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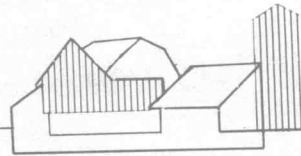
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FRB CHICAGO



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Farm debt declined again in 1984

Recent revisions confirm earlier expectations that outstanding farm debt declined marginally for the second consecutive year in 1984. As compiled by staff at the Board of Governors of the Federal Reserve System, the revised estimates show that outstanding farm debt at the end of 1984 totaled just under \$213 billion. The new level marks declines of 1.5 and 2.0 percent from the revised levels of one and two years earlier, respectively. The past two years also mark the first instances in which outstanding farm debt has recorded annual declines since the four-year slide that ended with 1945.

The latest estimates to the USDA's series on outstanding farm debt include end-of-year final tabulations for most reporting lenders as well as historical revisions, dating back to 1974, in the figures for farm debt owed to Federal Land Banks and to Production Credit Associations. The revised figures for FLBs and PCAs now include nonaccrual farm loans that were previously excluded from the reports on farm debt owed to those institutions. Including such loans provides consistency in the basis of reporting among all major types of farm lenders. It also raised figures on the combined farm debt owed to FLBs and PCAs since 1973 by a range of 0.5 percent to 2.1 percent, with the upper end of the range applicable to the ending 1983 figures.

The recent downturn in farm debt contrasts sharply with the accelerated growth that occurred in the 1970s. Outstanding farm debt roughly doubled in the decade of the 1950s and again in the 1960s, growing at a compound annual rate of 7.5 percent during that 20-year period. But in the 1970s, the growth rate for farm debt surged to a compound annual rate of 12.1 percent. Growth was particularly strong in the latter half of that decade, reaching a compound annual rate of 15.2 percent.

In retrospect, many of the financial problems in agriculture today have roots in the accelerated growth in farm debt in the 1970s. During that relatively prosperous decade for farmers, bidding on farmland was particularly aggressive as farmers sought to expand their operations and to take advantage of the then rapidly growing export markets for grains and soybeans. Considerable land changed hands at greatly inflated prices and with the aid of substantially higher amounts of debt financing. In addition, large capital expenditures, heavily financed with debt, for irrigation, tiling, and land clearing brought more land into production and heavier debt burdens. There were also large debt-financed expenditures in the 1970s that speeded the shift toward capital-intensive confinement facilities for livestock production. These factors, along with rapidly growing operating debt burdens and high rates of interest, culminated in annual debt commitments for the 1980s that a growing contingent

of farmers have found to be difficult to meet as declining exports, a waning consumer demand for red meats, and periodic droughts have eroded farm earnings.

The two-year slide in outstanding farm debt is the result of a number of factors. Farm loan demand undoubtedly has softened as financially stressed farmers have curtailed unnecessary operating and capital expenditures. Lenders have adopted more cautious lending policies in response to the declines in farm sector earnings and asset values in recent years. Moreover, an increase in charge-offs of farm loans has also contributed to the decline in outstanding farm debt. Reflecting this, the combined charge-offs of farm loans among banks, FLBs, and PCAs last year approximated \$1.3 billion. Other farm lenders no doubt also experienced substantial charge-offs last year.

Among the various farm lenders, the biggest decline over the past two years has been in farm loans owed to the Commodity Credit Corporation (CCC). Farm debt owed to the CCC, although rising sharply since last summer, totaled \$8.9 billion at the end of 1984, down more than 40 percent, or \$6.5 billion, from two years earlier. Because the CCC is the federal agency that operates the government's price support loan program, its outstandings tend to fluctuate according to the relationship between market prices and support prices. Because of the high crop prices that followed the PIK- and drought-reduced harvest of 1983, farmers had little incentive to put their crops under loan with the CCC. Hence new lending by the CCC dropped sharply. In addition, the high prices encouraged farmers to repay their existing CCC indebtedness so that the crops securing that indebtedness could be sold at the high prices. Also, the mechanics of the PIK program resulted in the cancellation of a substantial CCC indebtedness in 1983 and early 1984.

Among other lenders serving farmers, there also has been a substantial decline in the amount of farm debt owed to a broad, catch-all category of lenders referred to as "individuals and others". Preliminary USDA estimates—which may be subsequently revised—show such debt has declined nearly 7 percent over the past two years. With respect to the farm real estate debt owed to this class of lenders, the decline apparently reflects the sharply curtailed volume of seller-financing of farm real estate transfers. With respect to nonreal estate loans owed to individuals and others, the cut-back may stem from curtailed use of inputs by farmers that are often financed with merchant and dealer or by farm equipment manufacturer credit.

Farm debt owed to institutions within the Cooperative Farm Credit System (CFCS) has declined 2 percent over the past two years. All of the decline has been in nonreal estate loans owed to PCAs, which were down 13 percent from two years

Outstanding farm debt, 12/31/84

	Outstandings in \$ billions	% change in outstandings from			Percent of total
		Year earlier	2 years earlier	5 years earlier	
Farm real estate debt owed to					
Banks	\$10.2	9.2%	20.6%	18.0%	9.1%
FLBs	49.1	.5	2.8	64.5	44.0
Life Ins. Cos.	12.4	-2.1	-2.8	2.3	11.1
FmHA	10.1	7.3	10.2	40.8	9.0
Others	29.9	-7.5	-6.6	7.2	26.8
Total	111.6	-0.8	1.4	30.4	100.0
Nonreal estate farm debt owed to					
Banks	39.7	1.8	9.9	28.1	39.2
PCAs/FICBs	18.8	-6.6	-11.9	0.1	18.6
FmHA	15.6	6.9	6.0	74.2	15.5
CCC	8.9	-17.7	-42.4	75.4	8.8
Others	18.2	-3.9	-6.8	9.6	18.0
Total	101.3	-2.2	-5.5	25.9	100.0
All farm debt owned to					
Banks	49.9	3.2	12.0	25.9	23.4
CFCS	67.9	-1.6	-1.7	39.6	31.9
Life Ins. Cos.	12.4	-2.1	-2.8	2.3	5.8
FmHA	25.7	7.0	7.6	59.5	12.1
CCC	8.9	-17.7	-42.4	75.4	4.2
Others	48.1	-6.2	-6.7	8.1	22.6
Total	212.9	-1.5	-2.0	28.2	100.0

ago and down 16 percent from the peak of three years ago. Farm real estate loans owed to FLBs rose nearly 3 percent over the past two years, with most of that growth in 1983.

In contrast to the declines for all other lenders, farm debt owed to banks and to the Farmers Home Administration (FmHA) has trended higher the past two years. Farm loan outstandings at banks rose 12 percent in the two years ending in 1984. Loans secured by farm real estate registered the largest increase in that period—more than 20 percent—perhaps reflecting banks' efforts in securing additional collateral for some of their former nonreal estate farm loans that were not performing well.

Farm debt owed to the FmHA recorded only modest growth in 1983 but then rose 7 percent last year. The 1984 rise was about evenly divided between farm real estate and nonreal estate farm loans owed to the FmHA. The rise reflected a stepped up pace in new lending as well as a slowdown in repayments. Reflecting the latter, more than a fifth of the FmHA's portfolio of farm loans was delinquent in mid-1984, considerably more than for other lenders which report delinquency data. Repayment rates have no doubt continued slow, reflecting the substantial amount of loan restructuring and deferrals by the FmHA since September of last year.

The downtrend in outstanding farm debt appears to have continued into the early months of this year. But patterns among lenders are quite mixed and in some cases depart significantly from trends of the past year or two. Preliminary tabulations for all reporting lenders—which does not include farm debt owed to "individuals and others"—suggest a slight decline in outstandings in the first quarter. The initial indications are that the farm loan portfolios held by the CFCS and life insurance companies at the end of the first quarter were down from the ending 1984 level and—continuing the trend of the past few years—down from the year-earlier level. In addition, farm loan portfolios held by banks also declined in the first quarter, and may have dropped slightly below the year-ago level. In contrast, outstandings at the FmHA and CCC rose considerably. Preliminary indications suggest that the portfolio of farm loans held by the FmHA at the end of

March was up 2 percent from the ending 1984 level and up 7 percent from a year earlier. The upturn in CCC outstandings actually began in the last quarter of 1984 as low crop prices once again attracted a substantial movement of grain under the CCC's price support loan programs. The heavy movement continued in the early part of this year and no doubt boosted CCC outstandings to farmers well above the year-earlier level as of the end of March.

Gary L. Benjamin

Agricultural policy and trade

Exports of U.S. agricultural products, although still a major contributor to the overall trade balance, have fallen significantly in recent years. Since the peak in the early 1980s, U.S. agricultural exports have dropped more than 16 percent in volume and 23 percent in value. Agriculture and trade policies in this country, as well as abroad, have contributed significantly to this trend. In a recent report entitled *Impacts of Policy on U.S. Agricultural Trade*, analysts at the USDA evaluated the effects of different policies and provided a basis for understanding the complexities surrounding the 1985 Farm Bill debate as they affect agricultural trade issues.

Agricultural price support policies, although intended to stabilize domestic farm prices and income, can have a large effect on trade. Price support policies in the United States typically combine a system of loans and deficiency payments to achieve their objectives. The cornerstone of this system is the nonrecourse price-support loan from the Commodity Credit Corporation (CCC). Eligible producers can pledge their stored commodities as collateral for a specified amount of loan per bushel. This amount is referred to as the loan rate. Farmers can repay their price-support loans in cash or by forfeiting their ownership in the supporting collateral to the CCC. The latter option would likely be used if the loan rate exceeded the market price. Thus, the loan rate typically puts a floor under the market price of the supported commodity.

Deficiency payments are an additional component of the price and income support mechanism. Deficiency payments are based on a target price which is set above the loan rate. Deficiency payments are made if the average market price is less than the target price. The deficiency payment rate per bushel is the difference between the target price and the average market price and it is applicable to a producer's normal production. To be eligible for nonrecourse loans and for deficiency payments, producers are frequently required to reduce their planted acreage.

These price support policies can have important implications for U.S. agriculture, which is very dependent on exports. When the loan rate is above the world market-clearing price, as has been the case in recent years with the high value of the dollar, it places an umbrella over world prices. Because of higher prices, U.S. commodities become less attractive in world markets while commodities of other exporting countries become more price-competitive. This causes world prices to move up under the umbrella of high U.S. price supports, attracting additional production abroad and discouraging consumption. By boosting foreign output and lowering

consumption, loan rates above the market clearing price reduce the U.S. share of the shrinking world exports and simultaneously lead to surplus production here at home.

When loan rates in the United States exceed world prices, part of the cost is born by U.S. and foreign consumers in the form of higher prices. However, the bulk of this subsidy to both domestic and foreign producers is paid by U.S. taxpayers as the government accumulates and stores commodities to hold prices at the loan rate and makes deficiency payments to U.S. farmers.

While lowering loan rates and maintaining high target prices would overcome the penalties imposed on exports and continue to support farm income, such a policy could still have a major effect on trade. A policy of high target prices would support farm income in the United States and expand the U.S. share of world production. World prices, no longer shielded by the umbrella of high U.S. loan rates, would decline, tending to encourage consumption and trade. While consumers worldwide would benefit from the lower prices, U.S. taxpayers and foreign producers would in effect be subsidizing U.S. farmers. Deficiency payments to domestic producers would be funded by government revenues. In the absence of a costly U.S. acreage reduction program, foreign production would be curtailed and, be replaced by greater U.S. output stimulated by the high target prices. As a result, this policy would in effect subsidize U.S. agricultural exports and could foster retaliation by competing countries.

While domestic policies have a major effect on U.S. agricultural exports, the policies of importing countries as well as competing exporters affect the level of trade. Many importing countries attempt to support their producers' incomes by restricting agricultural imports. Countries can inhibit imports by taxing imports or by limiting the quantity imported. A frequently used form of import protection is a variable levy. After establishing the desired price support level, the importing country levies a tax on foreign agricultural products equal to the difference between the higher domestic support price and the world market price. The producers in the importing country benefit from higher prices at the expense of their consumers and of producers in exporting countries with restricted access to the market.

Another method of restricting imports is through the use of quotas. The United States and other countries use quotas to limit imports of particular commodities to some maximum level. When quotas are restrictive—below the level that would have been imported at the world price—prices in the importing country are boosted and producers there benefit at the expense of consumers and foreign producers. However, if the importing country does not sell the rights to its restricted market, the exporters that do obtain access to the high price market capture some of the benefit.

In attempting to protect domestic producers by restricting imports and supporting prices, importing countries stimulate their domestic production of agricultural products. In some instances the production incentive can be so great that it results in a surplus, transforming the country from an importer to an exporter of a commodity. A recent example of this is the European Economic Community. After several years of

increasing production, the EC, traditionally an importer, has become a net exporter of feed grains this year.

A country faced with surplus production while maintaining artificially high price supports can subsidize exports to dispose of the surplus. The difference between the domestic support price and the lower world price is the amount of the subsidy and represents a transfer from taxpayers to producers. However, foreign producers may bear some of the cost if the lower world prices pressure prices in their countries.

The loss of markets to subsidized exports has elicited calls for retaliatory measures from affected exporters. One measure frequently cited in the current discussion of U.S. farm export policy is targeted subsidies. While the U.S. has used targeted subsidies for many years in the form of low interest and guaranteed loans for selected purchasers of U.S. agricultural commodities, the recent attention has been focused on particular markets affected by the subsidy policies of competing exporters. The latest proposals call for payments in kind to exporters to effectively lower the price of commodities. Targeted subsidies can be beneficial to producers of the exporting country and consumers of the importing country if they increase the quantity demanded by the targeted importing countries. However, if the subsidy program merely encourages a substitution of concessional sales for commercial sales of the exporting country, the benefit of the subsidy is enjoyed by the importing nation at the expense of taxpayers in the exporting country. Moreover, if subsidized sales replace exports of other countries with no net gain in trade volume, displaced exports could result in greater competition and a loss of market share in trade with other importing countries.

In formulating its agricultural policies, the United States must recognize the effects they might have on world trade. The benefits of domestic price support programs must be weighed against their effects on U.S. competitiveness in world markets. In addition, to promote free markets domestic policies must be perceived as neither inhibiting nor subsidizing trade. Moreover, the potentially disruptive effects of policies intended to offset the trade practices of other countries must be fully understood. Balancing these competing considerations, particularly in light of the current financial stress in U.S. agriculture, will be difficult at best.

Peter J. Heffernan

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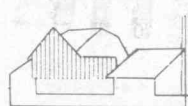
Selected Agricultural Economic Indicators

			Percent change from		
	Latest period	Value	Prior period	Year ago	Two years ago
Receipts from farm marketings (\$ millions)					
Crops*	September	11,634	4.2	-10	-5
Livestock	September	5,846	11.1	-7	-6
Government payments	September	5,685	-0.8	-1	-5
	September	103	-40.8	-88	-10
Real estate farm debt outstanding (\$ billions)					
Commercial banks	December 31	10.2	0 [†]	9	21
Federal Land Banks	December 31	49.2	-0.7 [†]	1	3
Life insurance companies	February 28	12.2	-0.7 [†]	-3	-3
Farmers Home Administration	December 31	10.3	1.1 [†]	5	10
Nonreal estate farm debt outstanding (\$ billions)					
Commercial banks	December 31	39.7	-4.5 [†]	2	10
Production Credit Associations	December 31	17.9	-9.0 [†]	-7	-13
Farmers Home Administration	December 31	16.4	-2.6 [†]	6	6
Commodity Credit Corporation	December 31	8.89	37.3 [†]	-17	-42
Farm loans made (\$ millions)					
Production Credit Associations	December	2,535	34.7	-13	-22
Federal Land Banks	December	201	1.7	-24	-37
Life insurance companies	February	41	68.4	-49	-42
Interest rates on farm loans (percent)					
7th District agricultural banks					
Operating loans	April 1	13.47	-1.2 [†]	-3	-2
Real estate loans	April 1	13.22	-1.0 [†]	-2	-2
Commodity Credit Corporation	May	9.38	-3.8	-14	3
Agricultural exports (\$ millions)					
Corn (mil. bu.)	March	2,801	-6.3	-27	-12
Soybeans (mil. bu.)	March	172	2.7	-3	1
Wheat (mil. bu.)	March	68	-15.8	-14	-20
	March	65	-30.4	-49	-53
Farm machinery sales^p (units)					
Tractors, over 40 HP	April	7,013	27.0	-11	-1
40 to 139 HP	April	5,326	24.5	-6	1
140 HP or more	April	1,687	35.7	-26	-5
Combines	April	295	26.6	-35	-45

* Includes net CCC loans.

[†] Prior period is three months earlier.

^p Preliminary



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