s and the developments in the 1980s so far, the paper goes on to define the problems in U.S. agriculture as declining equity, worsening of debt asset ratios and a growing incidence of non-performing farm loans jeopardising the life of many rural banks. The main thrust of the argument is that for the survival and long-term well being of U.S. agriculture, liberalisation of trade would be a most efficient strategy for the world market as a whole.

U.S. FARM POLICY AND PROSPECTS FOR AGRICULTURAL EXPORTS

R.L. Thompson, USA.

It is a pleasure to be with you this evening in Minnesota. I bring greetings from Secretary of Agriculture Dick Lyng. The numbers of you here for the Summer Tour and the Farm Management Congress bespeak the vitality of world agriculture, even in this period of adjustment for the U.S. sector.

Put simply, agricultural exports are the key to restoring economic health in the farm sector--and therefore, to the prosperity of American farmers. Without export growth, U.S. agriculture will continue to stagnate and the problems facing our farmers will not be easily solved. The key question before us today is: will the new farm bill--signed into law by President Reagan on December 23, 1985--improve our agricultural export performance?

To answer that question, we must always remember how different things are today from the 1970's when American agriculture grew tremendously. Exports of farm commodities soared, growing almost fivefold during the decade to a record $44 billion in 1981. Farmers were urged to plant fence-row to fence-row. With land prices rising rapidly, bankers were eager to finance this expansion. U.S. farmers responded by bringing an additional 55 million acres of cropland into production. They also purchased a great deal of machinery and equipment, and as a result many rural communities prospered.

A rising tide of optimism swept the American farm belt. Farmers were challenged to fill what was expected to be a widening gap between world demand and available supplies of farm products. At USDA's 1980 Agricultural Outlook Conference, the pervading theme was scarcity.

The U.S. Congress was equally swayed by the optimism of the times--the 1981 Farm Bill was the product of this optimistic outlook. Under the circumstances, it hardly is surprising that price supports enacted in the 1981 legislation were set at relatively high levels. But no sooner had the ink dried on that particular bill than the U.S. and world economies slowed dramatically. World recession reduced the growth in demand for farm products, halting the growth in trade. In this new bearish trading environment, the rigid price supports legislated in the 1981 Farm Bill, along with an appreciating dollar, effectively priced many U.S. products out of world markets while simultaneously encouraging expansion in competing nations.

The 1970's boom was replaced by the bust of the 1980's. One statistic, more than any other, tells the story. This year exports of U.S. agricultural commodities will be less than $28 billion, leaving large unused excess capacity on farms in associated sectors, such as inputs, transportation and the like. That's 37 percent below the peak of $44 billion in 1981. More than one-third of our export market has disappeared during the past five years.

However, even though exports have dropped sharply, U.S. farm output has continued to grow in the 1980's as farmers—responding to government price supports rather than to market signals--made increasing use of the capacity built up during the 1970's. The result: large stocks accumulated, farm commodity prices were pressured downward and government program costs soared. At the same time, land prices plunged in the deflationary environment of the 1980's. The land bubble burst.

Average land prices in the U.S. have declined 28 percent nationwide since 1981. In the worst affected states of the Midwest land prices have dropped 50 to 60 percent. This has resulted in a loss of wealth to the farm sector of more than $250 billion, and has undermined the financial position of many farmers.

Declining equity, worsening debt-asset ratios, and a growing incidence of nonperforming farm loans jeopardized the life of many rural banks. Last year, more agricultural banks failed than at any time since the Great Depression. This environment--declining farm income and a deteriorating agricultural credit situation--dominated last year's debate over farm policy.

The dismal economic environment spawned intense media interest. Hollywood focused on the plight of the farmer in three major movies; television and newspapers covered farm problems extensively; and even country-and-western singers got involved in the well publicized "Farm Aid" concert.

The one final ingredient was politics. This year, 22 Republicans in the U.S. Senate -- many from farm states -- are up for reelection. So as you can see, during deliberation of the 1985 Farm Bill everything seemed to be in place for more, rather than less, government help for farmers.

Given this highly charged environment, it is miraculous that any compromise was achieved in farm legislation. If there was a consensus, it was that previous farm legislation had somehow failed agriculture. A $60-billion-plus infusion from American taxpayers over the 4-year life of the 1981 Farm Bill failed to stem farm losses. Never in history had a farm bill cost so much, and yet during its life export markets eroded, farm incomes and land values declined and banks and rural communities found themselves in the midst of a painful economic slump. Virtually everyone agreed that changes had to be made.

The major objective was to resucitate flagging exports. At the outset of the legislative process, the Reagan Administration presented a strong case for a more market-oriented farm policy. The argument was that by reducing artificial price supports, American agricultural commodities would become more competitive in the world market, halting the erosion of exports and ultimately recapturing some lost market share.

However, lowering price supports to market-dictated levels entails painful adjustments. Therefore, income supports were set at high levels. This 1985 Farm Bill will see record outlays for deficiency payments. A major concern was that these policy objectives of market-oriented price supports and offsetting income payments be met within reasonable budget limits.

Yet, ironically, budget considerations provided the impetus for some radical farm groups to advance farm bill proposals diametrically opposed to the mainstream proposals for greater market-orientation. Reviving ideas of the 1930's, these groups won support in some quarters for mandatory supply controls. They argued that supply controls would enable government to raise price supports and boost farm income while simultaneously reducing the cost to the American taxpayer. These ideas, in fact, gained considerable momentum in the most severely depressed agricultural regions and were vigorously promoted by some congressmen from those areas.

Thus, underlying the debate over the 1985 Farm Bill was an argument between those who believed in greater market-orientation and those who saw the need for supply management and for rigid government control of farm output. These two divergent philosophical viewpoints have significantly different implications for U.S. agriculture and for world trade in agricultural commodities.

In fact, some farm groups continue to support mandatory supply controls. And of course the farm bill does require that the USDA conduct an opinion poll of wheat farmers to see if they favor supply controls on wheat that would result in wheat prices at least 25 percent above the average cost of production. The ballots were mailed out to wheat producers last week and must be returned by July 14. Results will be announced in early August. This poll is nonbinding, but it does continue to sustain the mistaken notion that mandatory government control of production is good for agriculture.

The real issue is not higher wheat prices--estimated at $4.15 a bushel based on 1986 costs of production--but mandatory government control of production. Supply controls and other forms of agricultural commodity cartels have never worked. If they can't be made to work for oil, why would anyone believe they can be made to work for farm products?

Supply controls would result in unprecedented federal intervention in agriculture. Over 50 percent of the wheat acreage would have to be idled and strict marketing quotas enforced. Prices could be propped up by such measures and, in the short run, farm incomes might be raised.

If controls were extended to feed grains, the livestock sector would face sharply higher feed costs leading to herd reductions and disruptions in the packing and processing industry. Smaller livestock herds and poultry flocks, unused plant capacity, bankruptcies, and unemployment would be the outcome.

In short, U.S. agriculture and agribusiness would face downsizing and stagnation, and would be denied the opportunity for growth. Mandatory supply controls offer false hope. They were rejected in both the House and the Senate during last year's farm bill debate. Yet, some people continue to spread the misleading message that mandatory supply controls offer a viable alternative for agriculture.

We all would like to see stronger prices for farm products. The wheat poll will tell us whether farmers believe in the marketplace or in further government interference. In the meantime, the 1985 Farm Bill is the law of the land. What does it offer? The wheat poll is just one item in a very mixed bag.

The farm bill does move U.S. agriculture somewhat in the directon of market-orientation. Some flexibility has been written into loan rates and the Secretary of Agriculture has been given authority for either additional cuts in loan rates--the so-called Findley provision--or for allowing loans to be repaid at a lower price--the so-called marketing loan. Wheat loan rates for 1986 will be 2.7 percent below 1985, and feed grain loan rates will be down 25 percent. In addition, the Gramm-Rudman -Hollings legislation to reduce the deficit will further reduce loan rates by 4.3 percent. On June 1 the new wheat loan rates went into effect and they are already reflected in cash markets. Corn loan rates will drop on September 1 and this is reflected in new crop futures.

At least as important as the cut in loan rates is the effective freeze in acreage bases and absolute freeze in program payment yields at less than last year's level. This means that the last 3 percent or so of

U.S. output will be produced for the world price, not the target price. The important point is that the target price is no longer a supply-inducer. The decision to buy that last ton of fertilizer will be based on expected world prices, not an artificially high target price. This removes a large incentive to overproduction and is one of the significant moves in this farm bill toward market-orientation.

Yet the reductions in loan rates are significant--they will permit U.S. agricultural commodities to compete in the world market on the basis of price for the first time since the 1970's. For the first time in this decade there is the prospect of growth rather than of a shrinking agricultural sector.

It is true that lower loan rates reduce the price protection for farmers. On the other hand lower commodity prices are offset by extremely generous income support provisions in the new Bill. Target prices are frozen initially and decline only slightly in the out-years of the bill. Consequently, deficiency payments will be larger. In addition the portion of the deficiency payment attributable to the Findley provision or to the marketing loan provision is exempt from the $50,000 payment limitation.

The combination of frozen target prices, sharply lower loan rates and exemptions from the payment limit means this is a costly bill. That could be a problem.

The typical policy reaction to large program outlays is to run large acreage reduction programs; by idling enough acreage prices can be propped up and budget exposure minimized. That, however, would defeat our attempts to halt the erosion of export markets and would simply perpetuate the unfortunate trend of recent years.

The new exemptions from the $50,000 payment limitation are bound to lead to news headlines of multi-million dollar payments to large wealthy landowners. That's not only bad policy, it's bad politics.

These problems aside, what are the prospects for exports under the provisions of this new farm bill? Our analysts predict that wheat export volume will increase 20 percent this year, and that corn exports will increase 25 percent. This will reverse the export trend of recent years. The U.S. share of world wheat trade last year was a disappointing 26 percent, way down from the 44-percent share we had in the 1970's. We are far from recapturing the market share of the 1970's, but the new price support policy will move us in the right direction.

The same is true for feed grains. We may not be able to recapture the 62-percent market share that of the 1970's, but surely we can improve on our disappointing 40-percent share of the 1985/86 world feed grain market.

In the case of cotton and rice, the farm bill allows only minor cuts in the basic loan rate, but mandates use of the so-called marketing loan. Essentially farmers will be allowed to pay back their crop loans at the prevailing world price. The difference between the original loan rate and the lower rate at which the loan is paid back represents a direct subsidy to the grower. Since this removes the incentive to forfeit the crop to the government, prices will be driven down to whatever level it takes to compete in world trade. Consequently our analysts are projecting impressive export gains for these two commodities.

Based on the export response generated by the rice and cotton marketing loan, it is perhaps not surprising that the wheat, feed grain and soybean sectors are now interested in a marketing loan for their crops. Secretary Lyng has rejected these requests. The marketing loan is a very expensive way to buy additional exports. Our analysis indicates that it costs about $17 for each additional cwt of rice exported under the marketing loan program and about $1.10 for each additional pound of cotton exported. That's way above the target price level for these two crops and it is difficult to justify on purely economic grounds. But it is the only way sanctioned by the Farm Bill to bring cotton and rice prices down to the world level.

If the marketing loan concept was used for wheat it would cost U.S. taxpayers about $5.00 for each bushel increase in wheat exports. For corn and soybeans it would cost about $6.00 for each bushel additional exports.

For this reason I am sure the Secretary will continue to oppose the marketing loan for wheat, feed grains and soybeans. But, at the same time, there is an array of other tools in this bill that will enable the U.S. to reassert herself as a competitive, high-volume, low-cost producer.

We will not be able to recapture our lost export markets overnight. It will take time but as we do, the United States can have a major influence on the rate of growth in global agricultural trade. Macroeconomic, trade and aid policies all can influence the rate of growth in the developing countries. And the United States also can influence the global environment towards trade liberalization.

For the United States to regain its competitive position in world trade, efforts must be redoubled in research and development to raise productivity and thereby reduce unit costs. Past R&D investments have accounted for at least half of U.S. agricultural comparative advantage but we have been falling behind in our public support of this area relative to our competitors and markets.

We also need to recognize that greater purchasing power in the developing countries is the basis for an expansion in world agricultural trade. Broad-based domestic income growth will raise demand for improved diets, and increased foreign exchange earnings will allow greater imports to support growth in domestic food demand. The United States has a good track record in turning food aid recipients into sound commercial markets. Japan, Korea, Taiwan are prime examples and we need to built future commerical markets for U.S. products in the developing countries.

Very importantly, we need to move into the next GATT round of Multilateral Trade Negotiations to move from the path of increasing protectionism towards a freer and more open trading environment. Without liberalization, the morass of tariff and nontariff barriers now in place will continue to reduce the stability of and participation in world agricultural markets.

With liberalization, we can expect the world market to operate more efficiently to the benefit of both importers and exporters. Trade liberalization also would lead to higher world market prices as all reduce subsidies that cause overpricing, and greater international price stability as market adjustments would be spread across a larger number of importing and exporting countries.

The United States will have to offer concessions in agricultural as well as nonagricultural traded goods to receive concessions. But that is the aim of the MTN, to avoid bilateral confrontations with key trading partners that could hurt the long-run prospects for agricultural export growth. Without question, the United States must continue to oppose protectionist leanings such as are included in the House trade bill. The growing tide toward protectionism threatens to undermine the operation of the market--particularly its ability to balance changes in supply and demand with a minimum of price disruption, and to move the market away from, rather than toward, a viable stable equilibrium.

As we move to regain our share of the global market, and continue into the transition to a market-oriented agriculture, some painful adjustments will be entailed. But in the long run this approach is the only assurance of a healthy and competitive farm sector for America.

Thank you.