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Office of Special Adviser to the President
for Consumer Affairs
Washington, D.C. 20201

September 21, 1984

Mr. Orville L. Freeman
Chairman of the Board
Business International Corporation
One Dag Hammarskjold Plaza
New York, N.Y. 10017

Dear Mr. Freeman:

Thank you for sharing your address to the March 1984 Export Conference with us. A natural concomitant of activities on behalf of consumers is a concern for the health of American agriculture. I have asked those on my staff involved with food and related agricultural issues to review your presentation carefully. We will transmit to you any comments or suggestions we might have. I assume, of course, that you have sent a copy of your paper to Secretary of Agriculture Block.

Sincerely,

Virginia H. Knauer
Special Adviser to the President
for Consumer Affairs

Bob Steeves____________
Howard Seltzer__________
HS/dbc
Typed 9-21-84

Business International Corporation

Bob -
- Do we have the expertise?
- Whatever we reply should be checked out with USDA
VK 9/1

August 1, 1984

Ms. Virginia Knauer
White House Office of Consumer Affairs
Advisor to the President
for Consumer Affairs
The White House
Washington, D.C. 20500

Dear Ms. Knauer:

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1) The US desperately needs a coherent, comprehensive, long range strategy for agriculture;
2) National dialogue aimed at developing such a policy is getting underway;
3) As the dialogue goes forward, it will be difficult to focus on a balanced policy because of the many groups that make up American agriculture.

Fractionalization, as you are aware, has always made it extremely difficult to develop and put in place a balanced policy for American agriculture. In our opinion, the enclosed address if widely circulated among thought leaders and opinion makers might serve a useful purpose in broadening thinking, thereby keeping the dialogue from drifting into special interest segments rather than the "put it all together" interchange necessary to consider widely divergent needs and to lay the foundation for a sound program.

What do you think?

We would appreciate:

1) Your comments on the approach, analysis, evaluation and proposals in my paper;
2) To whom should my paper be sent?

cc: Bob
Jae

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AUG 31 1984

After we hear from you and others, another document might be circulated. If the response justifies it, we could call a meeting later in the year to seek consensus on fundamentals.

Sincerely yours,

Orville L. Freeman
Chairman of the Board

OLF:jm
Encls.

Comparative Advantage in an Interdependent World: The Need for a Realistic Agricultural Policy for the US

Business International Corporation

Business International

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Business International services are designed to meet the growing—and changing—needs of international corporations, and those who work with them, for sound, sophisticated, up-to-date information, analyzed to provide decision makers with data and options for profitable economic growth.

Address
by Orville L. Freeman
Chairman
Business International
Corporation

Export Conference
Dean Rusk Center
School of Law
March 30, 1984

Comparative Advantage in an Interdependent World: The Need for a Realistic Agricultural Policy for the US

Let me tender my apologies for this ambitious title. When Dean Rusk invited me to address this important export conference he, reasonably, asked me to address myself to "some aspect of agricultural exporting." But the more I thought about it, the more it became clear to me that there is no aspect of agricultural exporting that can be usefully addressed in isolation. Indeed, US agriculture—both its fabulous and problem-fraught productive capacity and its vital function in the US trade balance and in the role the US plays in the current world economy—cannot be assessed, or even described, without analyzing the connections and complexities that constitute reality today.

So I decided to go for broke and to share with you my thoughts on what is needed to hammer out a comprehensive agricultural policy for the US that will be responsive both to domestic concerns and international requirements.

I would like to emphasize my profound conviction that the active participation of every one of you here is essential in defining and structuring such a policy and in assisting the process of implementation.

This is, I believe, a vital task. If the United States of America is going to continue its world leadership as well as improve the well-being of her own people, it is critical that we have a policy with clear-cut goals and objectives. I am certain that if there is public understanding, support and participation, an agricultural policy will evolve that is responsive to reality, and that the President of the US will be able to provide the leadership to put such a policy in place and carry it forward to execution.

Facts and Figures

Before addressing directly what I think an agricultural policy for this nation should encompass, permit me to identify the facts and forces that must be factored into a realistic policy. First and foremost is the critical importance of American agriculture to the well-being of our people and to our constructive role as leader of the free world. It is not an overstatement, I believe, to describe the accomplishments of American agriculture as the number-one production miracle in the history of mankind. Today only 2% of the population of the US is on the farm. On the average, each of these farmers feeds 76 Americans at prices that are lower as a percentage of personal income than they are anywhere else in the world. In addition, agriculture, directly and indirectly, is responsible for approximately 25% of US employment.

Between 1965 and 1980, while farm population decreased by one half, annual output in constant dollars tripled, increasing by over $100 billion. Between 1970 and 1982, grain production in the US climbed from 170 million metric tons to 330 million metric tons. And while US exports climbed from 38 million MT to 150 million MT, Soviet imports climbed from 8 million MT to 43 million MT. American family farm agriculture accomplished this with 350 million acres of land under plow, in contrast to the 500 million acres cultivated in the Soviet Union. The $44 billion worth of American agricultural exports in 1981 were an essential offset to our otherwise rapidly deteriorating balance of trade and current account.

At the Crossroad

Despite this unexcelled record, American agriculture today stands at a troubled and uncertain crossroad. All is *not* well on the farm. Aggregate income is the lowest it has been in 50 years. Farmer return on equity in 1981 and 1982 was a negative 9.2% and 6.5%, respectively, and will probably be negative again in 1984. Land values declined for the first time in 27 years. Exports have slipped in the last two years, suffering a 20% shrinkage. The debt/equity ratio is way up as farm debt climbed 300% between 1971 and 1983. Bankruptcies and foreclosures are sharply on the rise. The cost of price-support production control programs has zoomed, reaching a record $18.9 billion in fiscal 1983. If one includes the cost of the PIK program, price support costs were actually $28.3 billion, 10 times the average annual cost in the 20-year period from 1961 to 1981, and five times higher than the largest expenditures in those two previous decades.

What Went Wrong?

It is my contention that these adverse developments call for a careful, thoughtful reexamination of where we have been, where we are, and where we want to go. Only if there is recognition and understanding of the massive change that has taken place in American agriculture can we develop a viable and workable policy that will make it possible for this nation to regain lost ground and to take appropriate advantage of the magnificent productive plant that we have built over the past generation.

How, then, did we lose ground? How did we get ourselves into the mess we're in? The answer to that question is, of course, complex. But the key point is that agricultural policy, as implemented over the last two decades, has not reflected the fact that American agriculture is no longer national in scope. It is international. We are no longer relatively isolated from the rest of the world in any way.

To illustrate: In the 1950s, agricultural exports were less than 10% of cash farm receipts. Today, exports represent 30% of total cash receipts and 54% of crop receipts; production of four acres out of every 10 is destined for foreign markets. Typically, we export a fourth of the US corn crop, half of the soybean crop, 60–65% of the wheat crop, and over 40% of cotton and rice crops.

The Global Connection

What these figures demonstrate, dramatically and incontrovertibly, is that for the US agricultural plant to be continuously operated at an acceptable capacity level, foreign market share must be maintained and expanded. Farmers and agribusiness alike now have a vital stake in international conditions, economic and political, a stake that did not exist before the last decade.

The New Uncertainties

Agriculture, as all of you are aware, has always been subject to great uncertainties. Historically, these uncertainties were predominantly on the supply side. No one can control the weather. Disease and pests, equally unpredictable, also seriously affect supply. Adjusting production to signals in the marketplace is much more difficult, and the lead time required much longer than that for industry. These uncertainties continue. But uncertainties in demand have now become as great, or even greater, in the internationalized marketplace. Let me sketch for you two scenarios that will manifest these new uncertainties.

A Growth Scenario

The first scenario can be properly labeled a growth scenario. It starts with the fact that the middle-income developing countries increased their imports of grain from 12.7 million MT in the years 1960–63 to 44.7 million MT in 1977–79. With their own annual economic growth in a 5–7% range, these countries became an explosive market for agricultural products, particularly grain, resulting in firm and growing prices. Had the world not slipped into a major recession in 1980 and, with it, the threatening debt overhang we face today, US agricultural exports would not have slumped. As a matter of fact, had economic growth continued in those countries and around the world, the 38 low-income developing countries, whose increase in agricultural imports had climbed only to 8.7 million MT a year, would have accelerated their purchases as well.

It follows from this that, if the world returns to a reasonable level of growth and prosperity, with favorable growth rates in the developing world, the demand for food, and particularly for protein, would again explode. That is where future markets will be found. In fact, a number of studies projecting such growth conclude that there is actually a serious threat of major shortfalls. Some studies estimate a shortfall of as much as 70 million MT of grain by the turn of the century. Obviously, if this should happen, US agriculture would respond, assuming we still have the productive capacity. Prices would move up solidly and American agriculture would prosper. That is one scenario.

A Competitive Scenario

A more realistic scenario, given the current world economy still largely bogged down in recession, with the heavy debt overhang inhibiting growth and expansion of developing world markets, is that for at least the next four or five years, there will be strong competition for commercial world markets. During the late 1970s, the US became, in many respects, a residual supplier. This occurred in part because of a very strong dollar, and also because of price-support levels that were higher in some instances than the prices our competitors in world markets were able to offer. This we can no longer afford.

US policy, resting solidly on our comparative advantage as an agricultural producer, must be to move more aggressively into world markets and be prepared to meet competition everywhere. I emphasize *meet competition*. We would make it crystal clear that the US will not *initiate* export subsidies. However, we should also send a strong signal that if our competitors in the world market engage in export subsidies we will match them.

Therefore . . .

This nation, built on private enterprise in a competitive market place, should firmly set the course for an open, competitive world, with agriculture in the lead. In the process we can point the way for the industrial side of our economy to reverse its current tilt toward protectionism.

The Skewed State of Affairs

Currently, world agricultural markets are in an abnormal state. On a global basis, production has been expanded significantly as our competitors have been favored by excellent yields in the last few years.

At the same time, global demand has fallen sharply because of the world recession. The result is a glut of grain. The total carryover of grain stocks, plus the equivalent of idle acres in the US, has climbed to an all-time high of 283 MT or, in terms of world consumption days, to 68 days. For perspective, this carryover compares to 104 days in 1961 when I became Secretary of Agriculture. The problem we face in these terms is thus not a new one.

The immediate result is weak market prices and an acute recession in the agricultural sector of the US economy. Given these circumstances—and they are likely to recur in unpredictable but inevitable cycles—the US must have in place a domestic farm program to support and assist the American farmer. To make the program work, experienced and competent management must be in place.

Policy Premises

The policy premise for this program is twofold:

First, the production capacity of the US agricultural sector must not be seriously eroded. History has shown that we, at home, and the world internationally, will need American production capacity when global economic cycles emerge from their trough.

Second, and equally important as a policy imperative, both fairness and equity demand support by the government of this nation to the farmers who have contributed so much to our economic well-being, and who are uniquely subject to uncontrollable external causes, and to cyclical movements and global interactions.

Nevertheless, a policy and program to accomplish what, for want of a better word, I will call this defensive purpose, must be sensitive to global realities and designed in a fashion that does not result in the US pricing itself out of world markets.

A Feasible Program

Let me offer some ideas on how I think this can be done and on what it will take to design an agricultural policy for the US that will effectively integrate both domestic and international realities.

On the international front, the US must launch a carefully coordinated, major, sustained, integrated agricultural export offensive. Such an offensive should take advantage of our production superiority, our efficient agribusiness marketing systems, and of US exporters geared to foreign needs. The effort must recognize that demand has leveled off in the industrial countries, and that the developing world, now taking one third of US farm exports, offers the best opportunities for expansion in the years ahead, if and when those nations again show income growth.

It must be recognized that this offensive will be a different kind of game than we have known in the past, requiring a wider range of skills, resources and initiatives. An exporting strategy based on the notion that it can expand sales simply by writing orders will fail. We will have to do our homework. Americans will have to research potential customer countries in terms of their total requirements. We will have to look at consumer needs and wants, purchasing power, political pressures, the needs for infrastructure such as port facilities and transportation, and customer countries' needs for new production, storage, and processing technology, as well as farm products. In short, we will have to size up these opportunities in terms of packages that meet the customer's needs.

Happily, the US is solidly positioned to put such packages together and to tie them to a sensible domestic farm program.

Since 1954, and the passage of PL 480, this country has, on a concessional basis, moved over $100 billion of food and fiber to meet human needs, contribute to economic development, and build commercial export markets in developing countries all over the world.

Shipments since 1954 have ranged from 15.3 million MT of grain in 1967 to an estimated 4 million MT in 1983. In the process we have learned how food abundance can be effectively utilized. We have also learned how, if carelessly managed, it can be counterproductive.

An International Initiative

It is my conviction that the time has come to combine that knowledge and our farm abundance into a solid, efficient, international agricultural initiative.

Such an initiative should have four components.

1 Humanitarian We should reach out all over the world to help feed truly needy people. A major effort with a significant US contribution is now under way in drought-stricken Africa. That effort must be strengthened and expanded. In addition to relief, food aid should be tied into self-help projects focused on improving production potential, aimed especially at small producers.

2 Developmental The US should expand its economic development assistance program to many more developing countries. Food aid can be used to stimulate agricultural development in developing countries. Food-for-work programs, building needed infrastructure, can be highly successful if well managed.

Title 3 of PL 480 provides for the US to grant money it receives for agricultural commodities back to the country to finance agricultural development projects, with forgiveness of funds if the project is successful. The authority of Title 3 could be expanded to help finance investment by American agribusiness companies in developing countries. The present initiative of the Bureau for Private Enterprise in the AID Agency can make good use of Title 3. It should be given more support and resources.

The Industrial Policy Context

Our nation is engaged today in a great debate on industrial policy. We are trying to identify what should be the relationship between the government and the private sector as American industry faces new technology, new challenges, and new competition around the world. One can hardly pick up a newspaper or tune in a television station without exposure to the question of how to relate government and the private sector as we go forward to meet competition in world markets and successfully accommodate basic structural change.

There is no doubt in my mind that the private sector moves technology to use more efficiently than does the government, and that this is true in developing countries as much as in industrialized ones. Obviously, profit and risk criteria must be met if private agribusiness companies are to invest in the developing world and move modern technology in production and marketing to small farmers in the developing countries. My point here is that identifying these win-win opportunities for private sector activity in the developing world, and encouraging US companies to respond, could and should be an important ingredient of our national agricultural policy. Designed in close cooperation between government and business at the highest level, this kind of global enterprise would have a triple dimension for the US: It would yield profits; it would build export markets; and it would make friends in the political arena.

A Grain "SDR"

Another innovative way of putting American food abundance to constructive use in solving pressing global problems would be for the US government to make available to the International Monetary Fund a substantial volume of wheat, in addition to the credit already recommended by the President. The IMF could use this wheat to alleviate the debt loads that now plague many of the developing countries. The wheat could be supplied by the IMF to grain-importing LDCs, with payment negotiated over a period of time at appropriate levels of interest. Such a move would make it possible for hard-pressed LDCs to use foreign exchange they would otherwise spend on grain imports to meet their international obligations, or to invest in internal growth and development.

3 Marketing-Minded We must expand our market development activities, coordinating them closely with our economic development initiatives. Since the mid-1950s, the US has run a remarkably successful foreign market development program for agricultural products. It is a cooperative program between the Foreign Agricultural Services of the US Department of Agriculture and some 60 private commodity organizations, ranging from wheat and flour to raisins. The costs of these programs are shared by government and the commodity groups. These market development efforts need to be expanded. They should command top priority and adequate resources.

4 Competition-Oriented The US must fight unfair trade competition wherever it occurs, particularly in nations that use export subsidies, or have erected import barriers for agricultural products. This means developing a long-term strategy to prevent some countries from putting up new protective barriers and getting other nations to reduce unfair levels of protection, such as Japan still has for beef and citrus. Measures to fight protection and subsidies must be specifically targeted. The US must convince other nations that we are serious about unfair practices and that we will take steps to make these practices so costly that others will be discouraged from using them. Measures the US can use range from instituting countervailing subsidies to limiting access to the US market if we don't have fair access to other markets.

A Profile of US Agriculture Today

Before I proceed further with my policy recommendations on the domestic side, let me sketch for you a concise profile of what American agriculture looks like today. You may find the portrait surprising.

At present, approximately 112,000 farms—5% of the total number of farms—produce just under 50% of the entire output of food and fiber originating in the continental US. These are operations that had annual sales of $200,000 or more in 1981. It is important to remember that these major producers are mostly family farms, not what we think of as corporate farms. The great bulk, somewhere around 95%, are individually owned and operated family farm businesses.

At the other end of the scale are the large majority of farms, 1.7 million of them, comprising 71% of all economic units classified as farms by the USDA. These are generally small farms, frequently worked part time, with off-farm income covering a major portion of the family living expenses. These 1.7 million farm units, with annual farm sales of less than $40,000, produce only 12.5% of total US output.

The final feature of the profile consists of the medium-sized traditional family farms. These make up a little less than one fourth of all farms, some 580,000. They are predominantly family-owned and -operated, with the owner-operator engaged full-time in farming pursuits. Sales run between $40,000 and $200,000 annually. In the aggregate, these medium-sized farms produce 38.5% of the output of US agriculture.

So we have three general classes of farming enterprise that are different in size, productivity and income requirements. How then should a comprehensive, national farm program relate to each of these three groups?

A Three-Pronged Approach

Let us consider first the largest farms—the 5% who produce approximately 50% of the total output. According to a number of studies, these farms have cost structures that allow them to be profitable. They have, in recent years, benefited greatly from government programs, but there is considerable question as to how important those programs really are to the continued economic vitality of these larger farms; they could probably make it on their own.

The small farmers, too, are economically strong, albeit in a different way. Because their off-farm earnings are sufficient to fully offset the small losses of income from farming, these small farmers are relatively well off in economic terms, and apparently satisfied with their ability to live in rural areas and pursue farming as a secondary, part-time, or in some cases "hobby" operation.

The middle group, however, is in a different situation. Recent research by Texas A&M University covering cotton farms in Texas' southern high plains clearly suggests that government farm programs have been of major benefit to these medium-sized farm operators. The Texas

study found that, without a program along the lines of the farm program of 1981, only 42% of the medium-sized traditional family farms would survive over the next decade. In contrast, the Texas A&M Study found that 98% of the smallest farms would be able to survive for 10 years without any program. And the largest farms—those over 4,400 acres—would survive without any government programs. I think we can conclude that it is the middle category of farms where a long-range farm program is needed for economic survival.

No Change

Let me stress in this context that I foresee no drastic alterations in this profile. All the evidence from agricultural scholars concurs that, for the foreseeable future, the composition of the US agricultural sector will remain much as it is now.

The real question, therefore, is how can a program or programs be developed to meet the economic, social and cultural conditions of these diverse groups?

I have already cited evidence that the small producers would survive without any programs. National agricultural policy can do little to help or hurt this group of farms. However, state programs in the areas of education, health, medical service, roads, schools, etc. *are* important to the economic and social well-being of this group of nearly two million American families.

The group of large farmers would also do well without federal farm programs. These are educated, innovative producers, well financed, efficient, highly mechanized. They can compete effectively in both domestic and world markets. They are fully poised to take advantage of the food requirements of the world for the remaining years of this century.

The needs of this group will be best served by constructive trade and macroeconomic policies. These producers will benefit from government development efforts to stimulate the national economies of the world so that there is capability to purchase the needed food commodities, including those produced in the US. Export credit assistance efforts; export market development assistance; sensible, consistent international trade policy; stable and reasonably valued currency; good infrastructure in the way of transportation and port facilities—these are the policies that will benefit this group of highly efficient farm businessmen. Domestically, they need some assistance from public institutions in research, and a stable, economic climate of growth.

There is, however, one additional policy element to be considered for these large farm producers: However well trained, educated, financed, mechanized and efficient, they are still subject to the vagaries of nature. And because their market is international, they are also subject to global uncertainties and shifts in the economic and political climate. These factors, coupled with the large capitalization and credit requirements of farms with sales of $200,000 or more, subject these larger farmers to a much higher level of risk than many other businesses. Long-term policy should therefore provide a way to cushion the risk faced by this very important part of our productive economy.

At a minimum, a long-range farm program should provide a world market clearing non-recourse loan program for the large producers. This loan program would enable them, in periods of extreme adverse conditions, to assure orderly marketing and some degree of risk-sharing with the public. Such price support loans could be based on a three-year or five-year moving average of the world market prices or some significant percentage of that level.

An additional idea, which deserves further study and consideration, is the possibility of providing a mechanism whereby these large producers would have both the legal and economic ability to limit their production in periods when favorable weather conditions and unfavorable market conditions have combined to produce excess supplies. I have in mind a system in which, under a government-refereed and -sanctioned referendum, large producers of the major commodities could vote to decide if they wanted to have mandatory acreage and production adjustments so as to maintain a reasonable supply-demand balance. There would be little or no expenditures of public funds to carry out such a program. It would provide the economic and legal mechanisms to avoid wasteful and economically disruptive short-term surplus buildups.

Finally, and undoubtedly the most difficult challenge, is the effort to devise a sensible program to deal with the medium-sized family farmers. I believe we need to offer these farmers some system of income transfer protection, perhaps similar to the existing target-price concept. A scheme could be developed that would assure these farms a return from the marketplace, and from the farm program, that would enable the most efficient of them—and this would be a majority—to continue to be viable contributors to our society. Not incidentally, such a program might well include a requirement that the farmer follow sound soil-conserving practices.

Dealing fairly with these farmers is important to the national weal, not only because they produce nearly 40% of our total food and fiber output, but also because they are a vital part of the social and cultural fabric of rural America and, indeed, the nation. A modest expenditure of well under 1 % of the national budget could, in my judgment, be justified to protect and preserve this important part of our society.

The Need for Coordination

A meaningful agricultural policy, responsive to international and domestic realities, requires effective coordination of private and public programs and initiatives. As matters now stand, a wide range of activities need to be tied into logical and sensible packages. Currently, no person or group is performing this function. Recently, at the initiative of the Ohio Farm Bureau, a number of agricultural leaders got together in Chicago to discuss the need for a new leadership position to represent the private sector in export development for agriculture. I find much merit in their recommendations. But I believe we need more than a new leader in the private sector. We need a leader/spokesman to articulate and coordinate a new agricultural policy for this nation, indeed for the world. I suggest that he, or she, be a presidential appointee with Cabinet rank. This Cabinet member should not have direct line responsibility, but should have the complete confidence of, and direct access to, the President. This would make it possible for him, or her, to coordinate across the entire US government and the private sector, speaking with one voice for, and on behalf of, the President on all issues and topics involving US agricultural policy. This person would also maintain direct contact with foreign governments, at the highest level, to measure, in concert with the resident US Ambassador, the Secretary of State, the Administrator of AID, and the US Secretary of Agriculture, how US agricultural policy is being carried out.

Looking Back—and Forward

Twenty-three years ago, John F. Kennedy named me US Secretary of Agriculture. I was privileged to serve in that capacity for eight years. Then, the importance of agriculture to the well-being of the people of the US, and of the world, did not receive priority attention. Today, as we approach the mid-point of the decade of the '80s, the critical importance of agriculture, if mankind is to advance toward its goal of human betterment, is universally recognized. The time has come for this country, as the leader of the free world, to put in place a sound agricultural policy, and to give the highest priority to carrying it out—at home and around the globe.

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Business International Corporation

August 1, 1984

Bob -
- Do we have the expertise?
- Whatever we reply should be checked out with USDA
VK 9/1

Ms. Virginia Knauer
White House Office of Consumer Affairs
Advisor to the President
for Consumer Affairs
The White House
Washington, D.C. 20500

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2) To whom should my paper be sent?

cc: Bob
Joe

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AUG 3 I 1984

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Sincerely yours,

Orville Freeman

Orville L. Freeman
Chairman of the Board

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