Economics, Politics and the Farm Outlook

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Farm Credit Services of Mid-America Conference
Hyatt Regency Hotel
Louisville, Kentucky
Tuesday July 13, 2004

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Introduction

- **Will these prices hold?**
- **Commodity/farm policy**
  - **We have junked one traditional component of commodity policy**
  - **Why did we do that? What did we expect and what did we get?**
  - **Food and agriculture are different**
  - **Alternatives**
- **Land prices**
- **Future farmer challenges**

Will These Prices Hold?

- Definitely not (assuming a multi-year planning horizon)
- In fact, grain and soybean prices have dropped considerably from a month ago
- Prices for the CURRENT crop <u>might</u> rebound to month ago levels, however
  - Acreage estimates don't feel right to me
  - To much faith in "Rain makes grain"
- With current legislation and average weather:
  - $2 corn; $3 wheat; and $5 soybeans
  - Similar declines in livestock prices as cycles continue

In the U.S.—historically—there have been Two Major Components of Farm\Commodity Policy

- **Policy of Plenty:** Ongoing public support to expand agricultural productive capacity through research, extension and other means

- **Policy to Manage Plenty**: Mechanisms to manage productive capacity and to compensate farmers for consumers' accrued benefits of productivity gains

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We Have Dropped the "Managing Plenty" Part

In the past farm policies included:

- Floor price
- Supply management tools
- Price stabilization

Over the years and especially since 1996:

- All three were eliminated because of expectations—expectations that:
- **Exports would drive agricultural growth and prosperity, besides that…**
- *If markets are allowed to be allowed to work agriculture will do just fine*

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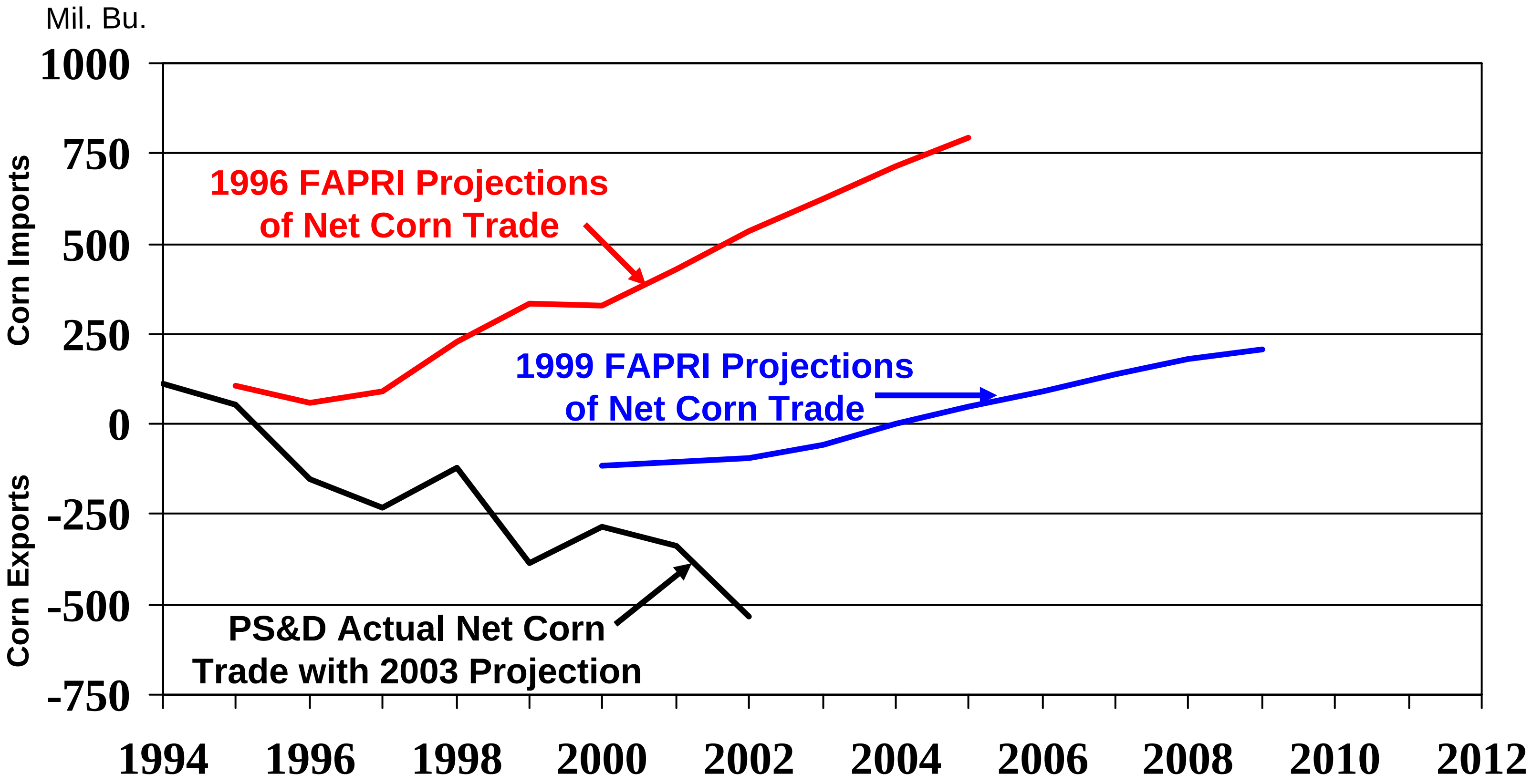
Expectations vs. Experience

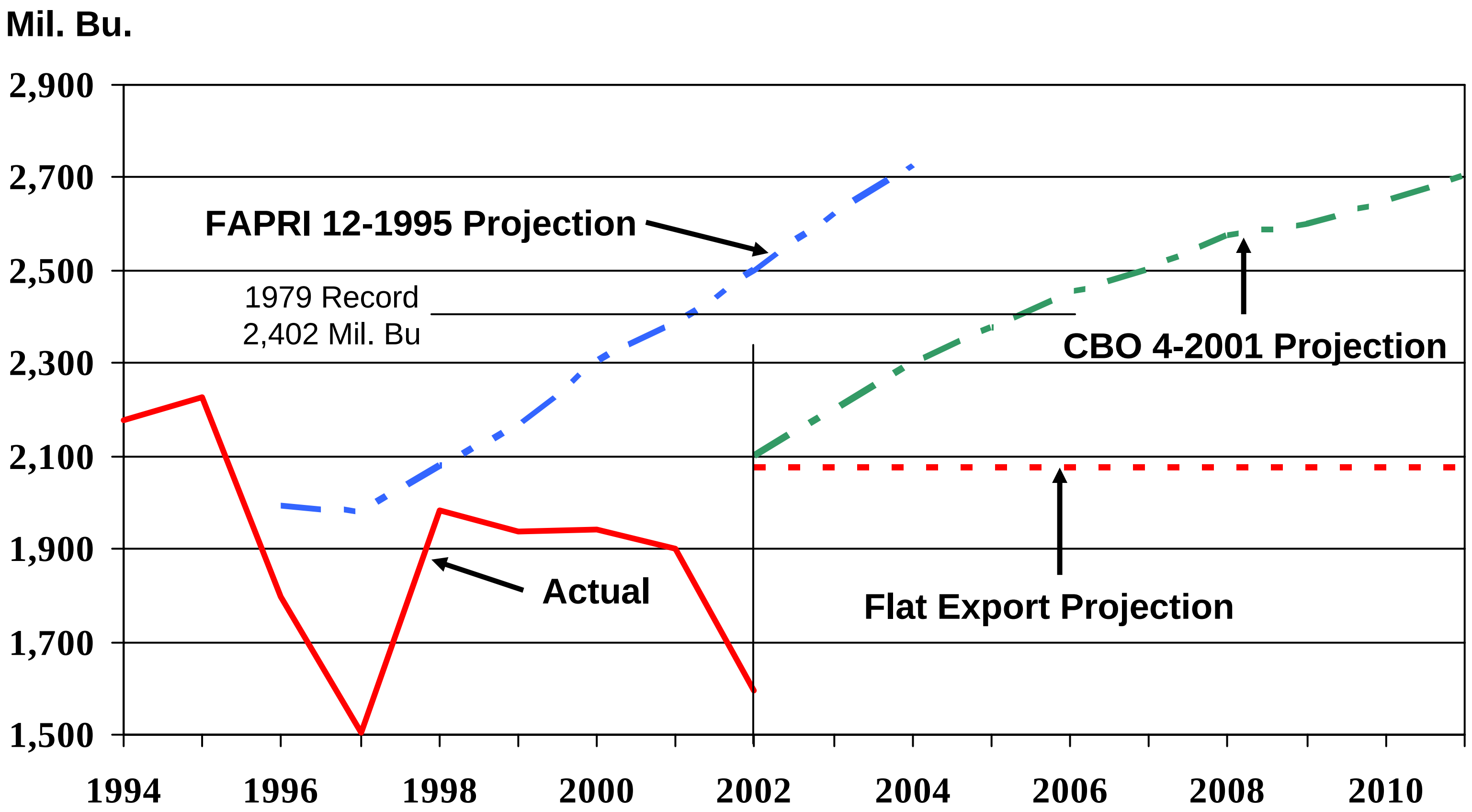
Expectation: Rapid per capita growth in China/Asia will increase demand and US exports

China Net Corn Trade

Comparison between 1996 and 1999 FAPRI projections and PS&D actual



Corn Baseline Projections
U.S. Exports



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Expectations vs. Experience

Expectation: Rapid per capita growth in China/Asia will increase demand and US exports

Experience:

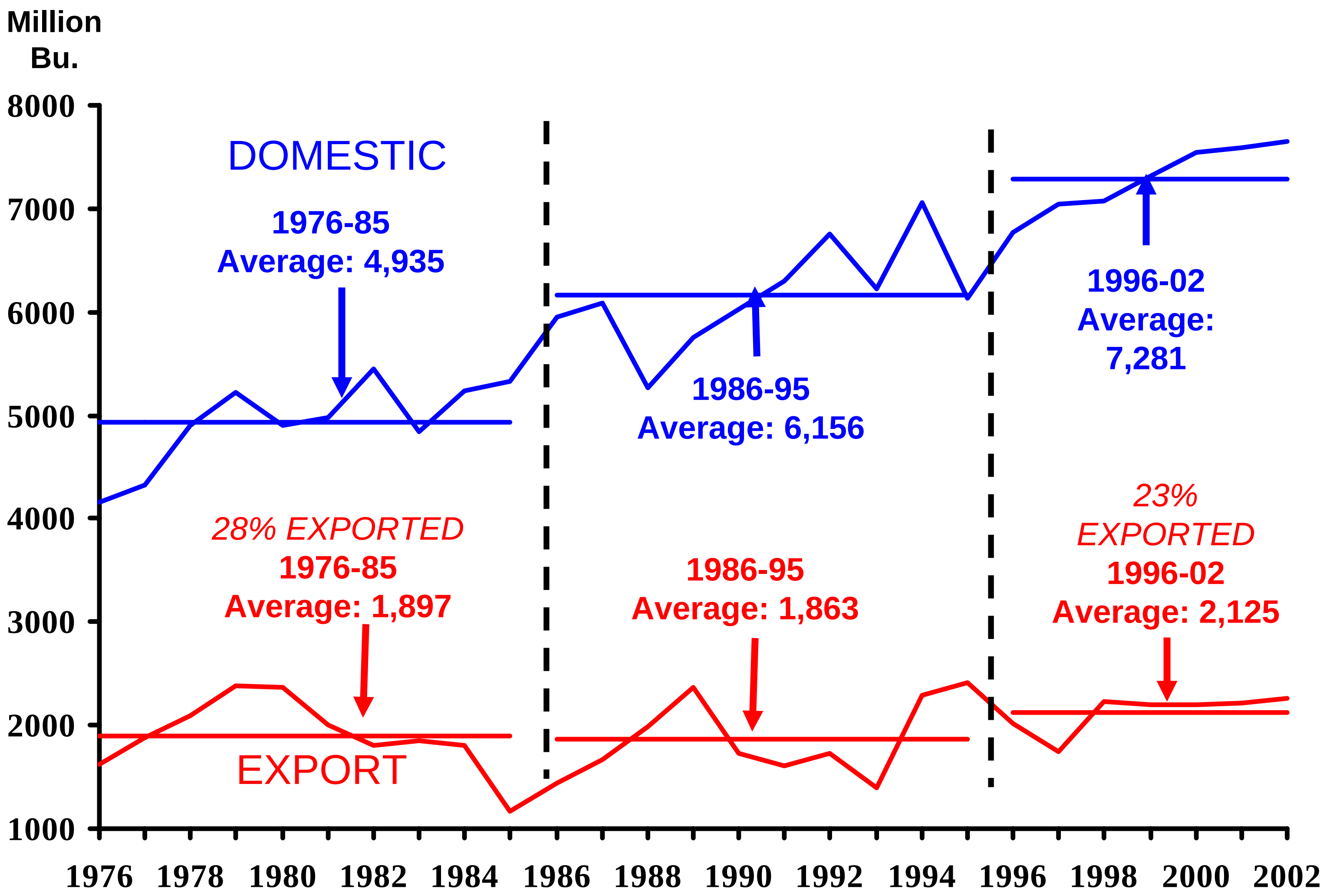
China exported over 500 million bushels of corn last crop year

Expectations vs. Experience

Expectation: Export led farm prosperity just around the corner (been saying this for over 25 years)

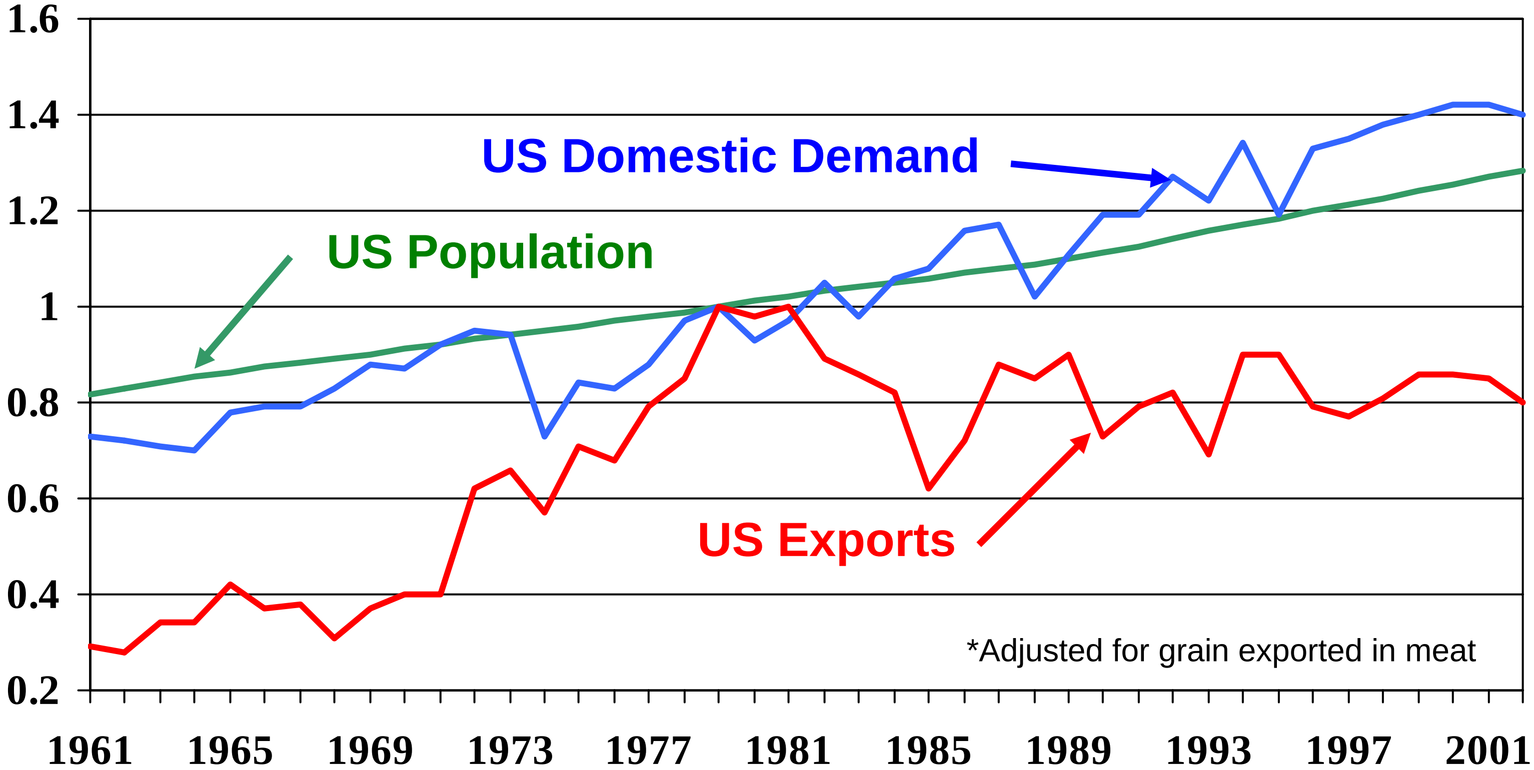
U.S. Net Domestic and Net Export Demand

Adjusted for corn fed to import and export beef, pork, and broilers



Source: USDA PS&D Database

Exports Did Not Deliver



Index of US Population, US Demand for 8 Crops and US Exports* of 8 Crops 1979=100

- **Exports down to flat for last two decades**
- **Domestic demand increases steadily**
- **Since 1979, exports have NOT been the driving force in US crop markets**

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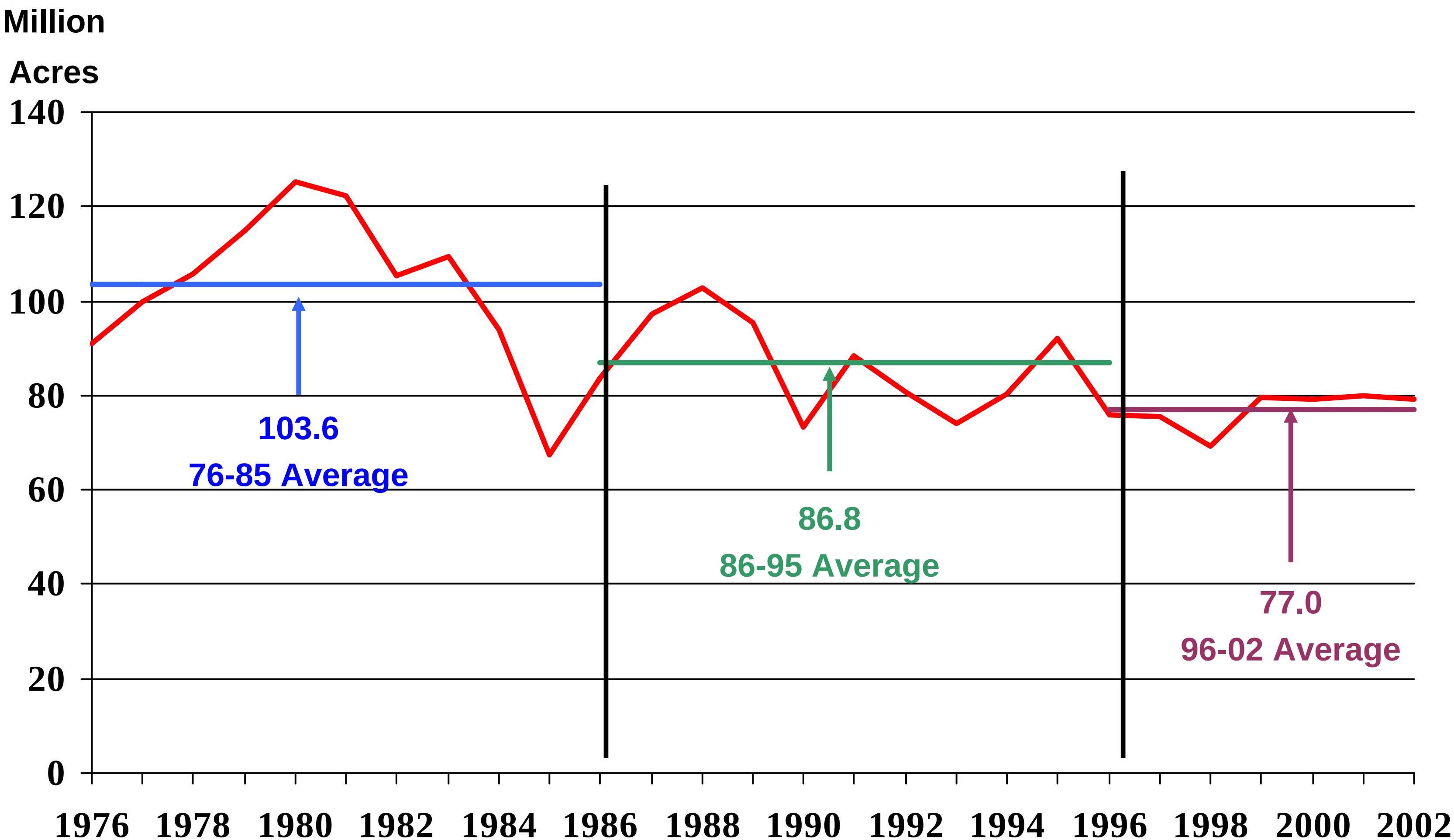
Net Export Acreage for 8 Major Crops



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Expectations vs. Experience

- **Expectation:** Export lead farm prosperity just around the corner (been saying this for over 25 years)
- **Experience:** Crop exports have been flat for years. Exports have not been the driving force of crop utilization

Expectations vs. Experience

Expectation: With no acreage set-asides and use of direct payments in US, competitors would not be under the US price support umbrella—would reduce production as needed

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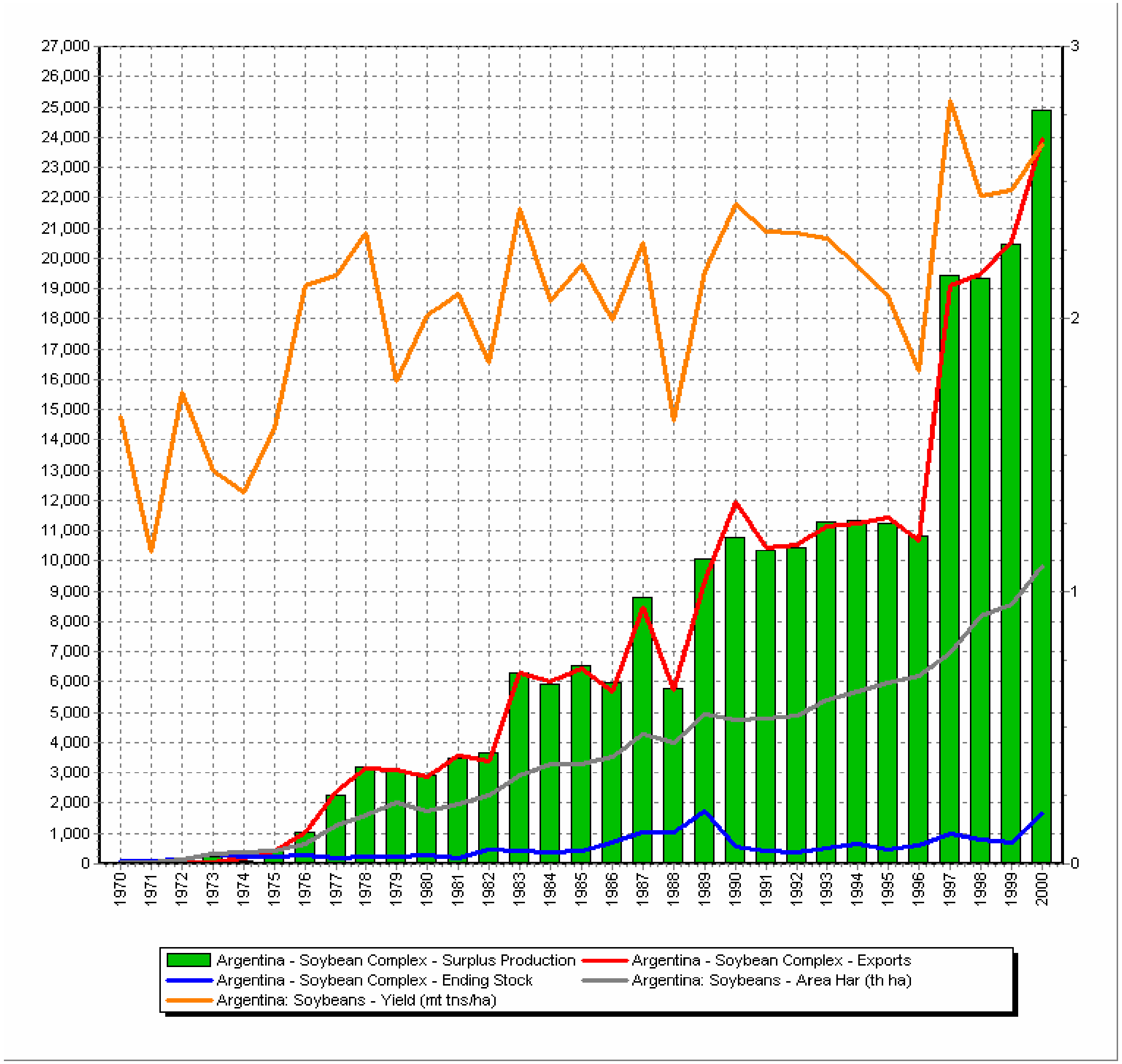
Argentine Soybean Complex Exportable Surplus and Exports



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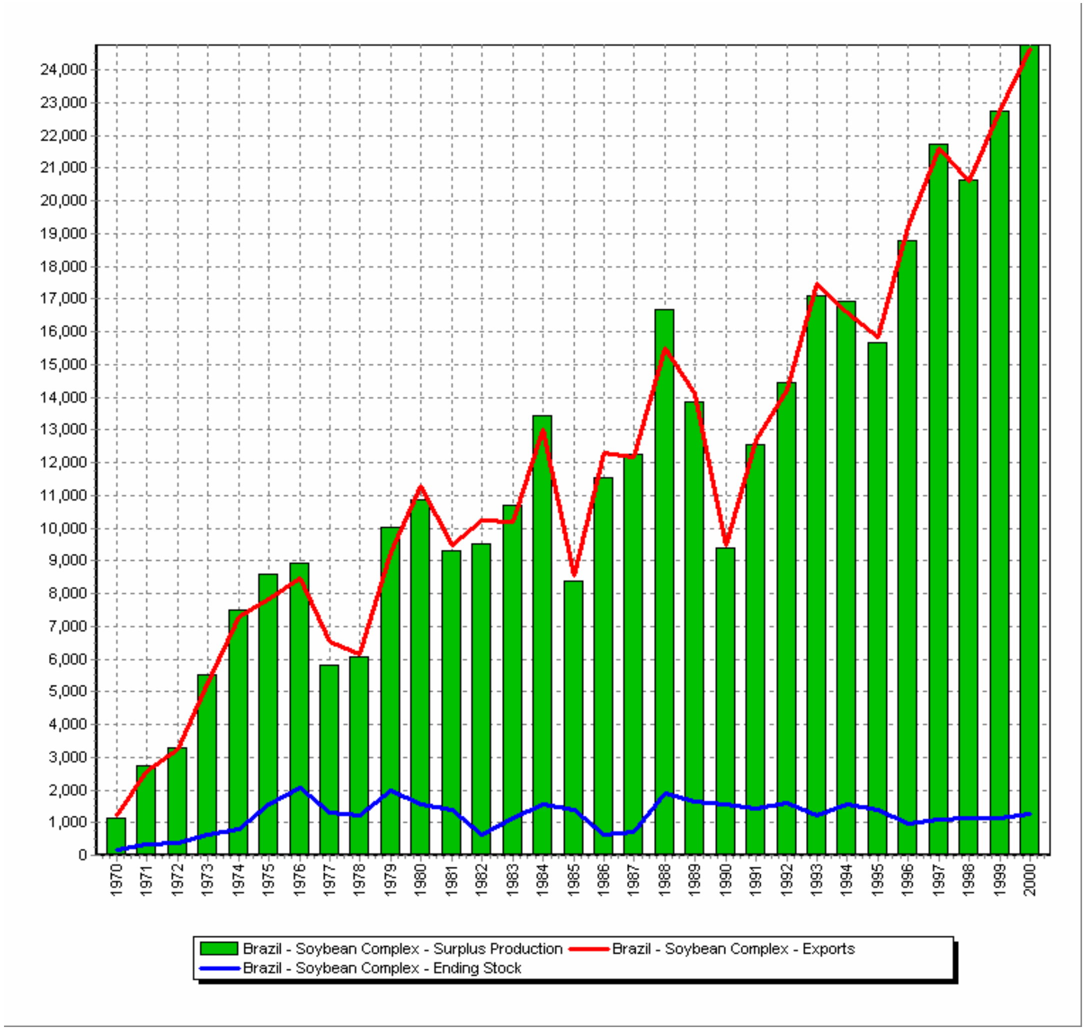
Brazilian Soybean Complex Exportable Surplus and Exports



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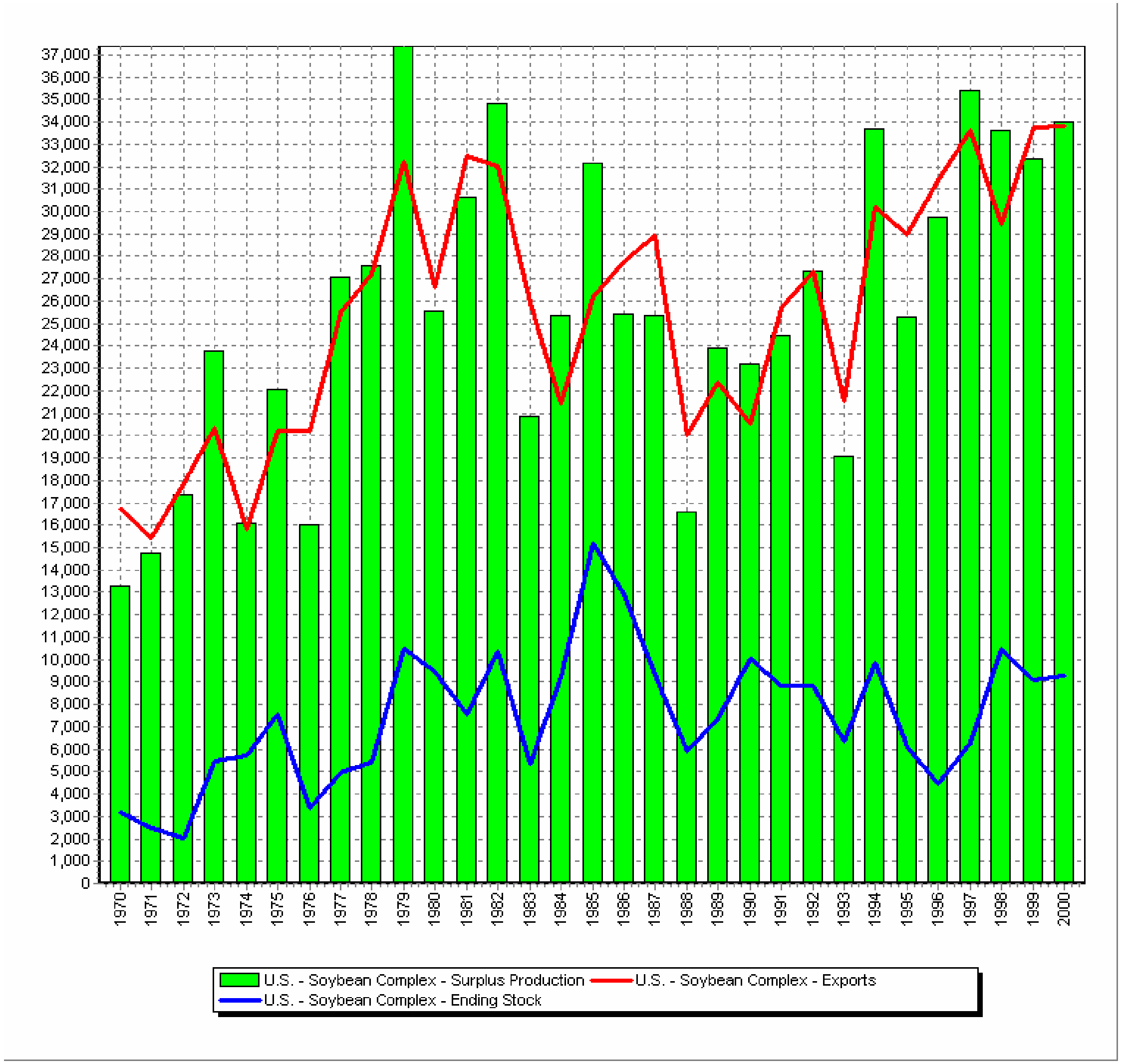
U.S. Soybean Complex Exportable Surplus and Exports



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Expectations vs. Experience

Expectation: With no acreage set-asides and use of direct payments in US, competitors would not be under the US price support umbrella—would reduce production as needed

Experience:

- Export competitors export all production above domestic demand
- Eliminating set-asides and lower commodity prices did not cause competitors to reduce acreage

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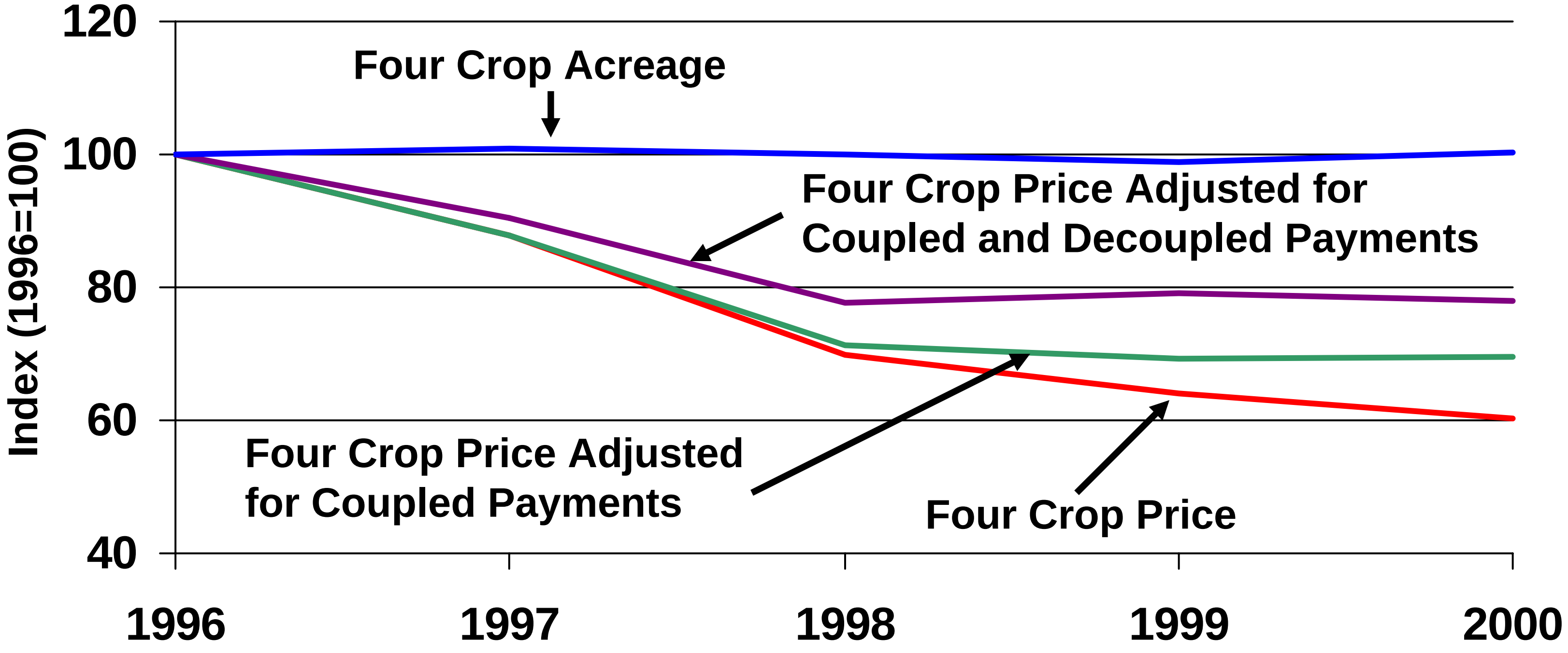
Expectations vs. Experience

Expectation: With planting flexibility & decoupled payments US farmers would plant for the market – reduce production when needed

Acreage Response to Lower Prices?



Since 1996

- ***Aggregate US corn, wheat, soybean, and cotton acreage changed little***
- ***While "prices" (take your pick) dropped by 40, 30 or 22%***

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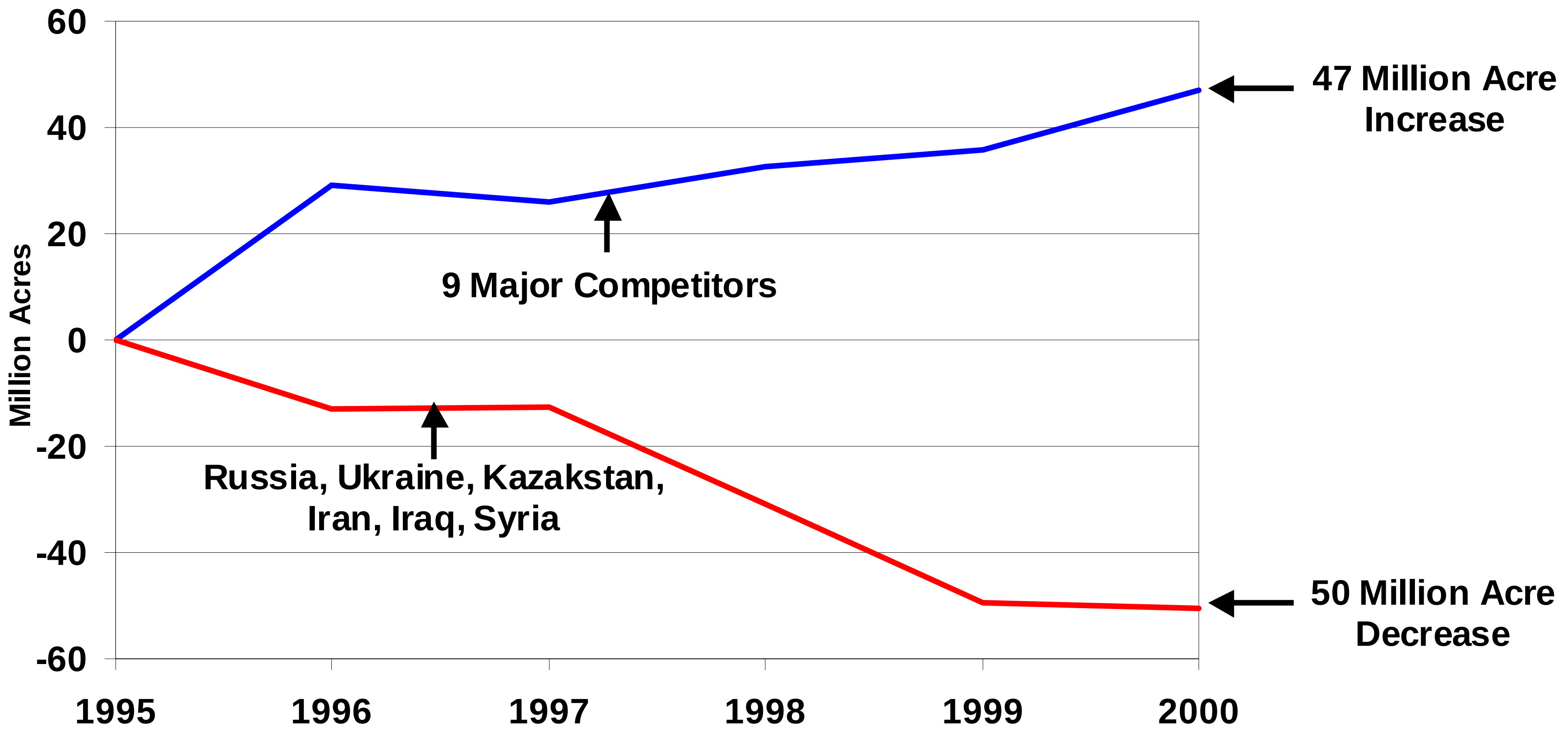
Change in 8-Major Crop Acreage of 9 Major Export Competitors



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Expectations vs. Experience

Expectation: With planting flexibility & decoupled payments US farmers would plant for the market – reduce production when needed

Experience:

- Farmers change the mix of crops but use all their acreage
- Farmers have every incentive to produce full out
- Land remains in production even if the current farmer goes bankrupt

Why Does Agriculture Have Chronic Price and Income Problems?

- **Technology expands output faster than population and exports expand demand**
- **Market failure: lower prices do not solve the problem**
- **Little self-correction on the demand side**
  - People will pay almost anything when food is short
  - Low prices do not induce people to eat more
- **Little self-correction on the supply side**
  - Farmers tend to produce on all their acreage
  - Few alternate uses for most cropland

Policy Premises

- U.S. and world output will continue to outpace demand
- Aggregate crop agriculture does not self-correct on its own (assuming otherwise is denying the obvious)
- Our export competitors are as committed to producing for international markets as we are
- Our import customers view food as a national security issue and abhor increased dependence

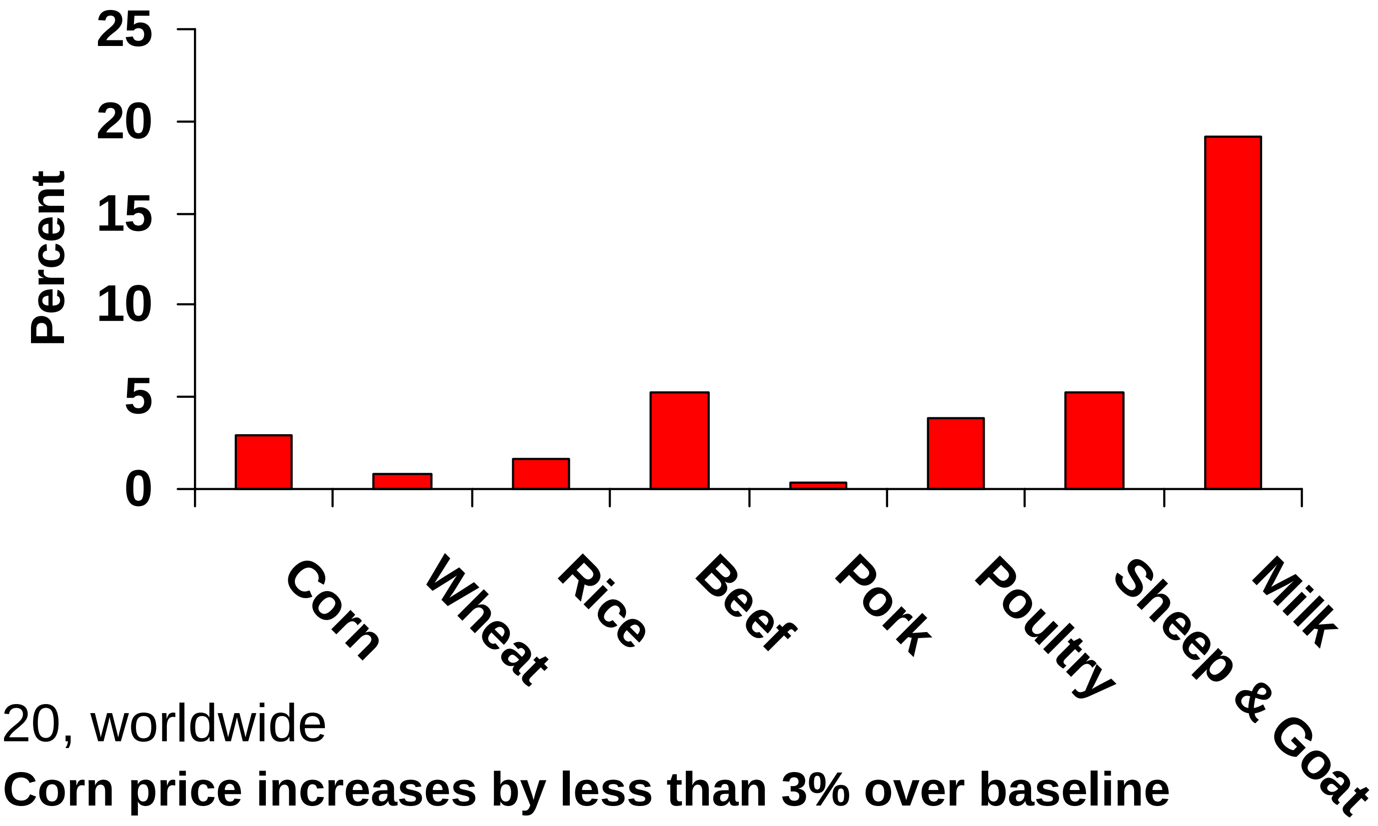
Possible Directions

- **Stay the Course**
- **Intensify the Free Market Prescription**
  - **Eliminate trade barriers and government distortions in developed countries only**
  - **Producers and consumers would be expected to properly adjust to market signals**
- **Bring back some traditional farm policy instruments**
- **Move toward dedicated energy crops**
- **Enlist multinational cooperation**

Stay the Course

- **More of the same**
- **Can expect:**
  - Continued low prices: $2 corn; $3 wheat $5 soybeans
  - Continued scheduled large government payments in US and developed world
  - Continued accusations of dumping
  - Continued benefits to livestock, importers and agribusinesses

Intensify Free Markets in Developed Countries



In 2020, worldwide

- **Corn price increases by less than 3% over baseline**
- **Wheat price increases by less than 1% over baseline**
- **Rice price increases by less than 2% over baseline**

IFPRI IMPACT

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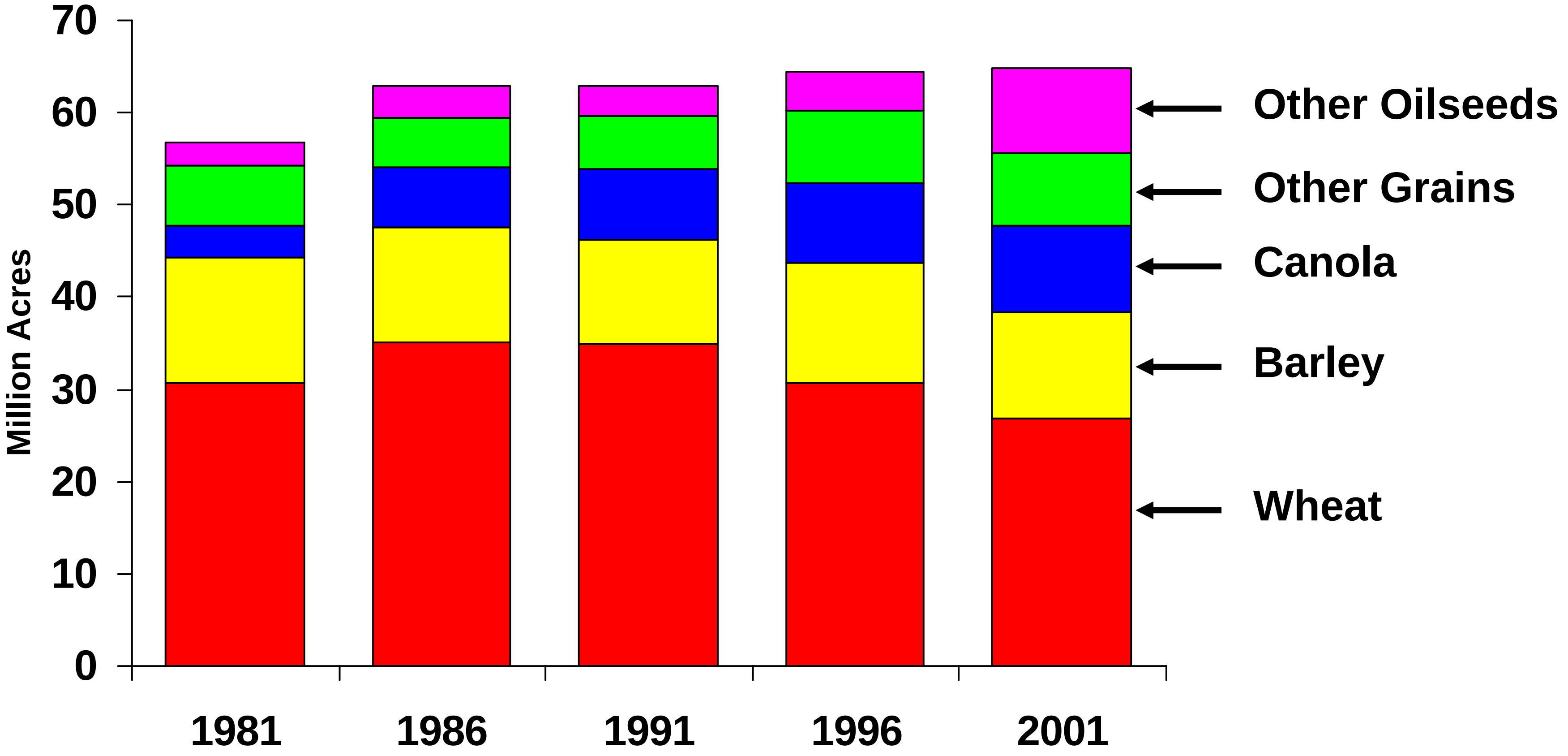
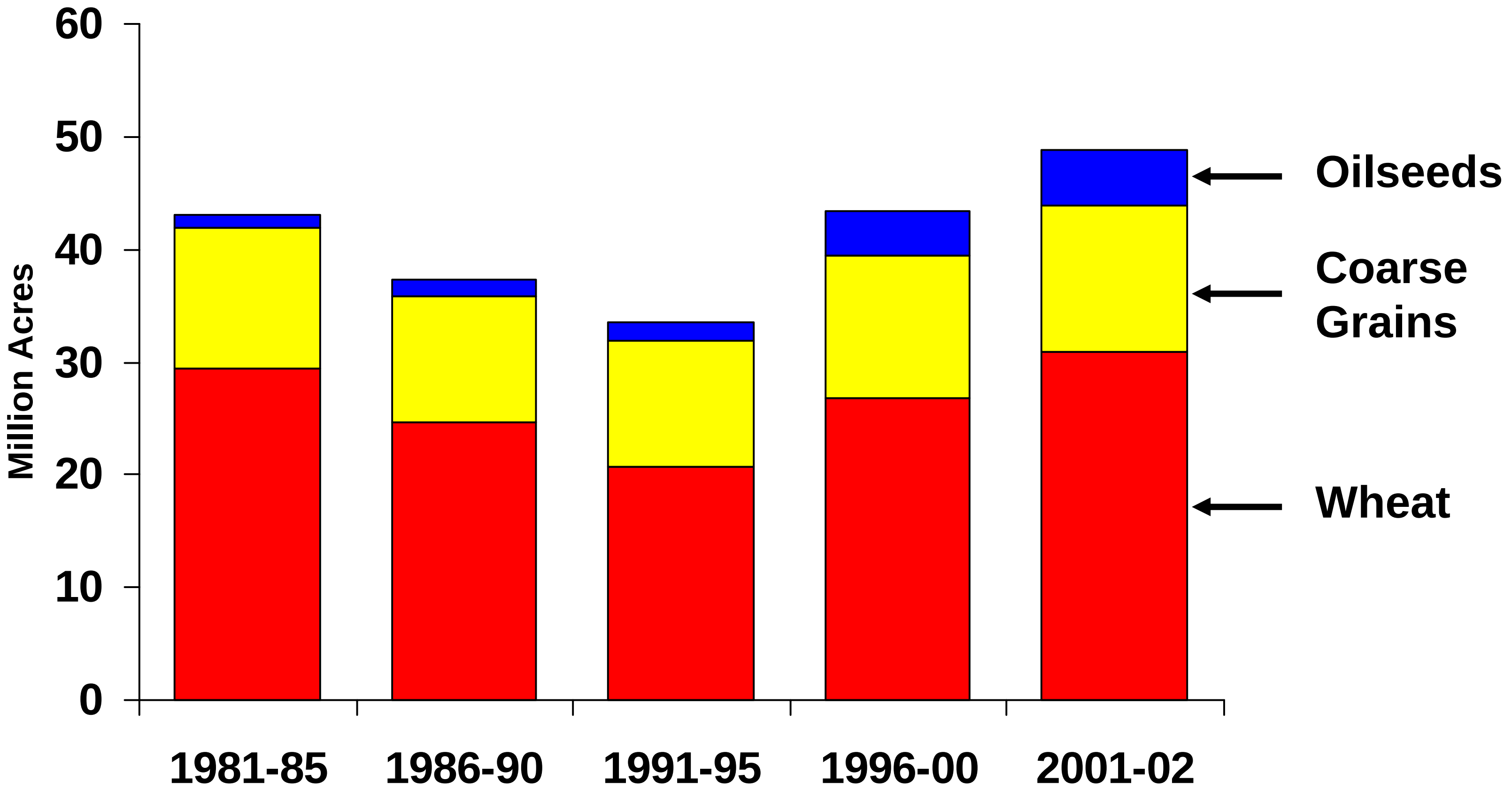
Canada: Farmland Planted



- Canada reduced subsidies in 1990s
- Eliminated grain transportation subsidies in 1995
- Crop mix changed, total acreage remained flat

Australia: Farmland Planted



- Australia dramatically reduced wool subsidies in 1991
- Acreage shifted from pasture to crops
- All the while, prices declined

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A More “Managed”

Alternative means of managing crop production could be considered

- Adding to existing CRP acreage
- Creating a shorter-term CRP-like program
- Reinstituting:
  - Annual Set-asides
  - Inventory/price support programs
- Energy crops – Could be a win-win-win

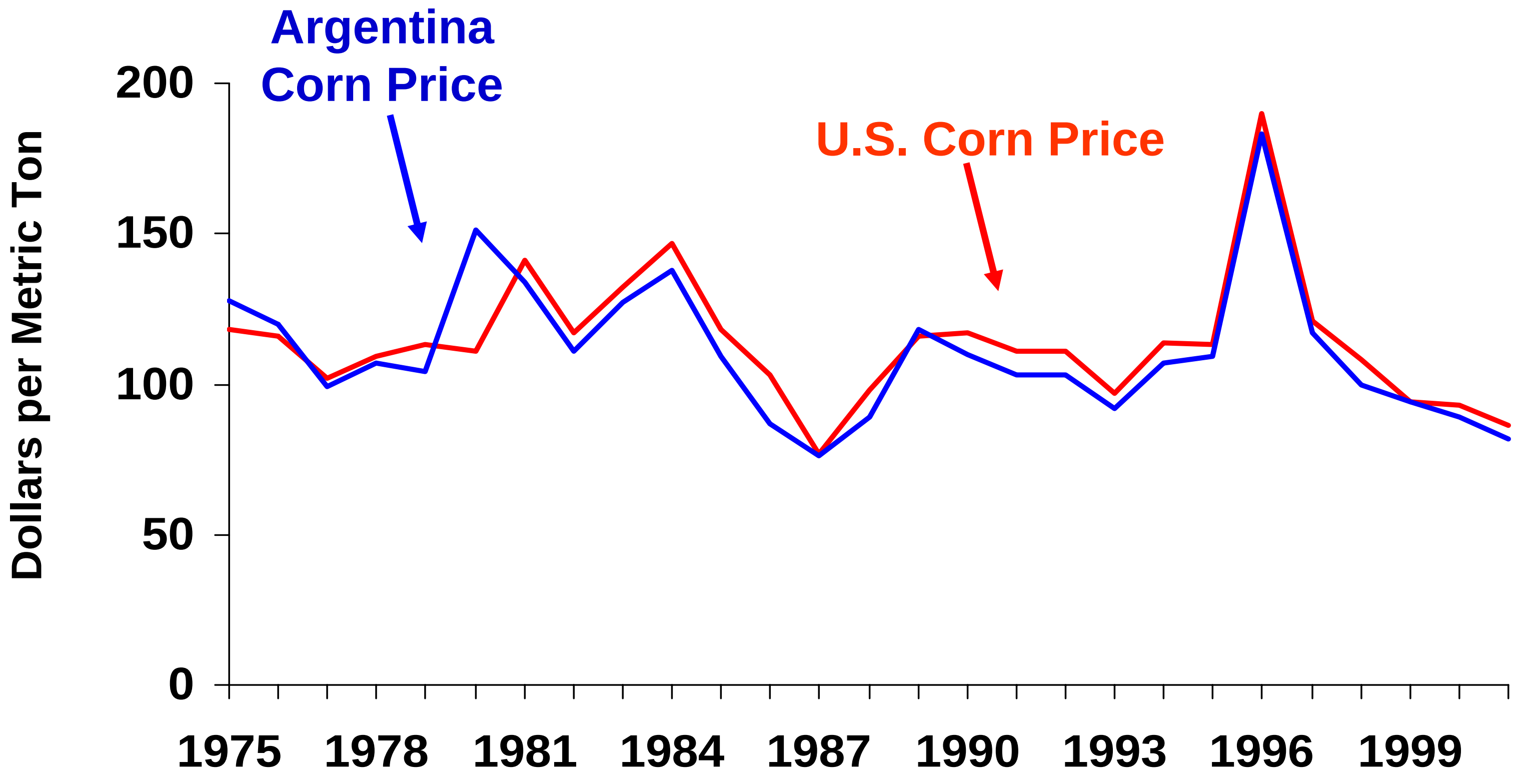
Merge Ag and Energy Policy

- Biofuels recycle atmospheric, not fossil, carbon
- Look at crops not in food equation
- Switchgrass
  - Perennial
  - Reduced inputs
  - Multi-year setaside
  - Burned in boilers for electricity
  - Converted to ethanol
  - Less costly than present ag programs

Multinational Cooperation

- Henry A. Wallace was right and Earl Butz was wrong – excess capacity, not scarcity, is the future of agriculture
- Presently the US can still affect prices with supply management
- Sometime in the future this will take multinational cooperation

Corn Price: US and Argentina



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Multinational Cooperation

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Worldwide Excess Capacity Will Be The Long-run Problem

- Dramatic yield increases in other countries
  - Cargill, Monsanto, John Deere, etc., etc., etc.
- Acreage once in production will be brought back in
  - Russia, Ukraine and others
- New Acreage
  - Brazil
  - China

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Touchstones

- Excess capacity is a good thing
  - We just don't need to use all of it all the time
- Managing production is the issue
- Total crop demand is not price responsive
- Total crop acreage reacts at glacial speed

Touchstones

- Most countries view food and agriculture the way we see national defense
- Our export competitors are as adamant about keeping their export markets as we are
- These “rules of the game” define how agriculture responds

Have Land Prices Peaked?

- GAO report on farm program payments
- WTO ruling in Brazil-U.S. cotton case
- Federal budget deficit
- Increased cost of production due to energy prices
- Increased interest rates on the horizon

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Farmer Challenges

- Low prices due to overcapacity from increased foreign production of grains, oilseeds, cotton, hogs, etc.
- Maintaining farm program expenditures
- Staying afloat—even (especially) the shakers and movers
- Recognizing that:
  - Can't export your troubles away
  - The U.S is not the low-cost producer
  - U.S. crop agriculture may be net-disadvantaged by WTO and other trade agreements

Thank You

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Comparative Advantage Theory vs. Realities of the Real World

"China attaches great importance to agricultural development and increasing the income of farmers."

"It is inconceivable that a country of 1.3 billion people will rely on others to feed themselves,"

Zhou Ming Chen, Chairman of the China National Cereals Oils and Foodstuffs Import and Export Corp.
Washington D.C.
February 17, 2004

"Faced with the choice of changing one's mind and proving one doesn't need to do so, ... we get busy on the proof."

John Kenneth Galbraith

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