Changing Agricultural Policy and the Implications for the U.S. Marketing System

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Thank you for the introduction. I am pleased to be invited to help set the stage for this 2-day in-depth look at transportation and American agriculture. I am going to address the major changes in farm policy in recent years and their implication for farm production and distribution. I believe that is one of the key factors affecting the demand for transportation services by the food and agriculture industry. But there are other factors. A second factor is longer term structural change, such as changes in the location of livestock feeding or foreign markets, or the development of new products through genetic engineering. A third factor is shorter term cyclical changes, such as the rise and fall of the Asian economies. Policy changes, of course, can affect the way structural and cyclical changes play out. I will draw a few observations on policy change for storage and transportation, but leave it to those who follow and to the workshops to more fully assess the consequences for transportation and storage services.

The Fundamental Principle: A Market-Oriented Farm Policy:

The most essential change in farm policy in this decade has been the steady shift from government intervention in markets to greater reliance on market forces to determine production and marketing. Farm policy today reflects a global consensus, evolving since World War II, that interventionist government farm policies have burdened national budgets, restricted efficient global production patterns, contributed to global farm surpluses, led to export subsidization to deal with the surpluses, and reduced world commodity prices. It is this thinking that was behind the two most obvious policy changes in this decade: the Uruguay Round Agreement on Agriculture and the 1996 Farm Bill.

I probably cannot overemphasize how evolving trade policy in general has affected domestic U.S. agricultural policy. Under the GATT, now the World Trade Organization, the average U.S. tariff on merchandise trade will fall from 60 percent in the Smoot-Hawley days of the early 1930s to 3.5 percent under the Uruguay Round Agreement. Reduced protectionism has been accompanied by an explosion in global merchandise trade, from about $500 billion in 1966 to nearly $5.5 trillion in 1996, an 11-fold increase in 30 years, that helped generate the greatest prosperity the world has ever known.

What has been done for merchandise trade generally was started for agriculture with implementation of the Uruguay Round Agreement beginning in 1995. The Agreement opened markets previously closed, limited internal farm support programs for the first time ever in an international trade agreement, reduced export subsidies and based sanitary and phytosanitary requirements on sound science.

And while this historic global agreement was being negotiated, the U.S., Canada and Mexico completed the North American Free Trade Agreement, which is reducing barriers to trade among the three countries, and changing the destination of U.S. exports.

The 1996 Farm Bill, coming on the heels of the Uruguay Round Agreement, reflects many of the Uruguay Round's provisions and the philosophies behind it. Most important is the principle that farm support payments linked to production distorted market incentives. The 1996 Act broke that link, decoupling payments and production. Supply control programs were also eliminated, export subsidies were capped, and emphasis was placed on using less distortionary programs to support farmers, such as crop insurance and conservation programs. The 1996 Act also eliminated subsidies paid to farmers to store farmer-owned grain. And commodity loans,

which once provided a hard floor on market prices and led to large government-owned surpluses, are now capped and structured to encourage marketing and not to prevent price declines.

Implications for Agricultural Markets

These changes in trade and domestic farm policy have three obvious effects: First, they change U.S. production capacity; second, they change incentives to produce specific commodities; and third, they change consumer demand for U.S. farm products. I would like to illustrate these changes.

Despite the ongoing structural and cyclical changes, we can still see clearly enough that recent policy changes are affecting producers and markets and putting new pressures on the U.S. storage and transportation system. First, consider production capacity. Eliminating supply control programs has changed the amount and location of crop land available for producers. Production capacity is greater. With the strong grain prices during 1995-1997, farmers utilized the expanded capacity. Under the old farm bill, which covered the 1991-1995 crops, an average of 22 million acres per year were set aside from production under annual supply control programs. Under the new farm bill, 0 acres have been set aside. Under the old farm bill, the acreage planted to principal crops averaged 314 million per year. Under the new farm bill, plantings have averaged 332 million acres, 18 million higher. More acres means more production and more demand for storage and transportation.

The second policy effect I mentioned is on production incentives. The separation of farm support payments from production means crop returns now depend solely on market prices and on market risks. This change, combined with the flexibility to plant alternative crops, has changed the mix of crops planted. For example, under the 1996 Farm Bill, up until the current drought,

returns have been higher and risks lower for irrigated corn for some producers in the south compared with cotton. The result has been more southern corn plantings and less cotton. Consider soybeans; its market returns jumped compared with corn when eligibility to receive the government payment for corn no longer required the producer to produce corn. The result was a major shift to soybeans since 1996, with the highest level of acreage planted ever to soybeans this spring.

Despite the southern drought, U.S. grain and oilseed production is likely to be quite high this year. For wheat, we have the same size crop as last year, despite 7 percent smaller acreage. We expect record-high soybean production and a very good corn crop in the range of 9-1/2 billion bushels. And for grain and oilseeds, carryover stocks are expected to be 2-3 times higher than 2 years ago.

Although new varieties are also a factor, the change in the mix of crops in some states has been profound. Let me give a couple of examples. North Dakota's oilseed area is up nearly 2.2 million acres this year, compared to the last year of the old farm bill, and wheat acres are down 1.6 million. We always like to illustrate things using Arkansas and Kansas–for obvious reasons. In Arkansas, cotton acres have dropped each year since the new farm bill and are now down 310,000 since 1995, while corn picked up 225,000. In Kansas, wheat's share of total crop acreage was very stable under the 1990 Farm Bill, averaging about 54 percent. Since the 1996 Act, wheat's share has dropped to 48 percent while corn, sorghum, and oilseeds increased.

These changes mean different harvest periods, different storage facilities, different production volumes and different shipping destinations. A wheat region that shifts to corn may

see production on 1,000 acres jump from 36,000 bushels of wheat to 136,000 bushels of corn, a 4-fold volume increase on the same acres.

The third and last policy effect I want to illustrate is on the customer base. The reduction in government intervention in the 1990s has been made with a eye to expanding exports as a means of maintaining farm income. The strategy is to liberalize markets to generate increased global economic growth to increase food and fiber demand, and then employ the U.S. comparative advantage in agricultural production and transportation to capture an increasing share of the growing global demand. The strategy worked in 1996 as global income growth was strong and U.S. agricultural exports reached $60 billion. Again in 1997, exports were a strong $57 billion and farm prices were firm. In addition, growing numbers of more prosperous foreign buyers have led to stronger increases in processed and high value products compared with bulk products. Although exports are expected to slip to $55 billion this year, as recession has hit Asia, and expanded production around the world has lowered crop prices, the effects of policy on where our customers are located are nevertheless quite noticeable.

For example, under NAFTA, U.S. trade with Latin America has surged. This year, we expect farm sales to Korea and Southeast Asia to fall by over $2 billion from a year ago, but sales to our NAFTA partners are expected to be up by $1.3 billion. These changes mean sharp shifts in shipment patterns. A good example is cotton. With the elimination of import quotas and tariffs on Mexican textile products into the U.S., U.S. cotton sales to Mexico have soared. This year, Mexico will import 1.4 million bales of U.S. cotton, compared with less than half that in the early 1990s.

The growth of U.S. meat and poultry exports in the 1990s reflects policies that opened markets as well as foreign income growth. The increase in exports from just 1-2 percent of beef and pork production in the 1980s to 6-8 percent in the 1990s, and the similar growth for broilers (broilers exports are now 17 percent of production), means more grain is now being exported in the form of meat and poultry--perhaps 300 million bushels of corn depending on conversion factors and the product mix. More grain is flowing off the farm to domestic locations such as the southeast for broiler and hog feeding and to larger feedlots in the southern plains, changing both the mode and destination of required transportation services.

Conclusion

I will end by saying that the historic changes in U.S. domestic and trade policy for agriculture, ongoing structural changes, such as the emergence of new crop varieties, and cyclical effects, such as weather aberrations and changes in the global economy, are generating a period of great dynamism in U.S. agriculture. New markets are being opened overseas, U.S. competitiveness and production capacity and flexibility are increasing. The upshot should be, as we get beyond the current downturn, stronger export growth in years to come, more processed and high-value product exports, more attribute engineered basic commodity production, increased trade with countries liberalizing their markets such as in Latin America, and perhaps greater year-to-year shifts in commodity production. Will, and how should, the transportation system respond to the changing shape of U.S. agriculture and its customers, and help capitalize on the new market opportunities? We can all look forward to the many coming speakers and workshops for a much more in-depth definition of those changes and opportunities, and how the U.S. transportation system can meet them.