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This is one of a series of articles written by Dr. David Kohl for the Minnesota State Farm Business Management Education Program.
Vol. #86

Getting a Grip on Agricultural Economics

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It is difficult to fathom that within a couple of months we will be at the start of the third decade of the 21st century. Some believe there will be more change in agriculture in the next 10 years than what has been observed in the past 70 years or since 1950.

As one examines eras and cycles by the decades, the 1950s and 1960s, also known as the postwar era, saw an increase in production gains and efficiencies. This period was followed by the 1970s with the expansion of global markets that led to a “go-go” mentality of economics with the mission to feed the world. However, that strategy was turned upside down with the sanctions, tariffs, and dramatic increases in interest rates to quell inflation. These changes decimated producers who were financially leveraged. The 1980s was known as the “no-go” economic era. However, the survivors fine-tuned their business practices. At the close of the 20th century, the 1990s was the “slow-go” economic era with an occasional boom in profits led by weather and demand shortages. However, much of net farm income during this time was in the form of government support payments.

The dawn of the 21st century found that farmers, specifically baby boomer farmers, were enjoying the benefits of the “go-go” great commodity super cycle. This economic boom was fueled by ethanol mandates, growth of the middle class in emerging nations, and the low value of the dollar. These factors developed record profits and capital asset appreciation with globalization being at its peak.

The teen years of the 21st century have not been kind to agriculture due to a stronger currency, disruption throughout the globe on trade issues, and the maturation of the ethanol industry. These factors, coupled with weather abnormalities, first hit profits and cash flow, then financial liquidity in the “slow-go” economic era. This period of time has been extremely stressful not only financially, but on emotions as well.

What lies ahead?

The coming decade is setting up to be a “fork in the road” economic era. Business IQ, innovation, and adaptability will lead to changes for those on the steady road to profit. On the other hand, balance sheet resiliency and waiting for the next positive economic cycle will be the strategy for others. Still other producers will be exiting the industry.

In getting a grip on this “fork in the road” of economic possibilities, what are the factors that need to be monitored from a 50,000-foot view or macroeconomic level?

Globalization versus decoupling

With one out of every five dollars of net farm income being attributed to exports, globalization has raised the bar of agriculture fortunes. However, the opposite is now occurring. The term *decoupling*, spurred by the populist movement, is in motion throughout the globe. Examples of decoupling include the trade tariffs and sanctions, Brexit, and the consequences of Brexit. These events lead to increased mistrust in trading partners, which hinders the free flow of goods and services.

Over the next few months, watch for the outcome of the United States-Mexico-Canada Agreement (USMCA). With Canada and Mexico being U.S agriculture's largest and third largest trading partners, respectively, this trade deal is critical for the economic health of the agriculture industry. This agreement is vital to prevent supply chain management disruptions in North American manufacturing systems, which will ultimately be the victim of failing to pass the USMCA. Because 80 percent of farm expenses are connected to energy, closure of USMCA is critical for energy management and stability of farm input costs. The U.S. is currently the largest energy producer, followed by Canada in fourth and Mexico in eighth. A large energy supply in North America brings stability to this category of expense management.

Trade deals with Asian and European trading partners are only in the early innings and will result in constant management of the business against price and cost volatility. Most likely any deal with China will be temporary at best. More competitive pressure will be the outcome of China’s Belt and Road Initiative. Now in the seventh year with over $268 billion of investments and loans to build agriculture infrastructure, this initiative will create more competition for U.S. producers. Currently, there are 28 new grain and livestock processing facilities on the drawing board in South America as a part of this long-term plan by China.

Low-margin era

As agriculture managers, one must plan for “base hits” with a focus on incremental, disciplined growth, rather than swinging for the proverbial fences or “homerun” strategies. Profits and cash flow will decide which fork in the road is in your destiny. One must have a proactive, grounded strategy with sound fundamentals in revenue, costs, debt, and balance sheet management. Managing expectations, with a focus on execution and monitoring, will be the strategy for choosing the positive fork in the road.

The anchor asset

Farm and ranch land has been the anchor asset that has resulted in financial resilience in the recent, slower "no-go" economic era. Real estate is 83 percent of the U.S. farm balance sheet that has provided a bridge over the economically and financially troubled waters. However, land equity often leads to complacency, reactive management, and producers who have a reduced sense of urgency to position the business for the future.

Fortunately, many baby boomer producers and spouses with deep pockets are still buying farm real estate. Demand for real estate should continue through much of the decade as low interest rates and uncertain returns in paper assets such as stocks and bonds results in a hard asset strategy. Outside investors, particularly new wealth, will use farmland assets as a wealth management diversification strategy.

The appetite of lenders and producers to restructure and refinance debt will be high on the radar screen for land value stability. Regulators who govern financial institutions will need to be closely watched for tightening of credit that could alter the supply and demand elements in local and regional areas.

Recession looming?

Are there storm clouds on the horizon for the general and global economy? Manufacturing industries around the globe and in the U.S. are in a recession with increased layoffs, less capital investment, and dramatic slowdowns in demand. The economic saving grace is the consumer, who is spending and incurring debt with confidence worldwide. Consumer spending comprises about 70 percent of the U.S. economy. Many experts indicate trade tensions and the next election will stall the recent economic expansion in late 2020 to early 2021. The decline in the stock market in the U.S. and abroad, which has been propelled by central bank strategy worldwide, may be the canary in the coal mine of the economic pits.

With that being said, the sunny side is emerging in agriculture. Producers are moving towards better business management. This includes capital and risk management, cost control emphasis, and debt management which all bodes well for the future of the industry. Another bright light in agriculture are the young and beginning farmers and ranchers, also known as "green shooters," who utilize good old-fashioned wisdom with emerging creative thinking to pave their road to success.