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The Main Street _____ Economist *Commentary on the rural economy*

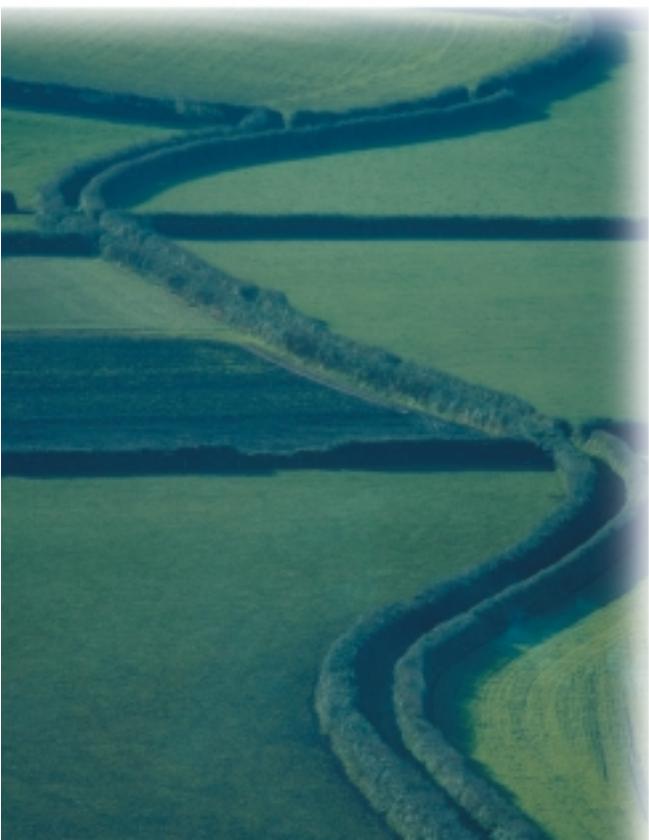


U.S. Agriculture's Trade Prospects

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Foreign markets are vitally important to U.S. agriculture. Each year the industry exports more than a fifth of its output, including an even larger proportion of the nation's major crops (about a third overall) and a smaller but growing proportion of livestock products (about a tenth). In recent years, however, the nation's farm exports have shrunk, triggering a downturn in the U.S. farm economy. Despite the current slump in farm trade, however, prospects for U.S. farm exports remain bright.

Improvement in the nation's farm trade balance hinges on growth in global food demand, driven primarily by income gains in the developing world. A healthy and growing global economy is the best environment for boosting U.S. agriculture's contribution to the nation's trade position. For the industry to reach its trade potential, a framework of domestic and international farm and trade policies that support free trade and foster rapid gains in global incomes is essential.



Recent Developments in U.S. Farm Trade

Boom and bust is an apt description of U.S. farm exports in recent years. In fiscal 1996, the industry's exports swelled to a record \$60 billion—about 10 percent of the nation's exports of all goods—producing a farm trade surplus of \$27 billion. Since then farm exports have dipped sharply, falling about 18 percent from the 1996 record. In fiscal 2000, the U.S. Department of Agriculture expects U.S. farm exports to improve only slightly to \$50 billion, and the expected farm trade surplus of \$11 billion would be the smallest since the mid-1980s.

The current slump in U.S. farm exports was triggered by a sharp drop in foreign demand and a surge in global grain production. In the summer of 1997, a wave of financial turbulence weakened incomes and currencies in key Asian and Latin American markets, trimming demand for U.S. farm products. At the same time, global production of the nation's leading crops—corn, wheat, and soybeans—ratcheted up during a four-year run of generally favorable weather. The surge in production outpaced weakened global consumption, causing global grain inventories to swell and U.S. farm exports to shrink.

Because such a large portion of U.S. agriculture's output is produced for foreign consumers, the industry's fortunes have closely paralleled its recent export performance. The nation's net farm income hit a record \$54.9 billion in 1996 when farm exports surged. Since then, farm income has fallen about 20 percent, a decline that would have been much greater without government subsidies that rose to almost half of net income.

Today, a recovery in the global economy is brightening the outlook for U.S. agriculture's foreign sales, although current projections suggest substantial improvement is still at least a year away. With farm exports expected to remain soft for the time being, the nation's farm income could fall another 10 percent this year, unless more government subsidies arrive.

Prospects for U.S. Farm Exports

Despite the recent downturn in U.S. farm exports, long-term prospects for the nation's agricultural trade remain fairly bright. That conclusion hinges on U.S. agriculture's productive capacity and prospective growth in world food trade. The United States is home to an expansive landscape of highly productive land, a favorable climate, leading agricultural technology, skilled farmers, efficient transportation, and an economic system that encourages innovation and efficiency. In concert, these elements make the industry a highly competitive, high-volume player in the global marketplace.

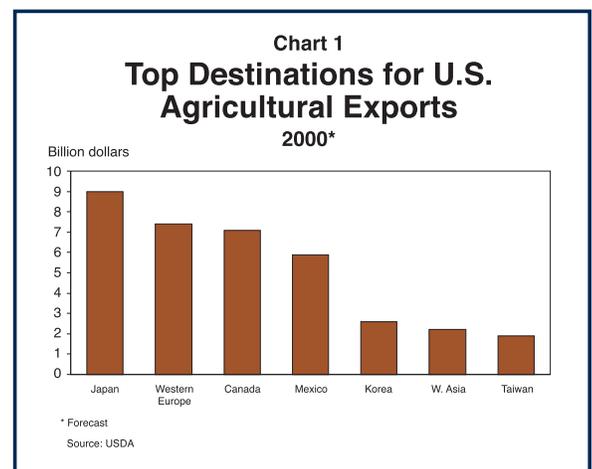
But the world food market is keenly competitive. Many traditional exporting nations, like Canada, Australia, and the European Union in the wheat market, and rapidly expanding newcomers, like Argentina and Brazil in the soybean market, compete vigorously for market share. Thus, U.S. agriculture's share of the world market is neither won nor held easily. But the industry is well positioned to maintain or boost its foreign sales when growth in the global market opens the door.

The world food market will almost certainly grow in the years ahead, as both populations and incomes grow. While most projections suggest global food production will keep pace with increasing food demand, the past two decades have shown that the world food market can be highly volatile. Changing weather patterns and shifting economic and financial developments cause swings in world food supplies, trade, and farm commodity prices. Thus, the recent surge and subsequent slump in U.S. farm exports are a likely prologue to the future.

Despite this ebb and flow, a growing world food market could provide opportunity for U.S. agriculture to expand its foreign sales. The two biggest markets for

U.S. farm products today are Japan and Western Europe (Chart 1). While large, these markets have matured, providing relatively little growth in recent years. In contrast, the next two leading markets—Canada and Mexico—have grown rapidly since the North American Free Trade Agreement was implemented in 1994.

Other leading candidates for growth in U.S. agricultural exports are developing nations. In Asia and Latin America, food demand is likely to grow rapidly with rising populations and per capita incomes. Population growth rates are much faster in



the developing world than in wealthier countries like the United States and European nations, and current projections suggest that by 2020 some 80 percent of the world's people will live in Asia, Africa, and Latin America.

Rising incomes are an especially potent force in boosting food demand in the developing world, because consumers there spend a significant share of their incomes on food—typically a third, a half, or more. During the 1990s, income growth in the world's developing nations far outpaced growth in the richer, developed nations. Although many developing economies have stumbled recently, they are on the mend again, brightening the outlook for the years ahead.

The effect of income gains and improved diets in the developing world is already evident in a shift in world food

trade from generic commodities to value-added food products. In the early 1980s, for example, generic commodities—primarily unprocessed grains—were more than two-thirds of U.S. farm exports (Chart 2). Today, that proportion has flipped with value-added food products comprising nearly two-thirds of the industry's exports. A striking example of this product shift is a sharp increase in U.S. meat exports. Since the early 1980s, U.S. exports of poultry products have risen 12 fold, pork 9 fold, and beef more than 7 fold.

Moreover, value-added exports have remained fairly steady, despite the current farm export downturn. Most of the decline in farm exports has occurred in traditional commodity exports. Thus, the shift to value-added exports could be a valuable stabilizer in U.S. agriculture's participation in a volatile world food market.

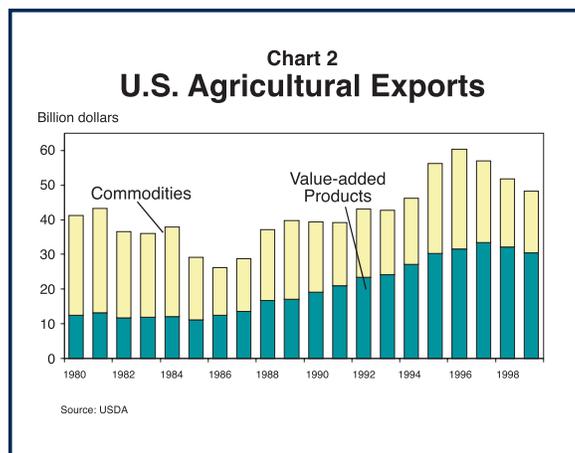
Policies for Boosting Farm Trade Prospects

U.S. agriculture's position and prospects in the world market suggest the industry should fare better in a growing global market. Otherwise the industry cannot take full advantage of its technological prowess and high-volume capacity. Both international trade policy and domestic farm policy can help.

International trade policies. U.S. agriculture's focus in international trade policy often emphasizes broadening the industry's access to foreign markets. The goals are to pull down foreign tariffs and other trade barriers and limit unfair competition from farm subsidies in other food exporting nations. But while unfettered trade not only opens foreign markets to U.S. farm products, it also gives developing countries broader access to global markets for their products of all types.

Consequently, prospects for farm trade gains are generally better when farm trade negotiations are included as part of a broader, multilateral agenda that spans a wider range of products and industries.

Such a broad trade agenda provides more flexibility for balancing trade concerns in other industries with the unique trade problems in agriculture, where trade remains much more restricted.



This widening of two-way trade boosts incomes and purchasing power among the most promising customers for U.S. farm products. Thus, agriculture's brightest promise rests in prospective new trade agreements. A new round of negotiations in the World Trade Organization, a broader trading relationship with China, and the development of a Free Trade Area of the Americas will each give an important boost to developing country incomes and food demand.

A specific farm trade problem, which is rapidly becoming both extremely difficult and potentially vital, is international product regulations—especially the regulation of genetically modified organisms (GMOs). GMOs include many new crop varieties developed with the aid of recent advances in biotechnology. The new technology is very popular in the United States but has met considerable resistance in Europe and Japan. Unless future trade agreements can strengthen the scientific basis for regulating GMOs, agricultural exports from the United States and other countries could be hurt, producer costs could rise, and consumers around the world could be denied access to valuable new products.

Domestic farm policies. The nation's domestic farm policy prescriptions must

also take into account international developments. Previous efforts to boost domestic crop prices with policies that cut back U.S. production have eroded U.S. agriculture's competitive advantage while encouraging bigger production by competitors eager to fill the market void. In addition, rigid farm price subsidies tend to wed the industry to commodity production, despite the shift in global food trade toward value-added products. In contrast, farm policies that preserve the industry's exposure to market prices foster nimble adjustment to shifting global markets.

The impact on global trade of national farm policies in other nations also remains a fundamental concern for U.S. agriculture. Aimed at protecting or boosting incomes of their domestic farmers, such programs subsidize farm commodity prices, encouraging surplus production that pushes down world market prices. The Uruguay Round of international trade negotiations aimed to reduce farm subsidies, and further progress in trimming these subsidies would be helpful to U.S. agriculture.

Conclusions

Unfettered trade promises a further expansion in the global economy, as producers from the United States and other countries gain freer access to world markets and consumers gain access to products from other lands. As global incomes rise, food demand grows—especially in the developing countries that are U.S. agriculture's most promising customers. The ebb and flow of U.S. farm exports is likely to continue in the years ahead. But a solid framework of policies that promote free trade and global income growth is the best bet to bolster U.S. agriculture's trade prospects.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City

March 31, 2000

Highlights from the first quarter survey.

- District land values rose in the first quarter of 2000, their second straight quarter of strong gains. Ranchland values jumped 3.2 percent, bolstered by strong livestock prices and a healthy demand from nonfarm buyers in the Mountain states. District cropland values rose, but dry conditions reduced Missouri and Oklahoma values. Government payments have underpinned farmland values despite weak crop prices.
- The district farm commodity price index, which measures average prices for district commodities, jumped 5.9 percent in the quarter. Rising feeder cattle prices boosted district ranchers' profits but limited gains for district feedlots. Rebounding hog prices and low feed costs blackened district hog producers' bottom line for the first time in several months. In the district crop sector, recent rains shifted market concerns from drought-reduced supplies to bin-busting harvests, causing crop prices to tumble.
- Despite low crop prices, district bankers reported fewer renewals or extensions and rising repayment rates for agricultural loans in the quarter. Nonetheless, bankers remain concerned about the reliance of farm borrowers on government subsidies to provide liquidity for farm operations.
- Average interest rates on farm loans increased 26 basis points during the first quarter, adding to producer liquidity concerns. At the end of the quarter, interest rates on new farm loans averaged 10.17 percent for operating loans, 10.03 percent for feeder cattle loans, 9.96 percent for intermediate-term loans, and 9.45 percent for real estate loans.

Note: 307 bankers responded to the first quarter survey.

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Farm Real Estate Values March 31, 2000

(Average value per acre by reporting banks)

	Nonirrigated	Irrigated	Ranchland
Kansas	\$631	\$1,023	\$367
Missouri	914	1,098	615
Nebraska	881	1,432	367
Oklahoma	507	764	365
Mountain states*	339	1,118	209
Tenth District	\$679	\$1,167	\$371
Percent change from:			
Last quarter+	1.61	1.87	3.15
Year ago+	2.90	3.62	6.20
Market high	-19.54	-18.96	-8.57
Market low	71.48	71.61	122.29

*Colorado, New Mexico, and Wyoming combined.

+Percentage changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Source: Federal Reserve Bank of Kansas City

Selected Measures of Credit Conditions at Tenth District Agricultural Banks

	Loan demand (index)+	Fund availability (index)+	Loan repayment rates (index)+	Loan renewals or extensions (index)+	Average loan-deposit ratio* (percent)
1998					
Jan.-Mar.	120	108	93	109	65.9
Apr.-June	123	100	78	118	68.0
July-Sept.	112	99	58	136	68.4
Oct.-Dec.	107	108	55	138	66.9
1999					
Jan.-Mar.	105	113	56	143	65.7
Apr.-June	107	107	71	127	66.5
July-Sept.	103	90	74	126	67.7
Oct.-Dec.	100	99	86	115	67.7
2000					
Jan.-Mar.	107	95	92	108	67.1

* At end of period.

+ Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

Source: Federal Reserve Bank of Kansas City