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AGRICULTURAL-FOOD POLICY PERSPECTIVE FROM WASHINGTON

J. Dawson Ahalt

In 1982 farmers were in their third year of depressed net incomes. Crop prices were under severe pressure and had fallen to the lowest levels since 1978. Even farmland prices were declining, in nominal terms, for the first time in three decades. Farmers who were highly leveraged were facing severe financial problems. Some will have extreme difficulty in obtaining adequate financing for their production expenses in 1983 and beyond.

U.S. agricultural exports which demonstrated an enviable record of growth in the 1970s decade in value and volume were declining for the first time in thirteen years. This means that the rapidly growing export market for U.S. farm products had stagnated or turned downward. As a result, commodity stocks, especially for grains increased dramatically. By the end of the 1982/83 marketing year the United States is expected to hold over 150 million metric tons (MMT) of grains which will account for nearly 60 percent of the world's carryover stocks. Nearly three-fourths of these stocks were in the farmer owned reserve or were owned outright by the Commodity Credit Corporation (CCC), they exerted a downward pressure on commodity prices. Put another way, 150 MMT of projected grain stocks represents half the annual total amount of U.S. grain used domestically and exported in recent years. So we have a serious problem.

FACTORS ADVERSELY IMPACTING AGRICULTURE

Six factors contributed to the agriculture price and income problem of the 1980-82 era. They were mainly, although not totally, international in scope and demand related:

1) The global recession; 2) The financial problems in Eastern Europe, Mexico and a number of other important developing nations; 3) The strong U.S. dollar; 4) U.S./Eastern Bloc tensions; 5) Unfair trade practices in the European Community (EC), Japan and elsewhere; and 6) Large global crop supplies.

The Global Recession

The worldwide recession of 1980-82 severely affected economic performance in all of the major developed market economies and virtually flattened the demand for agricultural commodities. The demand for feed grains used to produce meat, milk and eggs were most severely impacted. In fact, global consumption of feed grains which expanded an average of 16 million metric tons annually during the 1960s and most of the 1970s, was virtually flat between 1978/79 and 1982/83. Similarly, world consumption of wheat, which increased an average of

over 10 million metric tons per year in the 1960s and 1970s, did not increase from 1979/80 to 1982/83. The story is nearly the same for cotton and soybeans.

Most governments took some steps in the early 1980s to place their economies on sounder footing. Stringent monetary and fiscal policies succeeded in reducing inflation. Although unemployment will likely remain high in many countries, improved economic growth in 1983 is anticipated. Expanding economic activity should have a positive impact on the demand for farm products in 1983 and beyond. Unfortunately, the recovery is not expected to be strong enough to offset the other problems.

Financial Problems

Also contributing to a significant reduction in demand for grains were the financial problems facing Poland, Romania, Mexico, Brazil, Portugal and a number of other developing economies. The financial problems in these countries have enormous implications for lending institutions throughout the Western world. They also point to significant reductions in demand for U.S. agricultural products. East Europe was an important growth market for U.S. grains during the 1970s decade. During the crop year, 1981/82, U.S. corn and wheat exports were down more than 6.5 million tons or 60 percent from the peak reached during 1979/80.

Unlike the worldwide recession, from which the industrialized market economies are expected to recover, the financial crises in East Europe, Mexico and elsewhere will not be easily solved. These countries relied heavily on credit from financial institutions in the developed countries during the 1970s. The defaults in Poland and the problems incurred elsewhere encouraged lenders to turn elsewhere for investment opportunities.

Value of the Dollar

Another factor adversely impacting international trade in farm products, and especially demand for U.S. agricultural exports, was the 1980-82 strength of the U.S. dollar relative to other currencies. Decisions to devalue and eventually float the dollar in the early 1970s were major factors contributing to growth of U.S. agricultural exports in the 1970s decade. However, as the dollar strengthened relative to other currencies during 1980-82, U.S. farm products became more expensive to foreign buyers.

U.S. producer prices for corn, wheat, soybeans and cotton were sharply lower in 1982 compared with 1980. However, prices for these products to the foreign buyer were more expensive because foreign currencies weakened relative to the U.S. dollar. The

impact was greatest in the low income countries with typically weak currencies.

While the July-November 1982 decline in U.S. interest rates suggested that the dollar was easing in relation to other currencies, interest rates in other countries also declined, leaving the relationship relatively stable. Despite obvious problems in the U.S., the economic situation in most other parts of the world makes the United States look like an "investment haven." Hence, a strong world demand for dollars persists. As long as this continues, U.S. farm products will be relatively expensive to foreign buyers while foreign products will be attractively priced to U.S. buyers.

We must also realize that while domestic monetary policy has some influence over the various financial variables, exchange rates are set in an international market. Our ability to deal with this issue, even if we wanted to weaken the dollar, is limited. Agriculture is one of the few U.S. industries with a strong export market — but the farm community finds it difficult to generate interest in regard to this issue. Some have called for some form of exchange rate equalization fund. Future developments will be interesting.

East/West Political Tensions

The United States has made several sincere efforts to improve trading relations with the Soviet Union, but problems in Poland continue to spark political tensions between the United States and the Eastern Bloc countries. These concerns contribute to to uncertainty associated with East/West trade.

In response to this problem, there is intense interest in the sanctity of export contracts. The President offered the Soviet Union additional contract assurance on grain purchases under the long-term U.S./USSR grain agreement. This issue will continue to be debated until a satisfactory solution evolves. Over the long run the United States' reputation as a reliable supplier of agricultural products will depend on future performance.

Unfair Trade Practices

Few issues generated more concern during 1982 than the unfair export competition from the European Economic Community. For years the U.S. agricultural community wrestled with the Europe's Common Agricultural Policy (CAP) in an effort to discourage their high internal price structure and variable levy system. As the EEC is the United States' major agricultural export market, this contributes to rather delicate negotiations. As the EEC emerged as a major agricultural exporter, the situation becomes dramatically altered.

The EEC ranks as the world's second largest exporter of agricultural products. This is especially troublesome for the United States due to the EEC's use of export subsidies which enables them to compete in developing country markets. Currently the Community is the world's largest exporter of sugar, dairy products and poultry; the world's second largest exporter of beef; and a major exporter of wheat. Many of the EEC exports are highly processed — such as meat, manufactured dairy products, and flour — however, they still compete directly with raw agricultural commodity markets that the United States established over several years.

The heating up of the debate over the Community's use of export subsidies during 1982 was probably only the beginning. The EEC spends \$6 to \$7 billion annually on export subsidies. Many U.S. agricultural groups are pushing hard for the United States to take more aggressive steps to fight these subsidies. The General Agreements on Trade and Tariffs (GATT) Ministerial meeting in November 1982 was a forum addressed to resolve some of these problems. However, agreements satisfactory to the U.S. did not materialize, thus the pressures on the U.S. to take strong action continued to mount.

Burdensome Commodity Supplies

This brings me to the supply problem with which agricultural economists have traditionally dealt. World agricultural production of grains, oilseeds and cotton reached a new record in 1981/82, despite poor crops in the Soviet Union. In 1982/83 grain and oilseed production reached another record, while global cotton output dropped due to reduced crops in the United States. However, with large carryovers from the 1981/82 record crops, supplies in 1982/83 are record large.

Voluntary acreage controls have typically been the principal tools to which agriculture policy makers have turned in order to balance commodity supply with expected demand. In the 1970s the reserve program became an additional component. However, excess supplies of 1982/83 transcended the ability of traditional programs. Moreover, while 1983 will mark the second consecutive year that the United States has imposed voluntary acreage programs, the fact that the other major exporting nations have continued to expand planted area poses an additional problem for the U.S.

EMERGING GOVERNMENT INITIATIVES

Reviewing the evolution of 1980-83 problems provides guidance as to what actions should and should not be taken — it is particularly useful in clarifying what Government can do.

The No. 1 market for farm products is the domestic commercial market. The condition of that market depends on the strength of the economy. Thus, the first priority of Government is to help build and maintain a vibrant, strong and expanding job-making economy.

There are some encouraging signals. The 1980 inflation rate of 13 percent decreased to about 5 percent in 1982. The prime interest rate of 20 percent in 1980 dropped to 11 percent — and each one-point drop in interest rates on the outstanding farm debt has the potential to raise farm income 10 percent. Prices farmers paid for all commodities — including services, interest, taxes, and wage rates — increased 3.3 percent during 1982, compared with a 12 percent increase during 1980.

Farmers' No. 2 market is the export market. The rules of international trading are set by governments. So our Government has a responsibility to help American farmers capitalize on their efficiency by working to keep international agricultural markets competitive; to free up trade restrictions; and to counteract subsidized farm exports where American farmers must compete against foreign treasuries.

Export Credit Program

Where our Government is not successful in freeing up trade, or removing obstacles, or reducing foreign export subsidies, then we need to aggressively protect our markets. We favor using a greater share of our available public funds in aggressive programs to expand exports. On October 20, 1982, the U.S. Department of Agriculture announced a three-year "blended credit" program — interest-free direct export credits blended with government guaranteed private credit — to expand agricultural exports through lower interest rates on those exports. This blended credit program allocated \$100 million in Government credit to be blended with \$400 million in credit guarantees in fiscal year 1983. Within a month, use of the total \$500 million had been applied for by foreign customers. This cleared the way for the sale by private U.S. exporters of more than two million tons of wheat and substantial quantities of corn, vegetable oil, soybean meal and cotton.

At least an additional \$1 billion in blended credit beyond the \$500 million was authorized in October 1982. This new offer should also provide exports that would not otherwise be realized and give an added thrust to the goal of relieving the downward pressure on U.S. farm prices caused by excessive supplies.

The American public does not want the Government to sit by while our farm exports suffer. Every American has a stake in farm exports, since those exports create a favorable balance of agricultural trade that compensates for our deficits in industrial trade. Our strong favorable balance in agricultural trade benefits every American who uses petroleum or imported consumer goods. Every \$1 billion in agricultural trade creates an additional \$1 billion in U.S. economic activity; that means jobs — 35,000 jobs for each additional \$1 billion in exports.

We must maintain our creditability as reliable suppliers. That reputation has been tarnished only by our Government in the past — not by farmers and their ability to produce and compete. In early 1983, President Reagan acted to restore our role as a reliable supplier. He signed the Commodity Futures Trading Commission Reauthorization Act which contained provisions to ensure the sanctity of contracts for purchase of agricultural commodities. The Reagan Administration has a strong policy to support farm exports and that policy must and will be maintained with actions as well as words.

Production Adjustment Incentives

The Government also has a proper role in helping farmers make temporary economic adjustments. We can help farmers adjust production. The 1983 farm commodity programs were announced early. Although voluntary, we are strongly advising farmers to take advantage of 1983 programs in order to reduce acreage and better balance supply and demand. We are also concerned that other exporting nations are not exercising similar measures of restraint. All nations must realize that everyone cannot continue to subsidize their surpluses into the world market to support artificially high prices internally. Stocks are too large, production increases too great and demand is too weak for the market to absorb the surplus. Production adjustments must be made.

We can offer farmers loans on their crops to

carry them over harvest gluts and periods of unusual production. The Government provided a record \$12 billion in financial assistance to farmers in fiscal 1982, and while there is clearly a limit to this, two facts must be pointed out to keep these outlays in proper perspective.

First, \$6 billion of the \$12 billion in outlays in fiscal 1982 was in the form of commodity-secured loans that farmers will repay or turn the commodities over to the Government to sell. Secondly, the additional \$5-6 billion spent in 1982 to keep agriculture viable has to be weighed against the longer term benefits agriculture provides to the general economy.

A viable, productive agriculture provides the American consumer with a stable supply of high quality food at one of the lowest costs in the world. Agriculture's record output has been instrumental in keeping the farm sector's share of food price increases over the last three years to less than 12 percent, compared to a 33 percent general rate of inflation. If farm price increases had matched the general inflation rate, American consumers would be spending \$15 billion more for food this year. In addition, had farm prices increased at the general rate of inflation, both the government and the private sector would be paying \$5 billion or more in 1982 in payments for food stamps, welfare and related Federal programs, and public and private retirement tied to the cost of living. These savings, coupled with the contribution that agricultural export earnings make to the U.S. trade balance and increased employment, more than offset outlays to support agriculture.

Risk Aversion and Credit Initiatives

The Government can help farmers insure against natural risks with an aggressive crop insurance program. We have that kind in place; we are continuing to make improvements in it.

The Farmers Home Administration is working closely with the American banking community, and with the Farm Credit System, to help farmers find operating credit. In fiscal 1982, the Farmers Home Administration shared with private lenders in participation lending for 30,000 loans. That was nearly double the participation loans the year before.

Perhaps we can do more to emphasize research on new uses for farm products. We maintain a strong research program to increase farm production and reduce farm costs — it seems only logical that we also emphasize research and pilot projects to find new uses for the increased production.

Our common desire to rejuvenate U.S. agriculture should not blind us to the dangers of asking Government to go beyond what history has shown to be its capabilities. We may have to consider some dramatic and innovative approaches to 1980-83 problems, but there should be no doubt in anyone's mind that a strong, market-oriented agricultural policy with minimum Government intervention is the final solution — but how do we get there from here?

Payments-in-kind (PIK) Program

In addition to the additional funds for blended credit and the establishment of contract sanctity, President Reagan also implemented a

payment-in-kind program. A PIK program would call for payments-in-kind to farmers who agree to reduce their production beyond what is called for in the 1983 programs for wheat, corn, grain sorghum, rice, and upland cotton. The basic concept of PIK is that farmers are offered an amount of commodity as payment for reducing additional acreage.

The PIK program has several appealing and unique features:

- * Production can be reduced beyond that expected under the 1983 programs for wheat, corn, grain sorghum, rice, and upland cotton, and thus bring supply back into closer balance with demand.

- * Stocks can be reduced at the same time that production is cut back, lessening the overhang on the market at harvest in 1983 and enhancing the prospects for a market-led recovery in farm prices and incomes in future years.

- * The availability of market supplies will be maintained, signaling to exporters and importers that the United States fully intends to remain a reliable and consistent supplier when production adjustments are made. To meet our long-term export and food aid commitments, adequate reserves will be maintained.

- * Government outlays for domestic programs (e.g., loan volume, storage payments, deficiency payments) should decline.

- * The PIK program, unlike other emergency measures, is self-terminating when excessive stocks have been worked off.

- * Farmers would have the same or greater net returns while stocks are being reduced.

- * Sound conservation practices would be applied to a larger acreage.

- * Storage space problems would be lessened.

International Donation of CCC Commodities

The United States has been blessed with the capability to produce agricultural products beyond its own needs. With so many hungry people in the world, it seems only reasonable — in fact, responsible — that some of this bounty be shared.

We will need Congress to give the Secretary of Agriculture the authority to distribute surplus CCC grain stocks to the needy in other parts of the world. Authority should be granted under Section 416 of the Agricultural Act of 1949, as amended, to distribute stocks of wheat, feed grains, rice, and other commodities. Such authority was recently provided for surplus CCC dairy products. It should be extended to allow distribution of other commodities through public and nonprofit private humanitarian organizations. To assist in such donations, the CCC should be authorized to pay for any necessary repackaging, transportation, handling, and related charges. These donations would be in addition to PL-480 and other forms of U.S. aid already in place. Also, if the program is implemented, the commodities would be targeted in a way that does not compete with commercial sales abroad.

Production Incentives and Price Competitiveness

The umbrella over world prices created through the persistent upward ratcheting of domestic support prices during the 1970s inflationary spiral has served

to encourage production in other countries. This surplus production is then subsidized into the world markets we desperately need if we are to keep our agricultural base fully employed. We need to send the right signal to producers in this country as well as around the world.

Dairy is an excellent example of my concerns. For the last several years, dairy farmers have been responding to rising milk support prices rather than to actual demand levels. They have increased the dairy herd and production per cow in the face of excess supplies. Now, under pressure to reduce milk output, they have three hard choices: cutting back production, switching to other enterprises, or finding work off the farm. No one likes these choices, but there are no alternatives. We may find ourselves in the same situation with grains.

The 1981 Farm Act mandates that the target prices for wheat, feed grains, rice and cotton be increased each year over the life of the bill. While these increases may have seemed fairly reasonable in the context of rapid inflation, dramatic improvement has occurred in reducing the rate of inflation. The mandated increases in the target prices now provide incentive for production increases at a time when moderation is needed. Production costs increased only 3 percent in 1982, and many input prices were actually lower than in 1981. We must make sure that after stocks are reduced substantially, we do not have price supports and target prices that would get us back into the same situation we are in today.

AGRICULTURE AT A CROSSROAD

Agriculture is vital to the U.S. economy. It is vital domestically and vital to the international interest of the United States. Broadly defined, agriculture is the Nation's largest industry with assets equal to about 88 percent of all U.S. manufacturing corporations. Agriculture also is the Nation's largest employer. The value added to farm products as they flow through the economic system amounts to 20 percent of the Gross National Product and requires the services of more than 23 million people, or about 22 percent of the labor force.

There is clearly no substitute for a strong, market-oriented agricultural policy with minimum Government intervention. However, the present situation of burdensome supplies and weak demand calls for some bold, innovative actions to get agriculture back on course. In our efforts to restore prosperity to agriculture, we welcome your suggestions.

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