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AGRIBUSINESS MANAGEMENT

ECONOMIC TRENDS, PROGNOSTICATIONS, AND CONCERNS AS THEY RELATE TO AGRIBUSINESS

Economists are, as a group, often characterized as confused optimists. They are not so possessed as a natural result of their clientele, their professional colleagues, or their environment. While each may contribute to both his confusion and his optimism, they provide insufficient grounds for the general characterization. In my opinion, economists are confused because of the sorry "state of arts" they find within their profession and optimistic because they must be so endowed to survive in a field so depressing as economics. George Meany is recently quoted to have said, "Economists comprise the only profession I know of where great prominence can be attained by consistently being wrong." With the possible exception of the legal community, no other profession has, in recent years, been so subject to insults by the press and the general public. I make this statement not for the purpose of securing your sympathy, but for the purpose of acknowledging that my profession has some contemporary problems. These problems are very real, often self-induced, and generally without easy solution. Yet because of this inherent optimism, we continue to struggle on, stumbling into the darkness of unexplored federal fiscal programs, groping with the complexities of an ill-defined world market, and doing battle each day with those economic anomalies associated with election-year politics. It is from beneath this operational rubble that we occasionally raise ourselves to perpetuate the art of crystal ball gazing. Surprising, isn't it, in these times where the unexpected is commonplace, that anyone would either ask

for or pay attention to economists' prognostications.

Our profession is actually quite similar to that of the agribusiness manager. We pursue a prescribed sequence of academic training, which is designed to convey to us the theoretical and the acceptable. Then we spend the rest of our careers questioning why the "real world" does not seem to fit the accepted procedures or textbook theories. In this regard, the period of 1973 to the present has been a very difficult one for economists, particularly those concerned with agriculture. The textbook suggests that domestic commodity prices should not be very responsive to external and indirect influences. However, Russian grain purchases and Peru's failure to find the anchovies resulted in U.S. wheat and soybean prices reaching levels never before even considered by the agricultural economists. Similarly, the textbook theorizes that commodity prices reach their low point at harvest time and rise each subsequent month. However, at harvest time in the fall of 1974, wheat prices were at \$4.50 and declined almost 10 cents per bushel every month following. Finally, the textbook suggests that as federal support programs are withdrawn, domestic prices will become more free market determined. Yet, much to our surprise, this year we are finding feed and food grain prices responding less to conditions of demand and more to the conditions of employment under which the Gulf Coast dockworkers now find themselves.

Pervasive throughout this period has been an inflationary influence which has made your work and mine much more difficult. For example, your responsibility is to monitor and manage the operational activities of an agribusiness enterprise. Accuracy is both

necessary and desirable. Yet, how do you deal with the inaccuracies resulting from super-inflated financial data? How do you deal with the farm supply firm which reports 20 percent margins on its fertilizer sales when, in fact, half that margin is due not to the sale of that bag of fertilizer but rather to the fortuitous storage of that bag during a period of rapidly rising wholesale prices? Similarly, how does one deal with fixed asset evaluations when the replacement costs for the buildings and equipment are rising at 15 to 20 percent per year? Yes, double-digit inflation makes the practice of both our professions more difficult.

A Brief Historical Review

A series of unanticipated events in the world market, combined with modest crop failures in the socialist world and a foreign oil embargo, created a set of domestic market conditions in 1973, which resulted in skyrocketing commodity prices. Agricultural economists had long ago surmised that the demand curve for all food products was relatively inelastic, i.e., a relatively small reduction in quantity marketed would result in a proportionately larger rise in price. In fact, earlier attempts to implement various forms of supply control had proven successful, especially for the more specialized commodities. Yet, no one envisioned the compound effect on price of modestly reduced domestic food supplies and increased exports to Russia. In a very short time, the ripple effect of feed grain price increases was felt in the cattle-feeding industry and ultimately appeared in the form of a 22 point increase in the Consumer Price Index for all food. Farm income responded accordingly as total cash receipts from farm marketing rose from an annual rate of \$65.8 billion in the last quarter of 1972 to \$98.4 billion in the first quarter of 1974. Farmers' net income rose from \$18.2 billion to \$33.1 billion during this period and, for the first time in recorded history, surpassed the per capita average income of the urban U.S. resident. As agribusiness managers, you will remember this period well as the time during

which your aged accounts receivable positions improved dramatically.

Unfortunately, this fortuitous rise in commodity prices was, in just six months, followed by equally dramatic increases in prices for productive resources — many such increases resulting from the ripple effect of that winter's energy shortage. By this time, an inflationary psychosis had permeated our economy and no sector of economic activity was left unaffected. During 1974, the real purchasing power of U.S. wage earners declined for the first time since the Great Depression. Their reaction was predictable. They reduced, dramatically, their consumption of manufactured hard goods, especially automobiles and appliances. Faced with slowly moving inventories, manufacturers reduced production and cut their work force. The end result of this paradoxical sequence was a real reduction in gross domestic production, a sharp rise in unemployment, and a generally depressed business economy — occurring amidst ever-rising prices and wages. Economists coined the term "stagflation" in their attempt to explain, somewhat inadequately, how inflation and recession could occur simultaneously. Quite frankly, we were hard pressed to "legitimize" much of what was occurring during this period and, therefore, deserved much of the public criticism directed our way.

Stagflation also had its impact on U.S. agriculture and agribusiness. In response to ever-rising production costs and some softening commodity prices, farm receipts returned to the \$80 million level during the first two quarters of 1975 and annual net income dropped even more, to about 60 percent of the 1973 level (of \$33 billion). By external appearances, the most notable impact on agribusiness was a 50 percent increase in gross sales and an improved accounts receivable exposure. Internally, however, other stagflationary effects could be identified. For example, many firms discovered that existing levels of working capital were insufficient to handle the inflated

business volume. Similarly, many grain firms chose to hold their inventories late into 1973, making it necessary for them to ask for, and generally receive, substantial increases in their lines of credit. Obviously, not all such increases in the use of debt capital were matched with corresponding increases in equity. Many of this nation's commodity marketing organizations emerged from this period in a highly leveraged position.

Where to From Here?

Discussions of past history are made tolerable only insofar as they shed some light on what lies ahead. And, it is in this realm that economists truly "earn their keep." In an attempt to earn mine, I am obliged to offer the following for your consideration.

Most economists, myself included, are deeply confused about what lies ahead. I use the word "confused" rather than the word "uncertain" for a particular reason, i.e., uncertainty will always exist; whereas confusion, hopefully, will not. By far the most plaguing national dilemma is the question of how the economy might be nudged out of the 1979 recession without stampeding it into another inflationary spiral. The tax rebate and housing tax credit, of course, were but two examples of such subtle encouragement. Governmental fiscal policy, however, is still the most critical component — and also the most difficult to predict. To be sure, inflationary pressures have diminished, but prices remain at a level still troubling to the average voter-consumer. In my opinion, the annual rate of increase for the Consumer Price Index will rest at 7.5 percent for calendar 1976 and then begin to rise again in 1977 as inflationary pressures rebuild. The Ford-proposed reduction in the federal budget will not see the light of day before the election and will be forgotten shortly thereafter. Built-in rigidities, long-term commitments, and simple politics will render President Ford's proposed reduction unworkable in its present form. Industrial production will rise gradually throughout the remainder of 1976 but more in response to a

rebuilding of retail inventories and less in response to a sudden rise in consumer spending. Consumer confidence in the economy will remain at low levels, but rise modestly as election time approaches. Calendar 1976 will be filled with a continuation of "mixed" economic indicators. For example, unemployment will remain as high as 7.5 percent and fuel costs will continue their upward movement. Wage settlements through 1976 will average near 8 percent for the larger national unions and closer to 7 percent for individual locals. Hence, the average consumer will just manage to "stay even" and maintain a level purchasing power. All construction trades, but particularly the homebuilders and road builders, will remain in a relatively depressed state because of discouragingly high interest rates.

And what do I see for agriculture? 1976 will be a good year for U.S. agriculture — better than 1975. Net farm income will rise to \$30 billion, but fail to reach the 1973 high of \$33 billion. This net income improvement will result from gradual recoveries of beef, poultry, and dairy economics. Pork is already signaling this adjustment. Feed grain prices will remain at, or slightly below, current levels, as the current harvest of corn, sorghum, soybeans, etc., will total 20 percent greater than a year ago. However, despite the generally larger 1975 harvest, most commodities will flow smoothly through the food chain in 1976 because of current reduced levels of carryover stocks. Some exceptions in apples and other perishable specialty crops might be noted by early spring 1976. Total crop yield in 1976 will likely not reach the 1975 level and, coupled with export demand (Russian sales), will keep most commodity prices well above support prices. Some buildup of sugar and cotton inventories are likely in 1976 as world production reduces the current level of export demand. Further acreage increases will be modest, as much of the Central Plains and Corn Belt is already operating fence row to fence row. The big unknown remains energy. Shortages next spring of either fuel or natural gas could have

a dramatic impact on U.S. agriculture. Fertilizer prices, for example, have declined somewhat in response to the nation's growth in production capacity. If, however, actual utilization of that capacity is significantly reduced by interruptions in energy supplies, operating efficiencies will break down and user prices will again reach higher, discouraging levels.

A Sobering Thought

Before concluding my discussion with these daring prognostications and leaving you with false feelings of euphoria, I would like to share with you a few of my profession's economic concerns. Many of the ideas expressed here are those of my respected colleague Harold F. Breimyer (as they appear in *Economic and Marketing Information*, Vol. XVIII, No. 9, September 1975, University of Missouri Cooperative Extension Service). I trust that I have not misrepresented his views as I condense and compose the following.

The true strength of this nation's agribusiness industry lies not with its size, not with its operational efficiencies, and not with the combined talents of those who comprise it. While each may constitute a strong, positive component, the industry's true strength is based heavily on the economic vitality of all U.S. farmers. The economic results of 1973 and 1974 would suggest that farmers, as a whole, have improved their economic positions. While most data support this general contention, there are some less obvious, but equally important, weaknesses. These weaknesses, to the extent that they threaten U.S. production agriculture, reduce the prospects and economic vitality of the agribusiness industry. Those weaknesses are as follows:

Any economy, be it capitalistic, socialistic, or communistic, rests on physical productivity. Only as crops and livestock are produced from the soil, minerals and metals are extracted and processed from the earth, and fish are netted from the sea, can the human life be sustained and provided with a degree

of comfort. Services are but supplemental to this base of physical production. Agriculture has traditionally been a place where basic values are linked directly to physical productivity. Yet the idea of being paid for production and only for production ran into some value conflicts about 40 years ago when the very first federal farm program appeared. Revenues from the programs were not linked to a farmer's basic productivity; i.e., they lifted commodity prices to artificially high levels, offered supplementary parity payments, and paid farmers for holding land out of production. As a result, a farmer's cash income was the combined result of product sales and supplementary U.S. Treasury payments. In more recent years, the farmer's source of income has all but supplanted the latter as productive resources have returned to full utilization.

But beware of the above discussion because it is highly illusory. In fact, the greatest single source of income to U.S. agriculture has not yet been considered, i.e., appreciation in the value of land and other farm assets. From 1960 to 1974, realized net income to farmers from marketing and Treasury payments totaled \$225 billion. In the same 15 years, the value of assets employed in U.S. agriculture appreciated \$305 billion, land alone gaining \$244 billion. In short, more money was made from owning agricultural land than from farming it. Herein lie the weaknesses noted earlier.

Weakness Number 1: Who or What Receives the Reward? The point can be made that farming has long received a small bonus in the form of an increase in the value of farmland. In fact, I would argue that this small bonus often acted to offset a farmer's substandard cash income from his farming operation. It did so, however, only for those farmers who owned the land they farmed. Capital gains recently have been much faster, reaching five times their previous level, and by no means all returning to operating farmers (since many do not own their farms). As a result, big capital gains in recent years have mainly been not a reward for production

but, instead, a windfall reward for land speculation. As such, these rewards run counter to the principle that only physical production qualifies for an income reward because it alone contributes to the welfare of a nation.

Weakness Number 2: Agricultural Productivity. As capital gains exceed income from production, productivity may actually be diminished. After all, it stands to reason that where appreciation of assets offers greater rewards than actually utilizing those assets, new investments will flow toward land ownership. Farmland bought for speculation, hobby farming, or tax shelter is not likely to be farmed as efficiently as it might.

Weakness Number 3: Who Will Control Agriculture? Capital gains are a separate return to the landholding portion of agriculture. Our traditional structure has been to encourage the modest-sized family farm, largely operator-owned. Land values have risen fast. No longer is ownership of a farm seen as just a place of employment for the operator. Non-farm investors compete with farmers for the speculative ownership of this asset. The overall effect will be to steadily move land out of the hands of operating farmers.

Weakness Number 4: Distortion of the Tax Base. As soon as speculation lifts the value of land above its earning power in production, a problem arises in its tax base. A tax levied on an assessment that is accurately calibrated to earning power is a sound tax. One applied to a higher “speculative” assessment is burdensome and tends to drive land out of agriculture. It also serves to discourage farm operators from becoming owners.

Weakness Number 5: Estate Tax Exemption. Estate taxes attach a cost to the transfer of a farm to one’s heirs. They sometimes make it necessary that a farm be refinanced or that part of it be sold to get money to pay the tax. This likelihood is

increased with the rapid inflation in the price of land (and hence the appraised estate value). There is a proposal to decrease the amount of an estate that is not taxed. However, this proposal would only serve to make farmland more attractive to the outside investor. And if the tax were reduced only for “real” farmers, farm ownership will become exclusively hereditary and undoubtedly challenged in the courts on the basis of its constitutionality.

Weakness Number 6: The Cost of Deflation. Appreciation of assets presents another danger, i.e., that the inflationary spiral may come to an end. If this happens the adjustments are likely to be painful. Not only will there be speculative losses, those farmers recently purchasing land at inflated prices will find it difficult to justify their purchase on the basis of its productivity alone.

SUMMARY

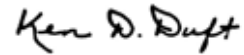
The economist’s task has been made substantially more difficult with the passage of a three-year period filled with unanticipated events and comprised of surprising economic relationships, most of which do not “fit” traditional theory. Yet, in their optimism, the economists struggle with this ever-growing list of imponderables and continue to fulfill their forecasting responsibilities. In this three-year period, U.S. agriculture has experienced the rewards of fortuitous commodity price increases and the punishments of inflated costs for productive resources. This author views 1976 as a good year for agriculture, but failing to reach the net income level generated in 1973.

Rapid appreciation of capital values in agriculture has yielded a windfall income to many thousands of farm families who have been in a position to cash in on it. We can rejoice in their good fortune and look approvingly at the positive influence their improved economic well-being has had on our agribusiness firms.

Unfortunately, this optimism rests on little more than a paper profit not yet realized-and perhaps never realizable to many millions in the agricultural economy. Its benefits are brief, false, and confined to a few. Its harm may be substantial when the bubble bursts because, as the liquidating farm owner cashes in successfully, he does so at the cost and risk of the next man buying it. Capital gains to one generation, therefore, became the burdensome capital cost to the next. Worst of all, the whole process of speculation

creates no real wealth for a nation where productivity remains unaffected or is even diminished. A nation such as ours cannot afford to build its economic foundations on footings so poorly constructed.

Sincerely,

A handwritten signature in black ink that reads "Ken D. Duft". The signature is written in a cursive, slightly slanted style.

Ken D. Duft
Extension Marketing Economist