
Will the Farm Rebound Lead a Rural Recovery?

By Jason Henderson

Economic headlines in rural America were mostly positive in 2003, especially in the farm sector. The farm economy broke out of its drought-induced recession. Low global crop supplies, strong demand, and high prices underpinned strong gains in U.S. farm income. Meanwhile, the nation's economic recovery appeared to forge a beachhead in rural America as job losses and factory closures eased in 2003.

It still remains unclear, though, whether the rural economy can build upon the optimism of 2003 in the coming year. Farm finances have improved, global supplies remain low, and prices are relatively high, but demand for U.S. farm products remains uncertain, especially in the light of the recent mad cow incident. While job losses on Main Street have eased, rural communities continue to struggle as they try to create the high-skill, high-wage jobs that pace U.S. economic growth.

This article discusses some of the economic headlines for the rural economy in the past year and the outlook for 2004. The first section describes the top economic stories emerging from the farm economy. The second section examines the economic headlines on Main Street. The third section explores the outlook for the rural economy in the year

Jason Henderson is an economist at the Center for the Study of Rural America at the Federal Reserve Bank of Kansas City. This article is on the bank's website at www.kc.frb.org.

ahead. If rural communities are to do well in 2004, demand for U.S. farm products must remain strong and new high-skill, high-wage opportunities must be created on rural Main Streets.

I. THE FARM SECTOR IN 2003

The farm sector posted a banner year in 2003. The cattle industry enjoyed a historic boom before mad cow disease led to a temporary bust in the market. During the first part of 2003, easing drought conditions produced a bin-busting grain harvest. A late summer dry spell trimmed U.S. crop production enough to boost prices, but in some regions the dry weather left pockets of financial distress. Trade winds continued to rock U.S. commodity markets as the value of the dollar, mad cow disease, Chinese trade conflicts, and a fizzle in global trade talks kept export market opportunities uncertain. In contrast, farm subsidies surged under the new farm bill, helping to boost U.S. farm incomes.

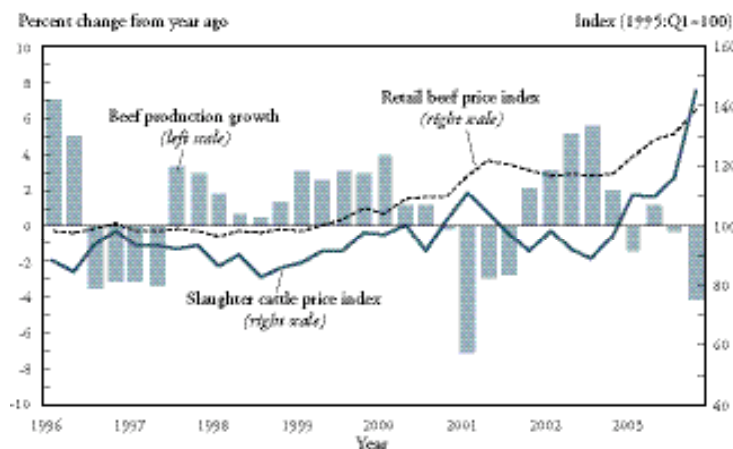
Boom to bust in a mad cow year

The biggest headlines in the farm sector were written by the cattle industry. Overall, the industry enjoyed a boom year. Comparatively low supplies and strong demand led to record-high prices and profits. But profit opportunities went bust literally overnight after mad cow disease was discovered late in the year in the state of Washington.

Heading into 2003, U.S. cattle and beef were expected to be in short supply. The 2002 drought forced cattle producers to send many cattle to slaughter and thus limited herd rebuilding. Throughout most of 2003, cattle on feed were 6 to 7 percent below year-ago levels. As a result, U.S. beef production slowed. The number of cattle slaughtered dipped below 2002 levels for most of the year (Chart 1). In addition, slaughter cattle weights fell below year-ago levels, further trimming beef production.

In May, the discovery of mad cow disease in Canada reduced global supplies of cattle and beef and diminished competition for beef in global markets. U.S. imports of Canadian live cattle and processed beef were halted immediately. Other countries around the world also closed

Chart 1
BEEF PRODUCTION AND CATTLE AND BEEF PRICES



Note: Calculations based on ERS, USDA data.

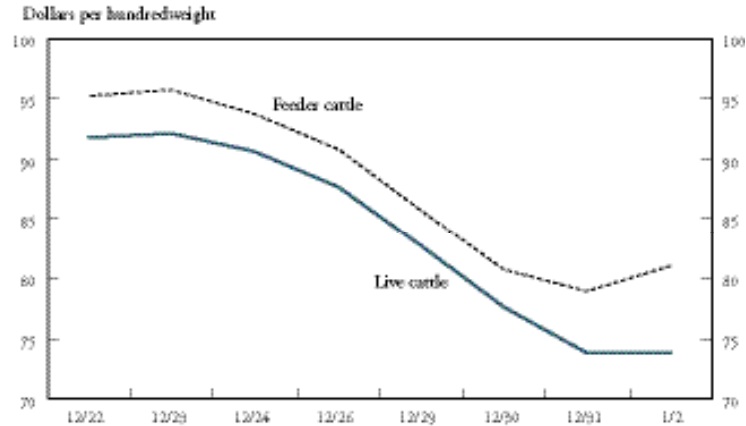
their borders to Canadian beef, providing additional market opportunities for U.S. beef exports. With Canadian exports to Japan halted, U.S. beef exports to Japan surged 26 percent.

The cattle and beef market also enjoyed rising demand for U.S. beef. Low-carb diets, such as the Atkins and South Beach diets, became increasingly popular and boosted red meat demand. Restaurants, industry advertising, and food packaging targeted people on these diets, contributing to the rising demand for beef.

On balance, short supplies and rising demand created record-high prices and profits for U.S. cattle producers. Slaughter cattle prices strengthened throughout 2003. By June, slaughter cattle prices were running 20 percent above year-ago levels. Prices surged to 30 percent above a year ago in September before spiking to an all-time high in October. Ultimately, prices peaked above \$100 per hundredweight, more than 50 percent above levels of a year ago. Prices for feeder cattle and processed beef also surged, lifting profits for all segments of the cattle and beef industry.

Profit opportunities were cut short, however, when mad cow disease was discovered in Washington in December. Global bans on U.S. beef and plummeting cattle and beef prices followed. Cattle

Chart 2
CATTLE FUTURES PRICES
Contract month: January 2004



Source: *The Wall Street Journal*

futures prices dropped 20 percent as U.S. beef production earmarked for export was redirected to the domestic market (Chart 2). On a more positive note, domestic demand remained strong in the face of food safety concerns. Bans on U.S. beef imports remain as major trading partners demand more safeguards on U.S. cattle and beef industries before they renew imports of U.S. beef.

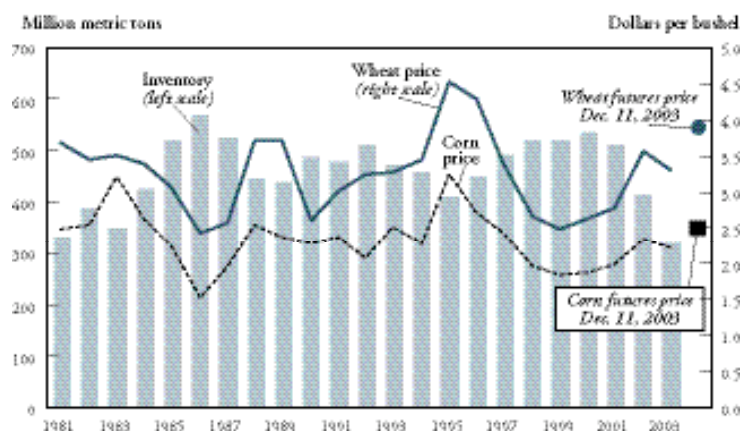
Drought gives way to a bin-busting grain harvest

While the cattle industry garnered much of the public's attention in 2003, the spring headlines centered on easing drought conditions and the prospects for bumper crops. Spring rains led to bumper wheat and corn crops that were sold at relatively high prices as world crop inventories remained near historical lows. But the dog days of summer cut the U.S. soybean crop.

Spring rains eased some of the nation's worst drought conditions and led to a banner year for U.S. grain production. By July, drought conditions had abated in most of the grain-producing regions and U.S. grain production rebounded sharply. The wheat crop was 44 percent above year-ago levels as the Great Plains states enjoyed dramatic upswings in

Chart 3

WORLD GRAIN INVENTORIES AND U.S. CROP PRICES



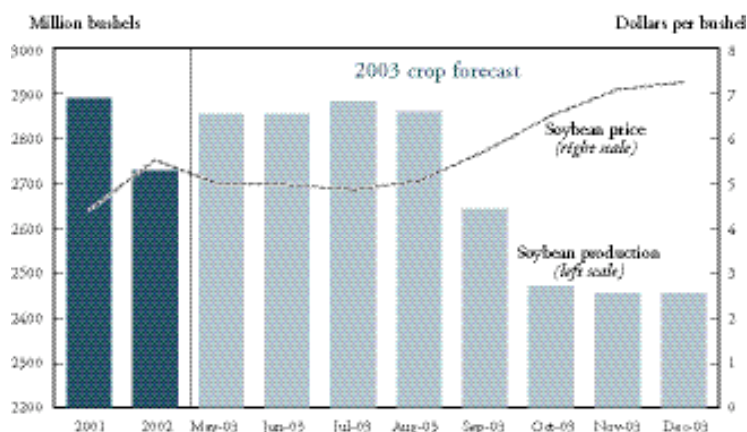
Source: USDA and Chicago Board of Trade

production. The strongest gains were in Oklahoma, Nebraska, Kansas, South Dakota, and Colorado, where wheat harvests weighed in at more than 70 percent above the 2002 drought-ravaged crop. A bountiful corn crop was also harvested in 2003 as yields reached a record high. In the western Corn Belt—the states west of the Missouri River—corn production turned up sharply. States in the eastern Corn Belt posted another bumper crop.

Despite bumper U.S. crops, world grain supplies remained historically low and helped underpin strong U.S. grain prices. At the start of 2003, U.S. grain stocks were approaching historical lows. In contrast to the bin-busting U.S. grain crops, drought conditions in other countries limited world grain production. In addition, world demand for grain was strong in 2003, pushing world grain inventories (ending stocks) for the 2003 crop to their lowest levels in over two decades (Chart 3). As grain inventories fell, U.S. grain prices rose, boosting U.S. wheat and corn crop receipts 5 percent above year-ago levels.

In August, though, searing temperatures spread across parts of the Farm Belt. By September, drought conditions had reappeared in the Great Plains and the Mississippi River Valley. Severe drought hit parts of Missouri, Kansas, and Nebraska.

Chart 4
U.S. SOYBEAN PRODUCTION AND PRICE



Source: *The Wall Street Journal*

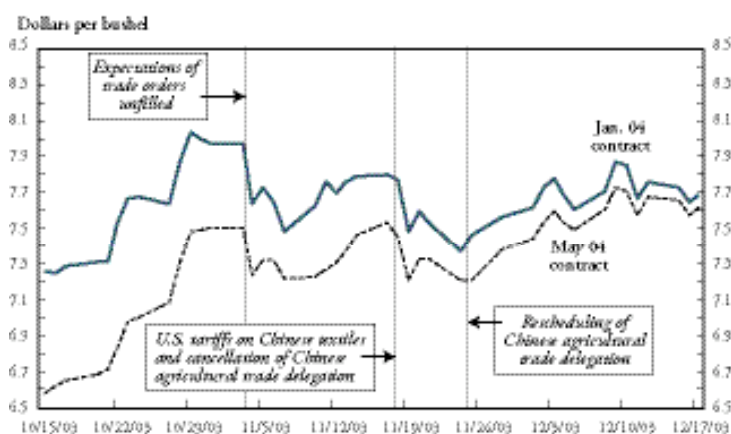
The drought trimmed the fall soybean harvest, spurring a run-up in prices. The 2003 soybean crop forecast was cut 7.5 percent in September and another 6.6 percent in October (Chart 4). As a result, soybean prices surged. By December, the farm-level average price had jumped from \$5 to \$7.25, boosting soybean cash receipts 20 percent above year-ago levels. Increased demand from China further supported the soybean price rally. The sharp rise in soybean prices boosted farm cash receipts forecasts.

While the drought helped boost prices in the soybean market, it also created pockets of farm financial distress. The inability to harvest a crop in drought regions limited farmers' ability to take advantage of the high commodity prices. As a result, many farmers faced continuing financial problems. According to a survey of Tenth District bankers, bankers in drought regions reported lower loan repayment rates and higher rates of loan renewals and extensions.

Trade winds rock U.S. commodity markets

The record-high prices and the resulting profits in the various agricultural markets in 2003 were driven in part by increased global demand. But 2003 was a year of ups and downs in world markets. The

Chart 5
U.S. SOYBEAN FUTURES PRICES



Source: Chicago Board of Trade

decline in the value of the dollar helped boost the demand for U.S. exports, while the mad cow incident abruptly halted beef trade. In addition, nonfood trade conflicts threatened soybean exports.

In 2003, the value of the dollar dropped 20 percent against the currencies of major agricultural competitors.¹ A weaker dollar makes U.S. products more affordable in foreign countries, increasing demand for U.S. products. As the dollar continued to decline, U.S. agricultural export forecasts were revised upward. For the year, forecasts for U.S. agricultural exports jumped 5.3 percent, after rising just 1.1 percent in 2002.

Other events helped support U.S. trade opportunities and commodity prices. In the cattle and beef markets, the Canadian mad cow disease incident sparked a surge in U.S. beef exports to Japan. The export surge helped support a spike in cattle and beef prices and boost profit opportunities. But, the U.S. mad cow disease incident abruptly halted U.S. beef exports, slashing prices and profits. When beef exports will regain their momentum is unclear.

In soybean markets, global demand was generally strong. During the year, strong demand from China, the world's largest importer of soybeans, underpinned a rally in soybean prices. Forecasts of China's soybean imports jumped 33 percent between May and November alone.

However, widening trade conflicts threatened future U.S. soybean exports, leading to huge price swings. In November, the United States imposed new import restrictions and trade barriers on a variety of Chinese products. China responded by suspending a visit to the United States by its agricultural trade delegation. Reports of fungus in U.S. soybean shipments to China shortly followed. The result was a sharp fall in U.S. soybean futures prices (Chart 5). Meanwhile, the United States suspended its steel tariffs, easing the ire of some trading partners that buy soybeans. In December, China finally sent its trade delegation to Washington and announced new U.S. soybean purchases, which ignited a price surge in soybean markets.

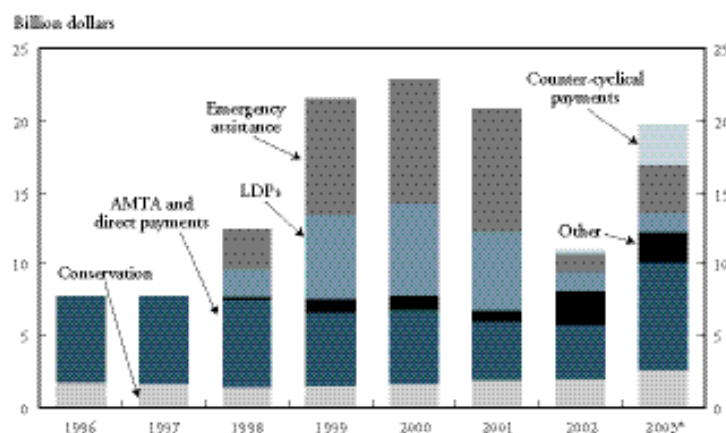
During 2003, international trade talks created further uncertainty over future trade relations. In September, international trade talks collapsed at the ministerial meeting of the World Trade Organization in Cancun. Fallout from these failed discussions has created new difficulties in finalizing a Free Trade of the Americas agreement. Farm subsidy payments are center stage in both trade negotiations. Negotiations remain at an impasse between nations with large subsidy programs (United States, Japan, and European Union), and developing nations with more limited or no subsidy programs.

Farm subsidies surge to boost farm income

Farm subsidies remain a major sticking point in international trade agreements, and the 2002 Farm Bill did little to ease the tensions. In 2002, a new farm bill added \$73.5 billion over 10 years to the previous baseline of federal spending for farmers. The new bill created a new counter-cyclical program for U.S. commodity producers and boosted subsidy programs that do not base payments on market prices. The surge in government payments helped push U.S. farm income to its highest level in seven years.

After falling sharply in 2002, subsidy payments under the new farm bill surged in 2003. Government payments jumped from \$11 billion in 2002 to \$19.7 in 2003 (Chart 6). The new farm bill included a new *counter-cyclical payment program* that pays farmers additional government payments after periods of low prices. The counter-cyclical program added \$2.7 billion dollars to government payments in 2003, although the pay-

Chart 6
U.S. GOVERNMENT PAYMENTS



*November 2003 forecast

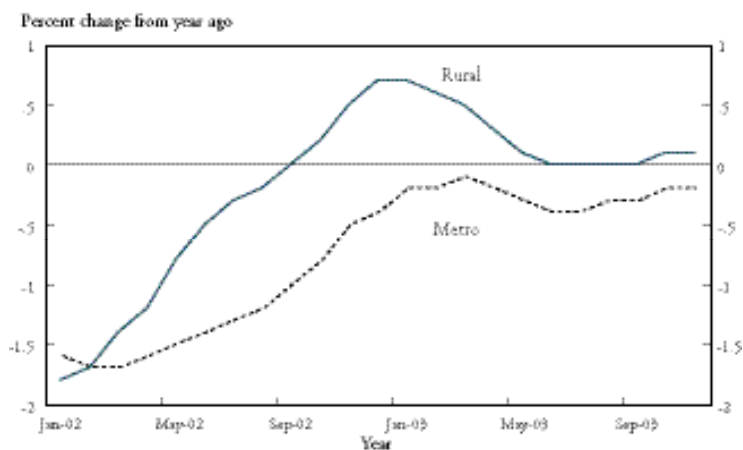
Source: USDA

ments fell short of earlier projections due to high commodity prices. High commodity prices also trimmed *loan deficiency program* (LDP) payments, since these payments also fall when market prices are high.

While high commodity prices limited counter-cyclical and LDP payments, the surge in government payments in 2003 was driven in large part by programs that do not depend on price. In the new farm bill, production flexibility contract payments were replaced by a *fixed government payment program*. In 2003, the cost of the fixed payment program was expected to reach \$7.7 billion, up from \$3.7 billion from similar programs in 2002. Finally, conservation and other ad hoc and emergency payments rose by \$2.7 billion in 2003.

The rise in government payments helped farm income surge in 2003. U.S. net farm income reached \$55.8 billion last year, 58 percent above the 2002 level and 18 percent above the five-year average. Adjusting for inflation, U.S. net farm income in 2003 was at its highest since 1996. Strong gains in cattle and soybean receipts contributed to the rebound in U.S. farm income.

Chart 7
RURAL AND METRO BUSINESS JOB GROWTH



Note: Calculations based on BLS data, three-month moving average.

II. THE MAIN STREET ECONOMY IN 2003

While the farm sector rebounded sharply in 2003, Main Street struggled to add jobs in an as yet jobless recovery. Heading into 2003, the rural economy appeared to be on the verge of a rebound. As the year progressed, job gains slowed and then strengthened. Still, the job gains were not evenly spread across rural America; nor were they concentrated in the high-skilled industries that offer the greatest hope of boosting rural incomes.

Is the jobless recovery over?

When the U.S. recession ended in November 2001, recovery did not immediately translate into employment gains on Main Street. Signs at the beginning of the year pointed to stronger employment gains but quickly disappeared until the national economy surged in the third quarter.

As spring turned into summer, the jobless recovery intensified its grip on Main Street. By March, rural job levels had exceeded year-ago levels (Chart 7).² But the same economic weakness that dampened the

national economy at the start of the Iraq War quickly spread to rural America. Throughout the summer, rural job growth slowed and by August rural job levels dipped below a year ago. On a positive note, job growth reported by rural businesses was stronger than the job growth reported by metro businesses.

The stall in rural job gains left the rural unemployment rate flat. As measured by the nonseasonally adjusted rate, rural unemployment averaged 6.2 percent for the year. Rural unemployment continued to run well above prerecessionary levels and the level posted in metro areas.

After a third-quarter surge in U.S. gross domestic product, rural businesses began to add jobs. As U.S. GDP growth spiked at 8.2 percent in the third quarter, output growth outstripped U.S. productivity gains and led to rising employment levels. In November, rural job levels edged above year-ago levels, and job growth continued to strengthen. The job gains enticed more people to enter the labor force and search for employment, leading to flat rural unemployment rates at the end of 2003.

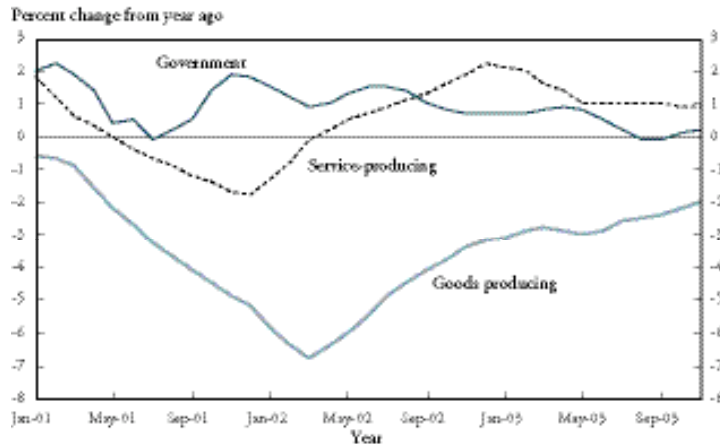
Mixed industry activity in the jobless recovery

Throughout the recession, rural America's contraction in employment was created by weakness in the rural manufacturing sector. Job gains in rural service-producing and government sectors partly offset manufacturing job losses. In 2003, however, weakness spread to service-producing and government sectors. Fortunately, the strengthening national economy at the end of the year led to growing job levels in the service and government sectors and smaller job losses in rural factories.

In recent years, rural America's job losses were created by contraction in the rural manufacturing sector. In 2002, rural factories shed 6.0 percent of their workforce. Roughly 45 percent of these losses were due to factory closures.³ In 2003, rural factories shed another 2.0 percent of their jobs in 2003, and roughly 40 percent came from factory closures. As 2003 came to a close, both rural factory closures and mass layoffs continued to ease.

In rural service-producing sectors, job levels faltered in 2003 but remained up for the year (Chart 8). Throughout the recession, rural service-producing firms continued to add jobs to help offset some of the losses posted by rural manufacturers. But after peaking in March,

Chart 8
RURAL BUSINESS JOB GROWTH BY SECTOR



Note: Calculations based on BLS data, three-month moving average.

job growth in rural service-producing sectors waned and continued to weaken throughout the summer. By September, job levels slid to just 0.9 percent above 2002 levels. In the fourth quarter, the service-producing sector produced strong gains to stabilize job growth in this sector. However, rural places still had difficulty adding high-skilled service jobs as more than half of the service job gains were concentrated in low-skilled recreation and retail industries.

After slowing for most of the year, government jobs rebounded with increased tax revenues. Since the beginning of the recent recession, government entities struggled to add jobs due to increased budget crises. By July 2003, the budget tightening at state and local levels had translated into losses of government jobs in rural communities. With the start of a new fiscal year in July, a rebound in state and local tax revenues led to new hiring by governments. That trend continued in the fourth quarter.

Even with the jobless recovery, the rural construction industry continued to boom. After a banner year in 2002, the number of residential construction permits stayed at historical highs, thanks to low interest rates and rising incomes. The average number of monthly building permits edged up, as did the average value of individual building permits. The total value of building permits in nonmetro areas rose 9.0

percent in 2003. Anecdotal evidence also suggested that the market for second homes strengthened as people used stock market gains to finance new construction or purchases.

III. THE RURAL ECONOMY IN 2004

Heading into 2004, the outlook for the rural economy looks promising, despite some uncertainties. Strengthening farm finances and comparatively small agricultural supplies will underpin agricultural commodity prices and farm incomes. But export activity and domestic demand remain uncertain. As the nation's economy strengthens, so should business activity and job gains on Main Street. Still, rural communities remain challenged to sustain economic growth by developing high-skill, high-wage job opportunities.

Cautious optimism for the farm economy

The 2003 rebound in farm income should lead to stronger farm balance sheets and farm finances in 2004. The sector's debt-to-asset ratio remained low as growth in farm assets outpaced rising farm debt. Rising real estate values are driving the asset value gains. According to Kansas City district bankers, land value gains slowed in the first half of 2003, but as farm income forecasts began to rise, so did farmland values. Farm finances also appeared strong heading into 2004. Throughout 2003, farm loan repayment rates rose and loan extensions and renewals slowed. If spring rains do not bring the drought relief that many areas need, however, agricultural credit conditions may suffer.

Small supplies of both crops and livestock should also underpin agricultural commodity prices and farm incomes in 2004. On the crop side, world crop inventories remained near historical lows heading into this year. Futures markets point to higher crop prices in 2004. On the livestock side, beef production is expected to drop. The cattle industry has been waiting to launch a new cattle cycle as some ranchers contemplate herd rebuilding that will trigger smaller numbers of cattle sent to slaughter and a decline in beef production. Pork production is also forecast to dip slightly.

The question remains whether supplies will be small enough to trigger a rise in farm commodity prices and income. The answer probably depends on the strength in U.S. export activity. Prior to the mad cow disease event, U.S. meat exports were expected to rise 3 percent in 2004, led by beef exports. Given the global bans on U.S. beef and the drop in cattle and beef prices at the time of this writing, livestock prices will probably remain under pressure from the lack of export opportunities and increased supplies at the U.S. meat case. On the crop side, U.S. grain exports are expected to jump 3.8 percent above the pre-drought export levels of 2001. November's trade conflicts with China sent the U.S. soybean markets on a roller-coaster ride to end the year, underscoring the volatility of farm commodity markets surrounding U.S. export activity.

Will job losses turn into job gains on Main Street?

Optimism appears to be rising on Main Street. As in the rest of the nation, the rural nonfarm recovery appeared to strengthen as 2003 closed. On the national level, the economic recovery is expected to strengthen and produce job gains in 2004. In rural areas, factory closures and job losses have slowed, state fiscal crises are easing, and service industries continue to post job gains. If the rural nonfarm economy continues to track the national economy, the rebound in jobs should continue to strengthen on Main Street.

Looking ahead, the challenge for rural communities is to capture more of the high-skill, high-wage jobs that have propelled U.S. economic growth over the past decade. Rural places lag their metro counterparts in the creation of these jobs. In short, fewer high-skilled industries call rural America home. In 2000, only 9.0 percent of rural earnings were derived from high-skilled producer service industries, compared to 25.3 percent in metro areas (Table 1). From 1990 to 2000, rural areas trailed metro areas in the earnings growth of high-tech manufacturing and producer service industries. In 2003, less than a quarter of the service-producing job gains were derived from the producer services sector that employs larger numbers of high-skilled workers. Growth in high-skilled jobs has improved but will need to be much stronger if rural communities are to participate in high-skilled activities that are propelling U.S. economic growth.

Table 1
HIGH-SKILLED INDUSTRY STATISTICS

	U.S. GDP growth ¹ 1990 to 2000 (percent, annualized)	Annual avg. wages ² U.S. 2000 (thousand dollars)	% skilled occupations ² (percent of jobs)	Earnings growth ³ 1990 to 2000 (percent, annualized)		Earnings share ³ 2000 (percent)	
				Rural	Metro	Rural	Metro
Total	3.2	32.9	23.3	2.3	3.4	100.0	100.0
Manufacturing	3.8	34.8	18.9	1.3	1.3	21.2	15.2
High-tech	5.4	39.9	27.6	1.2	1.6	6.6	8.8
Routine	3.3	29.9	10.3	1.4	1.0	8.8	4.6
Value-added	-5	29.5	9.3	1.2	.6	5.7	1.0
Services	4.0	31.7	24.7	3.3	4.3	45.3	62.5
Producer	4.9	39.7	36.6	3.7	6.2	9.0	25.3
Consumer	3.2	30.0	26.4	3.5	3.2	22.8	21.6
Recreation	2.3	18.9	8.3	4.0	3.7	4.2	4.4
Transportation, utilities, and wholesale	5.0	36.6	13.4	2.3	3.0	9.3	11.1
Other	1.2	36.9	20.9	3.7	4.5	33.5	22.4
Government	0.8	38.4	30.5	4.6	4.0	20.7	14.8
Agriculture	3.5	23.1	5.2	.1	3.9	4.3	1.0
Construction and mining	1.9	37.0	5.4	4.1	5.8	8.5	6.6

¹Calculations based on Bureau of Economic Analysis data, U.S. Dept. of Commerce.

²Calculations based on Bureau of Labor Statics data, Occupational Employment and Wage Statistics.

³Calculations based on Bureau of Economic Analysis data, Regional Economic Information System.

IV. SUMMARY

Hopes for a stronger rural recovery were boosted in 2003. The farm sector enjoyed a banner year. The cattle sector reaped an economic boom. Easing drought conditions led to a bin-busting harvest. Shrinking supplies of agricultural commodities on a global scale boosted U.S. exports and agricultural commodity prices. Meanwhile, signs of optimism also began to emerge on rural Main Streets. Factory closures began to ease and job losses turned into job gains.

Still, this optimism must be tempered by uncertainties. Mad cow disease has closed at least temporarily U.S. beef markets and drought conditions remain a potential threat to the 2004 harvest. On Main Street, rural job gains have not been widespread—nor have they been concentrated in the high-skilled industries with the best chance to boost rural incomes. Despite these challenges, rural America starts this year cautiously optimistic that a stronger economic recovery can emerge at the farm gate and on Main Street.

ENDNOTES

¹Calculations based on USDA's real trade-weighted index of U.S. agricultural competitors.

²Rural is defined as nonmetro for statistical purposes.

³Calculation based on mass layoff statistics published by the Bureau of Labor Statistics.