

9-15-1993

Outlook: Economy OK, but Significant Changes Coming For Agriculture

Donald Peterson
South Dakota State University

Follow this and additional works at: http://openprairie.sdstate.edu/econ_comm

 Part of the [Agricultural and Resource Economics Commons](#), and the [Regional Economics Commons](#)

Recommended Citation

Peterson, Donald, "Outlook: Economy OK, but Significant Changes Coming For Agriculture" (1993). *Economics Commentator*. Paper 295.
http://openprairie.sdstate.edu/econ_comm/295

This Newsletter is brought to you for free and open access by the Economics at Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. It has been accepted for inclusion in Economics Commentator by an authorized administrator of Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. For more information, please contact michael.biondo@sdstate.edu.

OUTLOOK: ECONOMY OK, BUT SIGNIFICANT CHANGES COMING FOR AGRICULTURE

by
Don Peterson
Extension Economist/
Marketing & Management

On August 16 and 17, Extension marketing economists from the North Central states and the USDA met at Purdue University to discuss the current agricultural price outlook. Topics of this outlook meeting included the general economy, the agricultural sector, crops, and livestock. This article will pass along some of the ideas presented on the general economy and the agricultural sector.

The General Economy

Despite all the political rhetoric and bad press, the U.S. economy appears to be in good shape. Unemployment is as low as it has been for several years, running less than 7%. Real growth, at about 2% per year, is about at its maximum, considering the economy's capital base (plant and equipment) which is the foundation for growth. This growth will be accompanied by 2-3% inflation, which is excellent compared to the 1970's. This puts nominal growth at 4-5%. In the past we have had faster growth periods, but during those times we had a relatively larger capital base on which to build. The erosion of our capital base during the 1960's, 1970's, and 1980's has reduced the potential for faster growth.

A couple of problems with the economy were pointed out. First, there is too much spending on consumptive purposes relative to tax revenues. Consumptive uses include such things as social security and retirement plans, medical care, prisons, interest on debt, and a great part of military spending. At the same time, there is too little government spending in investment relative to the deficit. Investment involves activities which will make the economy more efficient to the point that the resulting increased

income will pay for the added investment including interest. Examples include improved roads and transportation, research, investment in human capital, and education.

The second problem is that the private sector is acting too much like the government. It, also, is using too much debt to finance consumption spending and saving too little to invest in income-producing activities, whether real or human capital. In business, many resources have been devoted to leveraged buyouts, while investments for long run profits have been neglected. This has reduced the foundation for economic growth today. Immediate gratification has been a higher priority than future income.

The Agricultural Sector

Current Situation. The agricultural sector appears to be on par, or even better off than the non-ag sector. Currently, the average income for all farm families is higher than the average for non-farm families. This is not to deny that some farm families are having serious financial problems, especially those hit with drought or flooding.

The processing and distribution sector will grow in importance as measured by value-added and employment, relative to the production and input supply sector. Consequently, the spread between the farm gate price and retail price will continue to widen. This is primarily due to value-added activity, and consumers want more of it. That is, consumers want more processing done before they make their purchases. For example, you can now buy pork, chicken, and vegetables ready for the stir fry pan. This was not possible a few years ago. As more women move into the employed labor market and as more families are headed by single adults, the demand for more value-added will continue to grow.

The food processing sector has exhibited significant productivity growth since 1960. Automation and improved processing techniques have made this

possible. Along with this has been increased consolidation and concentration in the food industry. Concentration will likely continue as consumer concerns over quality and uniformity increase.

In the production sector, we can expect to see the number of farms and farm operators decline. Farms will continue to grow in size and gross sales of full-time farmers will increase. Farms that require less than a full-time operator will become more dependent on non-farm income. The financial position of the production sector has improved dramatically since the early 1980's in terms of improved income and reduced debt. Firms in the production sector are becoming more specialized as the level of technology increases and profit margins decrease.

Farmers are performing fewer of the economic activities in the food chain. For example, as government restrictions and safety concerns increase over chemical use, farmers are using more custom application rather than investing in high priced equipment necessary for proper application or getting the training necessary to meet government rules for application. This means on-farm expenses will continue to increase faster than sales as farmers provide less of the value-added on the farm.

The input supply sector will continue to suffer narrowing profit margins. The farm supply sector is a mature sector incurring only modest growth at best and some areas are experiencing retrenchment. With fewer farmers to serve, there is over-capacity in the input sector, resulting in reduced volume per supplier and flat to falling profit margins. Thus, this sector, like the production sectors, will experience consolidation and concentration as firms drop from the scene. Any growth in this sector will be in providing services which require highly sophisticated and expensive equipment and/or highly trained personnel. Service centers will become the profit centers in the future with the firm selling the inputs at cost. This is in contrast to a few years ago when services were provided free if the supplies were purchased.

Predictions and Projections. What can be expected in the Twenty-First Century? The following ideas were offered. Growth in domestic demand for

food products will slow to 1.0-1.5% per year. This slowed growth will be the result of more modest increases in real income, slower population growth, and slower declines in the relative price of food.

International markets will grow, mostly in North Africa, Mexico, Latin America, the Middle East, and the Pacific Rim. These are the areas with effective demand; that is, they have the money to pay for what they want to buy.

Consumers will continue to pay for more value-added in their food products. They will want the food they buy to require less home preparation, and want it fresh and safe. This means more processing and faster, more time-efficient transportation.

The industrial use of farm products will continue to grow. However, ethanol will grow slowly and will depend on government subsidy to compete in the energy market.

Consumers will increase their demand for more diversity in food products. This requires more precisely-defined raw food products to meet consumers' demands. Currently, about 15% of farmers are producing products for a specific end-use market. This is expected to grow to 30% by the year 2000. Likewise, about 20% of agriculture's output is being produced under production contracts. This will grow to 40% by the year 2000. Commodities such as corn, soybeans and wheat are expected to be more narrowly defined with an increase in the number of classifications of each, to more accurately meet specific user demands.

In the area of policy, farm program payments are scheduled to decline from 1992 through 1995. Budget constraints will likely maintain this trend. Along with budget constraints will be increased flexibility within the farm programs as a way to cut government payments to agricultural producers.

Regulation on farms and farm operators will continue to increase. These will be imposed in the name of food safety, environment protection, employee health and safety, animal rights and welfare, technology use, and market power. Most, if not all, regulations will



increase the cost of operating a farm. Livestock will be forced to less populated areas and to states with more friendly attitudes towards large livestock operations.

Technology. Technology will continue to advance and will eventually be accepted by the public, although some forms will run into political opposition such as bST. Information, monitoring, and sensing technology will continue to advance. Computers and sensors will monitor and control production and manufacturing processes, help farmers apply chemicals and seed according to soil types, crop variety and weed species, and monitor and control climatic and health environments of livestock.

Firm Size, Structure, and Performance. The size of most full-time farms will increase as new technology allows a single family to handle larger operations. The most economical farm size will be one that can keep 2 to 3 people employed full-time. In crop production, acreage will increase. Smaller operations will continue to exist, but only with income from off-farm sources. Cash flow will be the major factor in determining the survival of farming operations.

Profit margins per unit of output will continue to decline. The same will be true for other commodity type segments of agriculture, such as fertilizer and energy inputs. Good managers will earn above-average returns, with average managers earning less and below-average managers eventually being forced to seek other forms of employment.

Average real income for the agricultural sector will likely decline through the decade of the 90's. Production will increase faster than the increase in demand, forcing prices downward.

Land values will increase at about the rate of inflation, keeping real values about constant. The inflation fever in land is gone and farmers are buying only what they can afford using a minimum of debt. Much of the expansion will be by increased leasing of land. A ratio of renting 3 to 4 acres per acre owned is expected.

As new technology is developed, specialization will occur to exploit that

technology efficiently. Reduced labor requirements and larger, more complicated machines and systems will result. However, the farm family will continue to be the foundation of farm production, especially in the production of grain. Livestock production may see more separation of ownership, management, and labor. Large scale firms will increasingly dominate the input supply, processing, and distribution sectors, with small firms filling niches the big organizations overlook or choose to ignore.

Consumer demands for increased product specificity and diversity, combined with the cost advantage of flow scheduling in both food processing and production, will result in more concentration in food production, processing, and distribution. The increased interdependence will lead to increased contracting for specific products and/or vertical integration, reducing the use of spot markets, and make accurate price discovery more difficult.

The use of lease arrangements by agricultural processors and operators will increase modestly. Leasing will allow producers to conserve cash for covering operating expenses while people with excess cash can finance the purchase of the costly, highly specific resources.

Improved and more efficient transportation and communication facilities will mean less value of the plant will be determined by location. Lower transportation and communication costs mean more remote locations will be at less of a disadvantage.

Urban issues are going to become more important relative to rural concerns in the political arena as the relative importance of the production sector declines relative to the processing and input sectors.

Sector Adjustments. Hogs will see rapid consolidation and increased coordination as new technology is adopted and economies of size are exploited.

There will be fewer but larger hog producing operations and an increase in contract feeding. Farrowing units of 2,000 to 3,000 sows already exist and will become more common. Beef will suffer a declining market unless unit costs are



SOUTH DAKOTA STATE UNIVERSITY
 Economics Department
 Box 504A
 Brookings, SD 57007

Non-Profit Org.
 U. S. Postage
 PAID
 Brookings, S. D.
 Permit 24

Address Correction Requested

4

lowered so that beef can compete more effectively with hogs and poultry. Dairy is threatened by a declining market and increased international competition. The cut in the support for butter has increased the use of butter at the expense of margarine. U.S. food and feed grains are highly competitive on the world market. However, producers must remain diligent to keep that advantage.

Summary

The general economy, while slow by some standards, is doing about the best it can until our capital base is restored. The agricultural sector is headed for some significant changes during the 1990's. Government regulations will increase the cost of producing and processing food, resulting in lower aggregate income for the agricultural sector. Livestock will be forced to the less populated areas and to the states more friendly to large scale livestock operations.

The family farm will remain the main agricultural production unit, but changes in technology will result in larger farm units. The increased use of leasing will allow growth with less use of debt. Those farms unable to grow will need non-farm

sources of income to survive. Changes in technology will also increase the size and concentration in both food processing and input sectors. The food processing sector will see growth due to growth in value-added demand while the input sector will be flat or decline. Creating and maintaining a positive cash flow is going to be critical for survival especially in the production and input sectors.

World trade will increase. The major area with effective demand will be North Africa and the Pacific Rim. Limited credit will slow sales to areas without exchange funds.

**ECONOMICS
 COMMENTATOR**

EDITOR: Donald C. Taylor, Agricultural Economist



ECONOMICS DEPARTMENT
 South Dakota State University
 Box 504A
 Brookings, SD 57007
 Phone: (605) 688 - 4141

475 copies of this newsletter were produced at a cost of less than \$100

