



The Leading Edge of the Agricultural Economy

Current situation and future expectations

By

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General Outlook for 2001

The outlook for US agriculture in 2001 includes

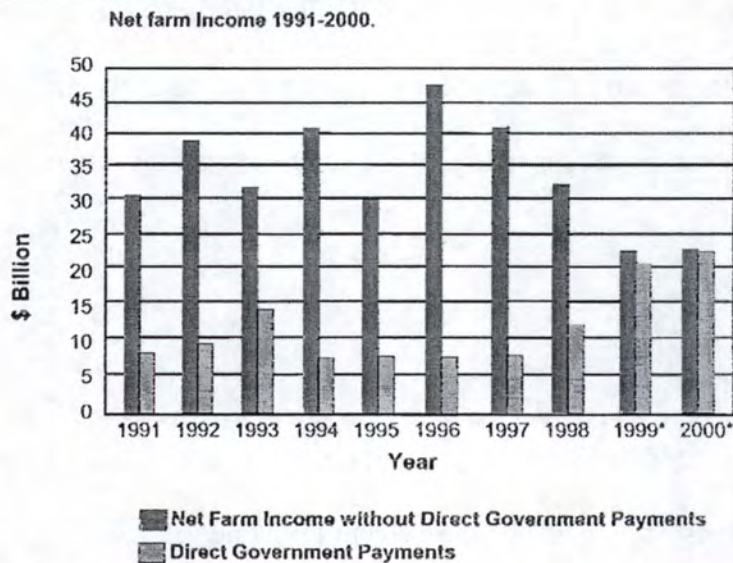
- (1) some recovery in farm prices,
- (2) favorable asset values and debt levels, and
- (3) lower farm incomes.

At first glance, this outlook seems to be fraught with inconsistencies. On the surface it seems that recovery of commodity prices should lead to higher farm incomes. On the other hand, if farm incomes are likely to be lower, it seems that should lead to unfavorable asset values and debt levels. As is often the case in today's economic world, these apparent inconsistencies are due to the fact that most economic issues, including the general situation of U.S. agriculture, are more complicated than they seem.

Agricultural commodity prices are expected to improve somewhat in 2001. Global stocks of most major crops are not excessive relative to historical situations. However, most agricultural prices are currently at very low levels. So expected improvement will come from very low bases. Strong improvements in prices of any particular commodities will only result if something (probably weather disasters) causes significant decline in global output of that particular commodity.

Even moderately higher farm commodity prices exert upward pressure on farm incomes. However, since 1999 farm incomes have been greatly supported by government payments (Table 1). Under current farm legislation and programs, government payments to farmers will decline very substantially in 2001. Projections are that they will decline by about 36 percent (from \$22 billion to \$14 billion). If this occurs, the decline in government payments to farmers will more than offset expected increases in farm commodity prices, so farm incomes will probably fall.

Table 1.



Source: USDA/ERS

*indicates forecast

Lower farm incomes seem to be inconsistent with the favorable asset values and debt levels in agriculture that were presented above, as part of the general U.S. agricultural outlook for 2001. Certainly, declining farm incomes do not help farmers financially. However, for such declining incomes to appreciably affect asset values and debt levels, they must usually occur over a longer period than just one year. Government payments to agriculture have supported farm incomes and asset values (especially land values) for

the last several years, and have also helped farmers keep their debt levels from growing. It is expected that, even with substantially lower government payments and lower farm incomes for 2001, asset values and debt levels of farmers will not be greatly affected. If farm incomes continue to be quite low beyond 2001, such indicators of financial stability in agriculture could become much less favorable. So government payments to farmers in 2001 will be very important determinants of farm income (or lack of it).

Examining the Details

Looking more deeply into the details of what will affect agriculture in 2001 does not appreciably change the situation described above. However, careful consideration of the details does facilitate better understanding of the complexity of the issues that affect U.S. agriculture today.

Farm Commodity Prices

Most agricultural commodities seem to have bottomed out, and indices of prices received for both crops and livestock are up about 5 percent from one year ago. However, as mentioned above, these increases are occurring from very low bases. Another factor that is likely to put upward pressure on agricultural commodity prices is the fact that the global economy, especially in Asia, seems to be growing once again. However, this growth is slow. Furthermore, the relative strength of the U.S. economy (much stronger than most of the rest of the world) will help to “keep a lid on U.S. farm exports.”

Once again, it may seem to be an anomaly that a strong U.S. economy damages U.S. exports of farm products. In this case, a strong U.S. economy has resulted in a very

strong U.S. dollar. This is largely because investors in other countries would like to hold U.S. dollars and investments denominated in U.S. dollars. They feel this way because they perceive U.S. dollars to be more stable (less risky) than other currencies. However, a highly valued U.S. dollar makes U.S. products (exports) more expensive to consumers in other countries. Consequently, they are willing to purchase and consume fewer U.S. products. The “flip side of this coin” is that U.S. consumers will pay less for imports from other countries as the strength of the U.S. dollar increases. So U.S. consumers benefit from a strong dollar while producers of U.S. commodities for export are hurt by a strong dollar.

Another global economic change that will not necessarily hurt U.S. farmers, but will necessitate that they adjust, is that world agricultural trade is moving away from bulk commodities toward more processed goods. Bulk commodities currently amount to only about 30 percent of world agricultural trade. Therefore, U.S. farmers have increasing incentives to produce niche market products and retain ownership of those products until value has been added to them.

So there are lots of reasons why, even though commodity prices are expected to increase somewhat, we are not likely to experience large increases in ag products across the agricultural industry. And finally, for 2001, it seems that energy and fertilizer costs will increase. Even relatively minor increases in these costs will dampen the positive effects of increasing commodity process.

Government Payments to Farmers

As mentioned above, under current farm legislation and programs there is no mention of the continuation of large government payments to farmers. Consequently, the biggest winners from government payments in the past (wheat, rice, corn, sorghum, oats, barley, cotton, soybeans) are likely to be the biggest income losers (from loss of government payments) in 2001.

Due to all of these issues, net cash farm income for 2001 is expected to be the lowest since 1994 (about \$4 billion below the average of the 1990s). The most likely, but by no means certain, relief for low farm income in 2001 is some form of emergency legislation to provide income support to farmers, as was done in 2000.

Financial Stability in Agriculture

Debt/asset ratios for agriculture are about 16 percent. These are down very substantially from the highs of about 23 percent in the mid 1980s. In addition, farm real estate values and rent continue to rise. As mentioned above, cash to farmers from the government over the last few years has contributed much to keeping the farm financial situation strong. Another important help has been cash from increasingly common off-farm jobs held by farmers and farm family members.

The 2002 Food and Ag. Policy Debate

A major issue that could greatly affect the future of U.S. agriculture has to do with the content of farm legislation that will almost certainly be written in 2002. This is already under serious discussion by national policy makers. The U.S. agricultural community

(and other interested citizens) will hear much more about this policy debate as 2001 progresses.

The 1996 Farm Bill (Freedom to Farm Act) resulted in movement to more open markets and an end to commodity programs. In the years since 1996, prices for most major agricultural commodities have declined considerably (Table 1). It seems that these

Table 1

**Producer Price Variation for Selected Idaho Commodities,
January 1996 and January 2001**

Commodity	Units	1/96 Prices	1/01 Prices	Change
Alfalfa hay	\$/ton	84.00	88.00	+4.8%
Barley	\$/bu	3.23	1.90	-10.0%
Dry beans	\$/cwt	17.60	16.90	-4.0%
Dry lentils	\$/cwt	18.67	14.88	-20.3%
Dry peas	\$/cwt	11.42	9.67	-15.3%
Potatoes	\$/cwt	6.25	3.55	-43.2%
Sugar beets	\$/ton	46.08	36.19	-25.5%
Wheat	\$/bu	4.81	2.88	-40.1%
Milk, all	\$/cwt	13.30	11.10	-16.5%
Beef cattle	\$/cwt	50.40	68.5	+35.9%

factors taken together, have set the stage for a vigorous debate about future U.S.

agricultural policy. It appears that this debate may focus on three major issues: (1) free trade, (2) national food security, and (3) farm income security. These issues are highly interrelated.

Free Trade

Free trade means that world markets are open to U.S. producers. It also means that U.S. markets are open to the world. Truly free trade results in lower prices for consumers, and since all people are consumers, then all people benefit from that aspect of free trade. However, free trade means that producers who do not have lowest costs will be hurt (possibly put out of business).

So, many of the benefits of free trade are spread over society in general, while many of the costs are focused on particular groups of society (producers who are hurt, and people and firms who work for and do business with these producers, respectively). Because of these simultaneously occurring benefits and costs of free trade, different people in different situations can have very different opinions about free trade. These different opinions can be legitimately held based on their own self interests. Legitimate ambivalence can even exist within individuals about how free trade affects them.

Food Security

A second major agenda item in the developing agricultural policy debate is food security. Food security relates to food availability and to food quality. The strict “free trade” response to food security concerns is “with globalization food will be produced wherever it can be produced most inexpensively, and it can always be purchased by others.” This is a good economic argument, but political constraints such as embargoes and wars can make the argument for producing food for everyone on a global scale operationally problematic.

Food quality usually refers to societal concerns about contamination of food with chemicals, disease organisms, and genetically modified organisms. Many consumers have concerns about foods produced in other countries where local standards do not sufficiently guard against such contaminations. Obvious issues relate to foods produced with improper chemicals or under unsanitary conditions. This usually is a concern expressed by consumers in developed countries when they consider importing foods from less developed countries. However, consumers in many countries (both developed and less developed) in both Europe and Asia, currently have food quality concerns about genetically modified agricultural commodities from the U.S.

Farm Income Security

So many farmers, agribusiness persons and general consumers have concerns about the future of U.S. agriculture and the future of free markets and globalization. Farm prices are low now and will probably still be fairly low in 2002. In recent years government payments to farmers have grown to the point that in the year 2000, the government made \$28 billion in payments to U.S. farmers. 2001 farm income will almost certainly be less than in 2000, and quite low in a historical sense, unless significant government payments to farmers are reintroduced this year.

Some will argue that the free trade response to farm income concerns is for farmers to get bigger and more efficient. Then production occurs in the most efficient locations and by the most efficient methods, farmers receive prices which cover their costs and consumers

get low prices (everybody is a consumer). However, some farmers will go out of business and some agricultural commodity industries might well disappear from the U.S.

Summary and Conclusions

In summary, the problems in U.S. agriculture are very real and very complex. Farm income will probably be down, quite possibly substantially down, in 2001. In addition, the nation is in the midst of an agricultural policy debate that is leading up to major agricultural legislation in 2002. U.S. policy makers are facing many critically important decisions that will, almost certainly, determine the future of food production in the United States, and quite possibly in the world. The policy makers involved in this process are not just agricultural policy makers. Increasingly, the breadth and importance of the issues of agricultural policy (trade, food security, food safety and others) are attracting substantial interest from policy makers representing consumers, general business and other interests. We truly live in interesting times.

List of sources of information utilized in this report:

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