THE U.S. FARM RECESSION—IMPLICATIONS FOR FARM AND AGRICULTURAL TRADE POLICIES

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Summary

The export dependent U.S. farm economy is currently in recession. Dairy farmers, who in 1998 appeared to be immune from the low prices received by hog, grain and soybean producers, saw manufacturing milk prices drop sharply in February 1999. With notable exceptions, the U.S. farm economy is in better shape financially than during the farm recession of the mid-1980s. Hence, the farm sector may withstand this recession more successfully than the 1980s recession. It will take weather that reduces world crop and livestock output, decisions by farmers in major world producing areas to cut back production, and/or economic recovery in important export markets to produce a strong recovery of the farm economy, all of which are difficult to forecast.

The Congress and Administration are likely to authorize large budget outlays of the type announced prior to the November 1998 elections during 1999 to help U.S. farmers weather the recession. Expect many U.S. dairy groups to lobby for continuation of the current USDA dairy price support program that is scheduled to end after 1999. Milk producers in high fluid utilization federal order markets will have powerful incentives to adopt or extend regional dairy compacts during the next year or two. If use of dairy compacts expands, this will exacerbate problems created for the Upper

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Midwestern dairy industry by the federal milk order pricing system. If the U.S. farm recession continues largely unabated into 2000, expect a partial return to provisions similar to those used prior to passage of the 1996 Farm Bill.

U.S. agricultural trade policy presently reflects Administration efforts to pry open markets for U.S. agricultural products and require trading partners to abide by decisions handed down by the World Trade Organization (WTO) in trade disputes. The U.S. will seek to obtain greater market access for agricultural exports, reduce use of European Union (EU) export subsidies, and greater transparency in operations of State Trading Enterprises in the WTO negotiating round scheduled to begin in late 1999.

Overview

The beginnings of the U.S. farm recession coincided roughly with the start of the Asian financial crisis which began in Thailand in mid-1997 and spread to the Philippines, Malaysia, South Korea, and Indonesia within months. Japan's economy, which was weak before the Thai-led crisis, slipped into recession in the wake of internal financial problems and developments elsewhere in Asia. The "growth markets of Asia" for U.S. farm products started to shrivel after these developments. Next, the Russian economy imploded in August 1998, reducing commercial agricultural export sales to that country. More recently in early 1999 Brazil's economy experienced problems which caused Brazil's government to devalue the real by about 40%, making that country a more formidable competitor for U.S. soybeans and soybean products in export markets. Partly as a result of these developments, U.S. agricultural exports—which reached $60 billion in fiscal 1996—now are predicted to be about $49 billion for fiscal 1999.

Another Important "Shoe Drops." The impacts of the U.S. farm recession have not been uniform in severity and timing. Hog raisers were among the hardest hit. Hog raisers who marketed hogs in late 1998 without ledger contracts or other contracts that cushioned the price decline received farm level hog prices similar to those recorded in the Great Depression of the 1930s. In 1998, U.S. dairy farmers appeared immune to problems that had beset producers of grain, soybeans, and hogs. But, the high milk prices that prevailed for part of 1998—which reflected weather-related supply reductions in California and elsewhere—have been replaced by a record $6 per hundredweight drop in the Basic Formula Price for manufacturing milk
to $10.27 in February 1999. Broilers, beef cattle, and certain horticultural crops remain as the chief agricultural items with at least modestly profitable prospects for 1999.

**U.S. Agriculture is Different from the U.S. Economy as A Whole.** The overall U.S. economy has recorded strong growth (6.1% Real GDP Growth in the fourth quarter of 1998) while much of the U.S. farm economy has been mired in recession. The March 6, 1999 Madison, Wisconsin Capital Times carried a front page headline that blared, "Milk Price is Set to Plummet." Alongside the headline was another noting that the "Dow Soars to Record." These headlines remind us that the U.S. economy as a whole is not as export dependent as agriculture and that the increasingly service-based U.S. economy is not necessarily vulnerable to damage from reductions in commodity prices. Indeed, the overall U.S. economy has benefited substantially from low world oil prices and other low priced imports. U.S. agriculture has been correctly labeled as "a capital intensive, export dependent, and interest sensitive sector." Especially regarding the degree of export dependence (one in every four dollars of U.S. farm output is exported), the U.S. farm economy is different from the U.S. economy as a whole. Exports account for only 10% to 11% of the aggregate U.S. GNP.

**Problems with the 1996 Farm Bill.** Unforeseen developments have made the Federal Agricultural Improvement and Reform Act of 1996 (1996 Farm Bill) less successful than many policymakers expected. The 1996 Farm Bill eliminated target prices, deficiency payments, and acreage reduction programs for grains and other crops. Removal of acreage reduction programs and other restrictions on farmers earned for the bill the unofficial title: "The Freedom to Farm Act." For dairy, the 1996 Farm Bill scheduled the USDA's dairy price support program—which supports farm prices for milk at designated levels through purchases of butter, cheese and nonfat dry milk—for elimination after 1999. Congressional support for passing the 1996 Farm Bill reflected beliefs that strong export markets would sharply reduce the need for government payments to farmers and supply control programs. The Congress and Administration are now re-thinking this point.
While shrinking exports are an important cause of the U.S. farm recession, the recession is not rooted exclusively in shriveling exports. Increased U.S. and world production of grains and oilseeds have contributed substantially to the current low prices for these products. Recently increases in U.S. milk production and declining cheddar cheese prices (Figure 1)—reflecting primarily domestic market developments—contributed to the sharp drop in U.S. manufacturing milk prices.

Many farmers and agribusinesses remember vividly the problems associated with the farm recession of the mid-1980s. Moreover, they recognize that the farm program safety nets (especially the higher loan rates, target prices, and deficiency payments) that existed for U.S. farmers in the mid-1980s no longer exist. Hence, questions are being raised about the U.S. farm recession. What will be the impact of the recession on U.S. net farm income? What caused the U.S. farm recession? How does the current U.S. farm recession differ from the farm recession of the mid-1980s? What is the government doing to help reduce the harmful financial impacts of the recession? How are provisions of the 1996 Farm Bill likely to change as a result of the farm recession? How is trade legislation likely to be affected by the U.S. farm recession. These and related questions are addressed below in a Question (Q) and Answer (A) framework. The U.S. dairy economy is emphasized in the analysis.

**Questions and Answers Relating to the U.S. Farm Recession**

**Q1:** How much will U.S. net farm income fall as a result of the farm recession?
A1: The USDA estimates that U.S. net farm income for 1999 will fall about 7% from 1998 levels to $44.6 billion [15]. The USDA's net farm income estimate for 1999 was made before the latest drop in milk prices. The recent drop in milk prices could shave up to $1 billion from the 1999 estimate of U.S. net farm income. The 1999 U.S. net farm income estimate is about 16.5% lower than the 1996 figure which reflected record high agricultural exports.

Q2: How much have U.S. farm exports declined during the past few years? Which commodities have recorded the largest drop in exports?

A2: U.S. agricultural exports for fiscal 1999 are forecast as $49 billion, down $4.6 billion (8.6%) from fiscal 1998, down $8.3 billion (14.5%) from fiscal 1997, and down $10.8 billion (18.1%) from fiscal 1996 [13]. The U.S. agricultural trade surplus is forecast to be $11 billion in 1999, the lowest since 1987.

Weak world demand and large world supplies account for much of the decline in U.S. agricultural exports during the last few years. The weak world demand reflects impacts of currency devaluations in Asia, Russia and elsewhere (which made U.S. imports expensive) and the recessions that followed in the affected countries. Partly for reasons noted earlier, U.S. soybean and soybean product exports are forecast to be almost $3.5 billion lower in 1999 than in 1998. Reductions in poultry meat export revenues reflect weak Russian import demand and lower prices. Several major export commodities are forecast to record little or no change in value for 1999 because declining prices will be offset by larger volumes. For example, the quantity of U.S. corn exports is forecast to be up by 17% in 1999 to 44 million tons while the value is unchanged from 1998 at $4.3 billion [13].

The USDA forecasts that U.S. dairy exports for 1999 will remain essentially unchanged from 1998 at $0.9 billion [13]. Exports of differentiated (value-added) U.S. dairy products, which had recorded strong increases during 1994 to 1997, declined modestly during 1998. Exports of ice cream, dried whey, lactose, whey protein concentrate and infant formula recorded mostly double-digit increases from 1994 to 1997 [17]. U.S. exports of ice cream and whey protein concentrate continued to increase during the January-September 1997 to January-September 1998 period but dried whey, lactose and infant formula exports declined by amounts ranging from 3.1% to 14.6% [17].
Exports of nonfat dry milk under the USDA's Dairy Export Incentive Program (export subsidy program) will help to maintain U.S. exports of this product during 1999.

Q3: How much impact did increases in production (in contrast to reductions in exports) have on U.S. farm prices?

A3: Doering and Paarlberg argue that the price impacts of declining exports have not been as serious as the media portrays [5]. Using elasticities that the USDA employed to analyze the impact of the Uruguay Round GATT trade agreement, they estimated that the Asian currency devaluations and falling aggregate demand in parts of Asia reduced the prices of the following products by the amounts shown in the short-run:

--Wheat, 4.1%.
--Coarse grains, 3.7%.
--Soybeans, 10.2%.
--Rice, 29.9%.
--Beef, 1.5%.
--Pork, 9.0%.
--Poultry, 5.0%.

Why were the price reductions less than might have been expected? First, according to Doering and Paarlberg, the Asian countries most severely affected were neither major agricultural importers nor agricultural exporters [5]. Of the Asian countries affected by the recession (South Korea, Malaysia, Indonesia, Philippines, Thailand, Hong Kong, and Taiwan), only South Korea was a large importer of U.S. agricultural products (5% market share). Moreover, South Korea received over $1 billion in General Sales Manager (GSM) credit guarantees which should have helped that country to maintain its purchases of agricultural products from the U.S. The remaining six nations combined accounted for 13% of U.S. agricultural exports. Of these, the most severely affected (Indonesia, Thailand, and Malaysia) buy only small amounts of agricultural goods.

If the Asian problems have not been the major cause, how do we account for the sharp drop in U.S. commodity prices? Doering and Paarlberg note that weather and production increases in response to the high prices of 1996 were contributing factors [5]. Expectations that existed in
1996 about short global food supplies failed to materialize. Production of all grains worldwide rose from 1,872 million tons in 1996/97 to 1,889 million tons in 1997/98. With excellent crops in South America and the U.S., world oilseed production rose from 261 million tons in 1996/97 to 287 million tons in 1997/98. The 1998 and 1999 Brazilian and Argentine soybean crops turned out to be larger than earlier estimates indicated, causing those two countries to become more important competitors of the U.S. in soybean export markets.

The Doering-Paarlb erg analysis was a "snapshot" of agricultural export market conditions existing prior to the spread of the "Asian contagion" to Russia and Brazil. Presumably because Japan was not forced to devalue its currency and didn't encounter problems comparable to those of the "Asian Tiger" economies, Doering and Paarlberg also excluded Japan from the Asian countries that experienced severe financial problems. Recognizing the uncertainties created by such omissions, they concede that "The concern now is that the economic problems in Asia will spread to other major markets for U.S. agricultural goods--in Japan and in Latin America--while global food supplies remain at record levels [5]." The concern they speak of has materialized. Hence, the generally small price impacts of the Asian crisis they describe understate the actual impact of depressed conditions in several regions of the world on U.S. agricultural exports.

Parallels exist between the Doering-Paarlb erg analysis relating to grains, oilseeds, and meat and the impact of foreign market conditions on U.S. milk prices. While exports of certain U.S. dairy products are important, trade developments do not have the same large impact on the U.S. dairy industry that they do for the grains, oilseeds, and meat. U.S. domestic milk prices are primarily determined by domestic supply and demand conditions. Thus, the U.S. dairy farmer's supply increases in response to better weather and the high milk/feed price ratios of 1998 were important developments contributing to the recent drop in milk prices. It is also noteworthy that the sharp reduction in milk prices followed what some might consider to be a modest (3.0%) increase in U.S. milk production.

Thus the origins of the U.S. farm recession rest strongly on two powerful developments: Weaker export markets and global increases in production of major agricultural products.
Q4: When will markets for U.S. agricultural exports strengthen enough to help pull the U.S. farm economy out of recession?

A4: This depends largely on (a) weather conditions in important crop and livestock producing areas of the world, (b) the extent of supply response (reductions in output) by farmers in different production areas of the world, and/or (c) the timing of economic recovery in Asia, Russia, and Latin America. How soon these factors will change sufficiently to strengthen the U.S. farm economy is obviously difficult to forecast.

Longer-term weather conditions are largely unpredictable. Hence, it is of doubtful usefulness to make predictions regarding the impact of weather conditions on world agricultural production.

The response of farmers and policymakers to the economic environment has at least a few predictable elements. The EU has crop setaside mechanisms that presumably will be used to restrict EU crop production and limit Union budget outlays for farm programs to acceptable levels. Under the 1996 Farm Bill, such measures are no longer available to the U.S. The major adjustments in the U.S. are likely to be adjustments among crops—e.g., possibly more soybeans and less corn in 1999—rather than reductions in aggregate crop production. Aggregate reductions in crop production will occur—for example by retiring marginal acres—if depressed prices persist for additional years.

More rapid producer response in the U.S. hog industry to low prices appears likely. Some economists have predicted that up to one-third of U.S. hog producers will quit the business as a result of recent low hog prices [9]. There is no way to know with confidence that the number of producers exiting the U.S. hog business will be of approximately this size, but many smaller producers are likely to leave hog raising. However, hog marketings will not decline proportionately because the large producers remaining in business will continue to market a large number and proportion of the hogs.

Any reductions in U.S. milk production in response to recent price drops will certainly occur farther into the future since milk prices have been high until February 1999. EU milk production and Canadian production will be constrained to near present levels by milk quotas. Milk production in the low-cost producing areas of New Zealand (presently experiencing a
drought), Australia, and Argentina will reflect weather conditions in their pasture-based production areas.

Predicting the timing of economic recoveries is fraught with difficulties. Few will hazard a guess on the timing of the Asian recovery. Last year Cargill's CEO predicted that Asia will recover in two to five years [11]. The economies of Thailand and South Korea appear to have bottomed out and to be making halting steps toward recovery. The expansion of U.S. corn exports to Japan, South Korea and Malaysia since November 1998 is an encouraging development, hinting that partial recovery of corn export demand is occurring in those countries. Indonesia is beset by such severe problems that it will be among the last to recover.

Standard & Poor's DRI—a macroeconomic forecasting group—predicts that a modest recovery of prices and demand for U.S. farm product exports will occur beginning in about 2001 [16] (Figure 2). This is probably a reasonable forecast—especially as it relates to Asia and Latin America. The economies of these regions may be capable of beginning sustained recoveries by then. However, to expect faster recoveries would underestimate the difficulties that these countries face in rebuilding their troubled banking and financial systems.

**Figure 2.**

*Commodity Prices Have Plunged*

(Producer prices, 1995:1 = 1.0)

<table>
<thead>
<tr>
<th>Year</th>
<th>Metals</th>
<th>Farm Products</th>
<th>Crude Oil (Refiners' acquisition cost, imported crude)</th>
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<tbody>
<tr>
<td>95</td>
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**Q5:** How does the current U.S. farm recession compare to the farm recession of the mid-1980s?
A5: There are similarities. Both farm recessions reflected the impacts of sharp reductions in farm exports, reflecting increases in the value of the U.S. dollar. However, increases in the dollar's value were larger in the 1980s. While the farm recession of the mid-1980s was severe, many of today's hog producers likely would argue that the recession they are experiencing is about as severe as a recession gets. However, there are major differences. In particular, there is not yet evidence of a farm credit crisis of the type that emerged in the 1980s. USDA analysts note that the absence of a credit crisis in the current farm recession reflects lower interest rates (the lowest farm interest rates since the end of 1994), more owner equity, better credit analysis and monitoring methods, and the generally better financial health of producers [12].

Statistics showing average debt to equity, debt to asset ratios, and real estate asset values for U.S. farmers during the mid-1980s, 1998 and 1999 appear below [14,15]:

<table>
<thead>
<tr>
<th></th>
<th>Average 1984-87</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt to Equity</td>
<td>27.4</td>
<td>17.9</td>
<td>17.4</td>
</tr>
<tr>
<td>Debt to Assets</td>
<td>21.5</td>
<td>15.2</td>
<td>14.8</td>
</tr>
<tr>
<td>Value of Real Estate Assets ($ Billion)</td>
<td>$592.2</td>
<td>$891.7</td>
<td>$904.1</td>
</tr>
</tbody>
</table>

These benchmark statistics support claims about the stronger financial position of U.S. farmers during the current recession. Current debt to equity and debt to asset ratios are substantially lower than in the mid-1980s. Farm real estate values are forecast by the USDA to increase by 1.4% from 1998 to 1999. This contrasts sharply to the change in farm real estate prices in the mid-1980s. From 1984 to 1985, for example, U.S. farm real estate values fell by 11.4% [14]. However, the forecasted increase in U.S. farm real estate values from 1998 to 1999 masks reductions in midwestern farmland prices that have occurred during the past year. The Federal Reserve Bank of Chicago reported reductions in the price of good farmland during January 1, 1998 to January 1, 1999 of 5% in Iowa and 4% in Illinois [7]. In Wisconsin, by contrast, prices of good farmland increased by 12% during this same period, reflecting in part last year's high milk prices.

To date the most adverse impacts of the current U.S. farm recession have been confined to sectors or regions—e.g., hog raising and certain wheat
growing areas. Nonetheless agricultural lenders are becoming more cautious about extending farm credit. The Farm Credit System has increased provisions for loan losses, partly in response to an increase in nonaccrual loans. The nonaccrual loans--loans not expected to be repaid in full with interest--represented 1.77% of Farm Credit loans at the end of 1998, up from 0.93% a year earlier [2]. More cautious lender behavior is understandable given the uncertainties that exist about when the farm recession will end. U.S. farm debt is expected to decline in 1999, breaking a string of farm debt expansions dating back to 1992.

Q6: How has the farm recession affected agribusinesses such as farm input suppliers and agricultural marketing firms?

A6: The effects on these agribusinesses parallel in numerous ways those that unfolded during the farm recession of the 1980s. The exception is the impact on farm lenders. As noted in A5, farm lenders have not yet been hit hard financially. Farm equipment sales have been reduced sharply. In December 1998, sales of tractors with over 100 horsepower were down over 40% from a year earlier [7]. Combine sales in December 1998 were down by a third from December 1997 [7]. These developments have had predictable negative impacts on firms such as AGCO, Case and Deere. Hog processors normally experience higher profits when hog marketings are large--like those of late 1998 when hog marketings were up about 10% from year-earlier levels. IBP, which had employed relatively few ledger or cost plus contracts profited strongly from the large hog marketings. IBP earned a record $91.8 million for the quarter ended December 26, 1998, up from $21.7 million in the year-earlier quarter [9]. Hormel and other processors that made greater use of ledger or cost plus contracts experienced smaller profits from the large hog marketings of late 1998. Cargill's grain export sales were sharply lower as a result of developments described earlier. Because of lower exports and Russian trading losses, the firm's earnings for the first fiscal quarter which ended August 31, 1998 fell 96% to $4 million [10].

Q7: What have the Congress and Administration done to deal with the U.S. farm recession? What policy changes are foreshadowed by the actions?

A7: Actions taken by the Congress and Administration just prior to the 1998 Congressional elections provided supplemental financial help to farmers. As noted by Doering and Paarlberg, if farmers took the first of
their 1999 transition payments in October 1998 and locked in loan deficiency payments at the early fall commodity prices, the federal commodity and conservation expenditures would have looked like this [5]:

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td>1998 Freedom to Farm Transition Payments</td>
<td>$5.7 Billion</td>
</tr>
<tr>
<td>First half of 1999 Transition Payments Paid In October 1998</td>
<td>2.7 Billion</td>
</tr>
<tr>
<td>Conservation Reserve Program and Other Conservation Payments</td>
<td>2.0 Billion</td>
</tr>
<tr>
<td>Special Disaster and Market Loss Assistance</td>
<td>5.9 Billion</td>
</tr>
<tr>
<td>Estimated Potential Loan Deficiency Payments</td>
<td>2.5 Billion</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$18.8 Billion</strong></td>
</tr>
</tbody>
</table>

Certain items in the schedule need explanation. The Freedom to Farm Transition payments for crop producers were included in the 1996 Farm Bill to help crop farmers adjust to a situation where the government would provide less support for commodity prices. The loan deficiency payments included in the 1996 Farm Bill provide a low safety net under prices. If market prices fall below a low fixed loan rate, the government will pay the farmer the difference between the loan rate and the market price. Unlike the programs that existed prior to 1996, the government does not take title to grain. The 1996 Farm Bill set loan rates low to prevent outlays except in low-price situations such as those experienced in the fall of 1998. Disaster payments represent a prominent component of the second to last item in the above schedule. In making certain disaster payments, the government abandoned its pledge to deny disaster payments to producers who failed to purchase crop insurance.

Revealing a preference for a strengthened crop insurance program, Secretary of Agriculture Glickman recently made the following comments with respect to the 1998 payments [8]:

"...$400 million from the 1998 emergency relief package (was earmarked) for a down payment on crop insurance reform. This step will increase participation by reducing farmers’ insurance premiums by 30 percent. That’s one of the key things we need to do to strengthen the safety net."

The payments identified in the schedule are not the only ones provided. U.S. dairy farmers will receive $200 million in payments this year
from a Dairy Income Loss Assistance Program. About 25,000 Wisconsin farmers are eligible for the payments—most will get between $1,000 and $3,500. A payment cap will limit payments to any single producer to $5,000.

Under a Section 32 program, smaller hog producers were authorized to receive $50 million in direct cash payments to help them weather the current economic crisis [6]. Producers qualified for direct cash payments if they (a) marketed fewer than 1,000 hogs during the last six months of 1998, and (b) are still in operation. Producers who marketed hogs under fixed price or cost plus contracts were not eligible for the payments. In addition, no producer whose gross income for 1998 exceeded $2.5 million was eligible for payments. The maximum payment for any single hog operation was $2,500. In addition, the government purchased a record $129 million in pork for the School Lunch program and federal feeding programs [8].

Finally, the government extended ethanol tax subsidies (scheduled to expire in 2000) until 2007.

The actions summarized above appear to identify a willingness on the part of the Congress and Administration to spend substantial sums to help farmers weather the current farm recession. This willingness reflects in part the flexibility made possible by current federal budget surpluses. The challenge facing farmers and farm organizations will be to craft requests to the Congress that will be most effective for reducing farm financial stress while retaining desirable features of the 1996 Farm Bill.

Q8: What is the Clinton Administration doing to expand export markets for U.S. agricultural products?

A8: The Clinton Administration is taking a tough stance with regard to prying open certain export markets for U.S. agricultural products and preserving the effectiveness of the WTO dispute settlement mechanisms.

Evidence of this tough stance appears in the "banana wars" that the Administration has engaged in with the EU. In short, the EU has favored imports of bananas from former European colonies in the Caribbean and Africa over bananas shipped from Central and South America by Chiquita Brands International, Inc. and Dole Foods, both U.S. companies [4]. Chiquita and Dole object to this preference pattern, claiming that is
discriminates against their banana exports. WTO dispute settlement officials have ruled against the EU three times on the banana issue. However, the EU has not responded to the rulings in a fashion that has satisfied Chiquita, Dole and the Clinton Administration. Accordingly, the Administration has slapped 100% tariffs on about $520 million of European exports to the U.S. These tariffs may be lifted later if the banana dispute is satisfactorily resolved. The outcome of the banana dispute is unclear. It could produce a messy trade war and further sour relations between the U.S. and EU shortly before new WTO trade negotiations that are scheduled to begin later this year. However, the U.S. probably had to take such action to prevent trading partners from ignoring WTO rulings issued in trade disputes.

Secondly, the U.S. appears likely to challenge EU actions that prevent U.S. beef produced with hormones from entering the EU. The Europeans have until May 13, 1999 to comply with a WTO ruling against their 10-year ban on imports of hormone-treated beef [3]. The challenge is supported by U.S. beef producers who complain that they lose more than $250 million a year in European beef sales as a result of the ban. This challenge will become intertwined with the strong European objections to importing agricultural items produced by modern biotechnology, especially genetically engineered products. If successful, the beef and biotech challenges could have far-reaching, demand-expanding implications for U.S. agricultural exports.

Thirdly, the U.S. has challenged under the WTO Canada's two-tier exporting system for dairy products. Canada pools certain Class V receipts obtained from dairy products sold in export markets at prices lower than those paid for comparable products sold within Canada. This scheme appears to be a hybrid producer and government-financed export subsidy. U.S. dairy industry groups and the Administration claim that Canada has used this scheme to make subsidized exports of dairy products exceeding the quantities agreed to by Canada under the Uruguay Round GATT agreement. The Canadian press has reported that the U.S. has prevailed in its WTO challenge but that Canada will appeal the decision.

These challenges have strong U.S. industry support and appear to be consistent with WTO rules. Complex trade issues--relating in agriculture to export subsidies, market access and state trading--will be confronted by the Administration when it begins the next round of WTO negotiations in Seattle later this year. The Administration will need "Fast Track"
authorization to engage meaningfully in the advanced stages of these negotiations. Getting such authorization probably will require the Administration to reach an accord with labor and environmental groups on trade issues.

**Q9:** What are the implications of the farm recession for farm and agricultural trade policies?

**A9:** The implications of the U.S. farm recession for farm and agricultural trade policy will likely be revealed in an incremental fashion. If conditions in export markets improve, say, because poor growing conditions produce crop shortages in important growing areas of the world, expect the 1996 Farm Bill to remain pretty much intact. On the other hand, if conditions in the U.S. farm economy continue to worsen, expect a movement back to legislation similar to that which existed prior to the 1996 Farm Bill. These points can be fleshed out with a few scenarios.

**Scenario Number 1 (Continued Deterioration through 1999):** Under this scenario, conditions continue to deteriorate in the farm economy and U.S. agricultural exports remain under $50 billion per year. For approximately the next year, expect supplemental payments for farmers of the type that were announced prior to the 1998 election. The Congress and Administration probably will not yet be willing to abandon the Freedom to Farm provisions of the 1996 Farm Bill. Moreover, because of anticipated federal budget surpluses, there will be enough budget flexibility to permit the Congress and Administration to make supplemental farm program payments similar to those announced before the 1998 elections. Programs such as improved crop insurance and revenue insurance will receive additional attention and may receive additional funding. But, plans to implement revenue insurance are plagued by an inadequate actuarial basis for the program. Agricultural export subsidy programs are likely to be used to the maximum extent permitted under the Uruguay Round GATT Agreement.

The USDA and other government agencies investigate whether actions under the antitrust laws are needed to deal with increasing concentration in the U.S. meat processing industry. A bipartisan group of 23 U.S. Senators has requested such an investigation in part because of profits earned by certain pork processors when producers were receiving low, Great Depression era prices for their hogs.
Sub-Scenario No. 1 (Program Changes for the Dairy Industry): While U.S. farm milk prices are expected to recover modestly from low levels of early 1999, dairy farmer returns for 1999 will be lower than in some recent years. With the $6 per hundredweight drop in Basic Formula Price in February 1999 vividly in memory, dairy farmer groups recognize how low U.S. farm milk prices might go in the absence of the present price support program. At the suggestion of industry groups, the Congress and Administration consider adopting a special, limited price support program for nonfat dry milk. This program has support because U.S. nonfat dry milk prices are weaker than butter and cheese prices and are likely to fall to near depressed world prices in the absence of the USDA dairy price support program. Figure 3 shows just how low the price floor provided by world prices (as measured by FOB Northern Europe prices) of nonfat dry milk might be. However, analysts point out that U.S. butter prices during 1990 to 1998 fell to within 5% of the USDA support level nearly as often--more than a third of the time--as nonfat dry milk prices. Hence, while U.S. butter prices were high in 1998 there is no assurance that they will stay sharply above the support level for an extended period. Accordingly, rather than craft a limited support program for nonfat dry milk, the Congress and Administration opt to extend the present price support program until 2002.

Lower milk prices give producers additional incentives to establish dairy compacts in Eastern and Southern markets. While compacts reduce milk consumption and lower milk prices by approximately $.20 per hundredweight in non-compact areas, they appear under plausible assumptions to be capable of raising producer milk prices by roughly $.75 to $1.00 per hundredweight in compact areas [1]. Accordingly, expect producer groups in the higher Class I utilization federal order markets of the Northeast, East, and South to lobby strongly for authorization to extend or create the compacts. If use of compacts expands, this will exacerbate the problems created by federal order prices for the Upper Midwestern dairy industry.

Scenario Number 2 (the Farm Recession Deepens and Continues Into 2000): Under this scenario, no significant improvement appears to be in prospect for the U.S. farm economy as the 2000 elections approach. This creates additional pressure for more sweeping action, causing the Congress to consider what economists call a "recoupling" program. This would mean at least temporarily going back to a program akin to the one that existed
prior to passage of the 1996 Farm Bill. Such a recoupled program would include higher crop loan rates and acreage reduction programs, and possibly target prices and deficiency payments. Secretary Glickman argued for a variation of such provisions in a February 1999 speech when he said [8]:

"We no longer have the ability to control production when demand falls. In the past, I have asked for the authority to extend commodity loans, uncap those commodity loans, and seek set-aside authority in limited circumstances. I am once again calling on Congress to work with me to meet these emergency circumstances that farmers and ranchers are facing."

Scenario No. 3 (Prolonged Farm Recession): The programs described in scenarios No. 1 and No. 2 could be temporary. If no substantial recovery of the farm economy occurs before 2002, consideration would be given to a more permanent return to supply control and price support programs of the type that existed before the experiment with the 1996 Farm Bill. Findings of the Commission on 21st Century Agriculture, which among other things was charged with evaluating the impact so the 1996 Farm Bill, will be taken into account in structuring the new more permanent legislation. Aggregate Measures of Support commitments made by the U.S. under the Uruguay Round GATT Agreement would be adhered to and would modestly limit the amount of support provided to farmers under the legislation. Environmental programs receive heavy emphasis under the program.

Scenario No. 4 (The Trade Policy Scenario): Under this scenario, the Administration strives to keep the Congress and industry groups from jeopardizing gains that farmers and agribusinesses have made through expanded agricultural trade. A key concern is that loan rates for grains and soybeans will be raised to levels that price these products out of international markets. In this connection, veteran policy analysts remember how the high loan rates embodied in the 1981 Farm Bill made U.S. grains uncompetitive in foreign markets. It took several years to get grain loan rates down to levels that made U.S. grains fully competitive in foreign markets.

While a strong case can be made for continuing the present dairy price support program until 2002, it will be noted that doing so will reduce incentives to expand U.S. dairy exports.
In the WTO negotiating round that begins late in 1999, U.S. trade negotiators will seek to reduce export subsidies—particularly those used by the EU, gain greater access for U.S. agricultural products in a number of foreign markets, and to require state trading enterprises such as the New Zealand Dairy Board to make their activities more transparent.

References