



The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

Papers downloaded from AgEcon Search may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.

Historic, Archive Document

Do not assume content reflects current scientific knowledge, policies, or practices.

1.90
C 2008

C2

STASIA

OUTLOOK '86

PROCEEDINGS



Agricultural
Outlook
Conference

United States
Department of
Agriculture

Dec. 3-5, 1985
Washington,
D.C.

John K. Hosemann

Senior Economist, American Farm Bureau Federation

Annual Agricultural Outlook Conference
Session #3, Washington, DC

For Release: Tuesday, December 3, 1985

My discussion of the farm financial situation and outlook has the following parts:

1. Where's the debt and who owes it?
2. An assessment of the financial situation from the farm operator's perspective.
3. Potential adjustments of debts and assets held by farm operators.

In analyzing the financial situation at the Farm Bureau, we see continued adjustment of the farm operator debt load to levels that can be serviced from farm earnings. We see debt coming down to match earnings and not earnings going up to meet debt service. Estimates of where we are in the debt adjustment process vary depending on assumptions. We could be one-third done in writing down unserviceable farm operator debt.

The recent ratios of farm debt to net farm income are two to three times the levels of the last 30 years. From the farmer perspective the key questions are: how will this excess debt be discharged and how will the losses be shared?

Discussion of the financial situation often gets confused by various ideas that may help some farmers, e.g., lower interest rates, higher commodity prices, lack of credit, declining land prices and the problems in the Farm Credit System. Each distracts from the central economic issue at hand -- reducing the farm debt load to levels that can be handled out of expected farm earnings. Only then will farming be back on sound economic footing.

Where's the Debt? Who Owes the Debt?

Everyone agrees there is a debt problem in agriculture, but no one is quite sure how much debt is out there, who holds the debt, what the debt is being used for or how much of it can be repaid. Proposals to deal with the debt problem must recognize some of these unanswered questions, if they are to be effective.

ANNUAL AGRICULTURAL OUTLOOK CONFERENCE
USDA • DECEMBER 3-5, 1985 • WASHINGTON, D.C.

Conventional wisdom puts total agricultural debt at about \$212.9 billion on December 31, 1984. This is the estimate put out by USDA. USDA has put out end-of-year debt estimates for a number of years drawing on official estimates from the Farm Credit Administration, the Federal Reserve, the Commodity Credit Corporation and the Farmers Home Administration. Lending by farm input suppliers, individuals and others is estimated by USDA. Table 1 contains the complete USDA estimate of agricultural debt as of December 31, 1984.

TABLE 1

OUTSTANDING FARM DEBT
DECEMBER 31, 1984
(BILLION DOLLARS)

LENDER	REAL ESTATE		NON-REAL ESTATE		TOTAL	
BANKS	\$10.2	9.1%	\$39.7	39.2%	\$49.9	23.4%
FLB/FICB	\$49.1	44.0%	\$18.8	18.6%	67.9	31.9%
LIFE INS. CO.	\$12.4	11.1%	-----	-----	\$12.4	5.8%
FmHA	\$10.0	9.0%	\$15.7	15.5%	\$25.7	12.1%
CCC	-----	-----	\$ 8.9	8.8%	\$ 8.9	4.2%
OTHER	<u>\$29.9</u>	<u>26.8%</u>	<u>\$18.2</u>	<u>18.0%</u>	<u>\$48.1</u>	<u>22.6%</u>
TOTAL	\$111.6	100.0%	\$101.3	100.0%	\$212.9	100.0%

SOURCE: Board of Governors of Federal Reserve System. "Agricultural Finance Databook," July, 1985.

Many analysts and policymakers assume that the entire \$212.9 billion is owed by farm operators and that all the interest and principal payments associated with these debts have to come from production agriculture. A lot of these assumptions have been discredited by more specific debt estimates.

In early 1985, USDA did a Farm Costs and Returns Survey. Farm operators were asked detailed information about their agricultural income and expenses during calendar year 1984 and the value of their assets and outstanding debt as of January 1, 1985. Farm operators reported that as of January 1, 1985 they had agricultural production related debts of \$120.2 billion. Table 2 summarizes farm operators' responses on debt held as of January 1, 1985.

TABLE 2
DISTRIBUTION OF FARM OPERATOR DEBT BY LENDER
JANUARY 1, 1985
(BILLION DOLLARS)

LENDER	REAL ESTATE	NON-REAL ESTATE	TOTAL	
Commercial Banks	14.1	18.9%	19.8	43.3%
Federal Land Banks	27.1	36.5%	2.9	6.3%
Production Credit Associations	4.3	5.8%	7.6	16.5%
Farmers Home Administration	11.7	15.6%	4.6	10.0%
Commodity credit Corporation	.2	0.3%	1.4	3.1%
Merchants	.2	0.3%	2.0	4.5%
Individuals	12.0	16.1%	5.2	11.3%
Others	<u>4.8</u>	<u>6.5%</u>	<u>2.3</u>	<u>5.0%</u>
TOTAL	74.4	100%	45.8	100%
			120.2	100%

Source: Farm Costs and Returns Survey, 1984, USDA.

By combining some of the lender groups shown in Tables 1 and 2, a direct comparison can be made between the two different estimates of outstanding debt. These appear in Table 3.

TABLE 3
COMPARISON OF TWO MEASURES OF AGRICULTURAL DEBT
JANUARY 1, 1985
(BILLION DOLLARS)

LENDER	1) TOTAL AGRICULTURAL DEBT	2) FARM OPERATOR DEBT	DIFFERENCE
Banks	49.9	33.9	16.0
FLB/PCA	67.9	41.9	26.0
FmHA	25.7	16.2	9.5
CCC	8.9	1.7	7.2
Others	60.5	26.5	34.0
TOTAL	212.9	120.2	92.7

1) USDA 12/31/84

2) USDA Cost/Returns Survey as of 1/1/85

The differences in debt data cannot, obviously, be ignored. Since the USDA estimate of agricultural debt comes from official sources, a reasonable assumption can be made that the estimate of \$212.9 billion of agricultural debt on December 31, 1984 is an accurate estimate.

The evidence available indicates that the farm operator debt is a reasonable estimate. The survey covered a lot of areas other than farm debt and assets, and the results from these areas are consistent with estimates from other sources. For example, the estimate of wheat production for 1984 based on the survey data was within a couple of percentage points of the wheat production estimate from the Statistical Reporting Service.

The estimates of farm operator assets and debts are also consistent with the results from the 1978 Census of Agriculture credit survey that was done in 1979 and the 1982 Census of Agriculture.

We can say with a fair amount of confidence that the farm operator debt estimates from the USDA Farm Costs and Returns Survey is a reasonable estimate of the actual debt held by farm operators.

With that out of the way, the question then becomes, if farm operators do not control the other \$90 billion, then who does?

The most obvious answer for part of it is landlords. These people borrow money to finance land purchases and under various types of crop and livestock share lease programs are responsible for some inputs, which may be financed by borrowing. With the amount of outside investment that came into agriculture from the mid-1970's until the early 1980's, this amount may be larger than many people guess. Unfortunately, no data is available on this. What we do know is that in 1982, 42 percent of the farm land operated by farmers was rented from other owners. There are many more farm ownership units than there are farm operator units.

Some owners of land use it as collateral to borrow money for nonagricultural purposes. The loan is on agricultural land, but the purpose is totally nonagricultural.

People who live in rural areas borrow from institutions that serve agriculture and often the line between agricultural loans and nonagricultural loans gets rather blurred. This is particularly true for houses and small acreages.

A portion of the debt held by farm operators is debt associated with normal living activities like cars, housing, furniture and similar items. This was estimated by USDA at \$13.9 billion on December 31, 1984. Since 69 percent of the farms produce only 13 percent of the output, the majority of this debt is held by farmers who rely on off-farm income to pay the debt.

Even after considering this, it's still hard to believe that nonfarm operators hold \$80 billion of agricultural debt. What definitely can be said is that farm operators are not responsible for all the \$213 billion of debt labeled as agricultural debt and any new credit policies based on the \$213 billion number will be in error.

The few people who have seriously studied this issue generally agree that the nonoperator debt is probably in stronger hands than the operator debt. Farmland investors have other incomes to help meet principal and interest payments and landowners that used land collateral to borrow for other purposes did not plan to rely on the land to repay the loan.

Any credit program that is aimed at representing the best long-run interests of production agriculture must direct its central focus on the estimated \$120 billion plus debt held by farm operators and the debt adjustments that must take place around this number.

Summary of the Financial Situation of Farm Operators

The agricultural finance situation is a complex web that ties together farm operators, landowners, financial institutions and farm input suppliers. How people view the situation is somewhat influenced by their position in the web and how they perceive the construction of the web. Since the financial health of all portions of the farm financial situation depends on farm operators' abilities to generate cash flow and income to pay debts, a review of the financial situation of farm operators is key in analyzing the farm credit situation.

We have found that the best source of the financial situation of farm operators is USDA Agriculture Information Bulletin Number 495, "Financial Characteristics of U.S. Farms, January, 1985." This study summarizes financial and cash flow data provided by USDA's Farm Costs and Returns Survey. The survey gathered cost and return data from farm operators for calendar year 1984 and debt and asset values as of January 1, 1985.

The survey included all size farmers, but our analysis only included those operators with gross sales of \$40,000 a year or more. These are the full-time and part-time operators that produce almost 90 percent of the agricultural output. Virtually all of the farms with sales of less than \$40,000 per year have operators who provide for most of their family living and debt payments with off-farm income or have operators that are semi-retired. From a policy standpoint these operators pose little, if any, problem.

In summary, all farm operators had assets of \$544.0 billion and debts of \$120.2 billion, a debt-to-asset ratio of 22.1 percent, on January 1, 1985. Operators with gross sales of \$40,000 per year or more had assets of \$371.6 billion and debts of \$99.1 billion, a debt-to-asset ratio of 26.7 percent. Of these producers, 69 percent had debt-to-asset ratios of less than 40 percent and 31 percent had debt-to-asset ratio of greater than 40 percent. Almost 5 percent of the operators had debt-to-asset ratios above 100 percent.

Farm operators with debt-to-asset ratios of less than 40 percent control 75 percent of the assets and 36 percent of the debt held by farm operators.

For operators with debt-to-asset ratios of less than 40 percent, 34 percent had negative cash flows in 1984. Among operators with debt-to-asset ratios of 40-70 percent, 61 percent had negative cash flows. Of the operators with debt-to-asset ratios of 70-100 percent, 75 percent had negative cash flows. For operators with debt-to-asset ratios above 100 percent, 70 percent had negative cash flows.

Debts, Assets and Cash Flow of Farm Operators

The two key variables in looking at the financial condition of farm operators are debt-to-asset ratio and cash flow. The first gives an indication of the amount of lender losses that would occur if an operation is restructured or liquidated and the second gives an indication of the farm operator's ability as a going business concern to generate cash flow to pay production expenses, interest, principal and living expenses. Table 4 shows the amount of assets and debts held by farm operators based on debt-to-asset ratio and positive or negative cash flow.

TABLE 4
ASSETS AND DEBTS HELD BY FARM OPERATORS WITH GROSS SALES
OF \$40,000 PER YEAR OR MORE
JANUARY 1, 1985

<u>OPERATOR GROUP</u>	<u>NUMBER OF FARMERS</u>	<u>ASSETS</u>	<u>DEBTS</u>	<u>ASSETS MINUS DEBTS</u>
		-----	MILLION DOLLARS	-----
D/A RATIO 100% Plus	30,578	9,030	13,049	(4,019)
D/A RATIO 70-100% NEGATIVE CASH FLOW	33,682	15,232	12,621	2,611
D/A RATIO 70-100% POSITIVE CASH FLOW	11,183	4,744	3,655	1,089
D/A RATIO 40-70% NEGATIVE CASH FLOW	73,622	42,980	22,958	20,022
D/A RATIO 40-70% POSITIVE CASH FLOW	47,814	21,475	11,057	10,418
D/A RATIO 0-40% NEGATIVE CASH FLOW	147,776	103,911	16,587	87,324
D/A RATIO 0-40% POSITIVE CASH FLOW	291,801	174,220	19,183	155,037

SOURCE: Farm Costs and Returns Survey, 1984, USDA

Potential Lender Losses

The information in Table 4 provides a good base for looking at potential lender losses. Those farm operators with higher debt-to-asset ratios are more likely, in general, to cause lender losses than those with lower debt-to-asset ratios, and those operators with negative cash flows are more likely to cause lender losses than those with positive cash flows. What we do not know is what has happened to asset values and debt loads since January 1, 1985 for these groups and what is likely to happen over the next year or two.

A reasonable assumption would be that with some erosion of land prices since January 1, 1985 and relatively depressed farm equipment markets, net proceeds of asset sales would be about 20 percent less than the asset values of January 1, 1985. Another reasonable assumption would be that debts for these operators have increased by 10 percent since January 1, 1985. Many other combinations of adjustments of debts and assets could be used and arguments could be made in support of other adjustments, but these appear to be good ballpark estimates.

For the purpose of this analysis, the assumption is made that any operator who is liquidated or faces substantial financial restructuring, will have assets valued at 20 percent less than the January 1, 1985 estimates and debts 10 percent higher than those of January 1, 1985.

The other assumption that has to be made is about the percent of operators in each of the groups shown in Table 4 that will be forced out of business or undergo a substantial financial restructuring that may result in financial losses for lenders. The only thing we can do is make reasonable guesses.

A good place to start is with farm operators with debt-to-asset ratios of greater than 100 percent. A reasonable assumption is that all of these operators will exit agriculture or undergo financial restructuring. This group is in bad shape and getting worse quickly.

The next worse group is those with debt-to-asset ratios of 70-100 percent and negative cash flow. Lenders will likely try to stop the hemorrhaging here before this gets worse. The assumption is made that 80 percent of these will exit or undergo financial restructuring.

A third group that may face substantial pressure is those with 70-100 percent debt-to-asset ratios and have positive cash flows. These operators have met their financial commitments, but lenders may be concerned about their ability to repay future loans. The assumption is made that 50 percent of these operators will exit or undergo financial restructuring.

The final group that may be under pressure is those operators with debt-to-asset ratios of 40-70 percent and negative cash flows. These operators have decent balance sheets, but lenders will be concerned because they are losing net worth under current conditions. The assumption is made that 35 percent of these will exit or undergo financial restructuring.

Those are the four groups that face the greatest financial pressure. For the purpose of this analysis, the assumption is made that little or no lender losses will occur in the other three groups of farm operators.

Table 5 provides a summary of changes in assets and debts and likely lender losses under the scenario just outlined.

TABLE 5
POTENTIAL LENDER FINANCIAL LOSSES IN AGRICULTURE

OPERATOR GROUP	ASSETS & DEBTS (MIL \$)	PERCENT			ADJUSTMENT MENT (MIL \$)	LOSS (MIL \$)
		ADJUSTED VALUE & DEBTS (MIL \$)	OF OPERATORS MAKING ADJUST- MENTS	VALUE OF ASSETS & DEBTS IN ADJUSTMENT		
D/A RATIO	9,030	-20%	7,224	100%	7,224	(7,130)
100%	13,049	10%	14,354	100%	14,354	
D/A RATIO						
70-100%	15,232	-20%	12,186	80%	9,749	(1,357)
NEGATIVE	12,621	10%	13,883	80%	11,106	
CASH FLOW						
D/A RATIO						
70-100%	4,744	-20%	3,795	50%	1,898	(113)
POSITIVE	3,655	10%	4,021	50%	2,011	
CASH FLOW						
D/A RATIO						
40-70%	42,980	-20%	34,384	35%	12,034	3,195
NEGATIVE	22,958	10%	25,254	35%	8,839	
CASH FLOW						
TOTAL LENDER LOSSES						(8,600)

As can easily be seen in Table 5, the big losses for lenders occur with those operators with debt-to-asset ratios greater than 100 percent. After the adjustments in value of assets and debts, they have about twice as much debt as assets. Some losses occur with those operators with 70-100 percent debt-to-asset ratios and negative cash flow. Those with debt-to-asset ratios of 70-100 percent and positive cash flow are about break-even from the lenders view point. Lenders lose no money on those with debt-to-asset ratios of 40-70 percent and negative cash flows because after the adjustments of assets and debts, the value of assets substantially exceed debts.

Combined losses from the three groups are about \$8.6 billion. This probably understates actual losses because losses were based on the situation of each group of operators rather than each operator. A reasonable estimate under this scenario is that lender losses would be about \$10.0 billion with about three-fourths of the losses coming from operators with debt-to-asset ratios of greater than 100 percent on January 1, 1985.

Several other scenarios were run to test other likely outcomes. If asset and debt values remain at the January 1, 1985 level and the same operators exit or face major restructuring, lender losses would be about \$5 billion. That would be about the least losses that could be expected. Losses are not likely to exceed \$10 billion, unless assets decline in value by more than 20 percent.

Now that we have identified that \$10 billion of farm operator debt will be lost, the next step is to look at the who and when of taking the losses. For the sake of discussion, it is safe to say that this debt will be written off over a three year period of calendar 1985 through 1987. Unless our computer slipped a gear, that is about \$3.3 billion per year.

Whether lenders can absorb \$3.3 billion per year is somewhat unknown, but the limited amount of information available indicates that they can do so. According to the Federal Reserve, insured commercial banks wrote off \$900 million in agricultural production loans during 1984. The Farm Credit System wrote off about \$400 million of loans in 1984, three-fourths of which were PCA loans. For 1984 these two groups of institutions wrote off \$1.3 billion of agricultural loans.

Loan write-offs have been running substantially larger so far in 1985. Commercial banks wrote off \$550 million in loans for the first half of 1985 and we are guessing that they will write off \$800 million in the second half for a total of \$1.35 billion for the year.

The farm credit system wrote off almost \$300 million in the first half of 1985 and we expect them to write off \$650 to 700 million in the second half of 1985. Total write-offs for the system will be about \$950 million, and banks and the farm credit system together will have written off about \$2.3 billion.

But this is not the end of the write-offs. We expect substantial adjustments of loan values in the "other" category. You may recall from the earlier numbers that "other" lenders had about \$48 billion of total agricultural debt using USDA's December 31, 1984 estimates with \$30 billion of it in real estate debt. Farm operators reported they owed merchants, individuals and others about \$26 billion with \$17 billion in real estate debt as of January 1, 1985. We believe that \$1-2 billion of this debt will be written down during 1985, particularly on land debt. This will mostly be paper transactions that recognize that some pretty "bad" judgments were made a few years ago and the time has come to renegotiate.

The bottom line is that write-offs of farm operator debt will likely be in the \$3.5 - \$4.0 billion area for 1985 and we will be well on our way to cutting \$10.0 billion over three years. Note that these numbers do not include write-offs by insurance companies, Farmers Home Administration and the Commodity Credit Corporation. These will be smaller than the categories mentioned above, but certainly not insignificant.

Since I am this far out on the limb already, I'll plunge on into 1986. Commercial banks will likely have loan write-offs at the 1985 level, but not larger. The Farm Credit System will have larger write-offs with the increase coming in land loans. The other category will have write-offs at about the same level. FmHA write-offs will be small while CCC write-offs will increase substantially as they take over a lot of the 1985 crop put under loan.

In 1987, write-offs by commercial banks and others will decline substantially. Farm Credit System and FmHA write-offs will increase.

This is not to say that all of this will be pretty or nice, only that the process is already going and may not be as frightening as some would imply.

Concluding Comments

From the farmer's perspective, the financial situation boils down to a question of whether the reduction in debt will be "paid for" through farm operators leaving farming and the assets repurchased at lower prices by other producers or through debt restructuring for present farmers that will facilitate an orderly reduction by some specific date of the farm operator debt down to serviceable levels. Debt restructuring by definition means a loss sharing among borrowers, lenders and taxpayers.

If all the farmers associated with the lender losses I discussed earlier are forced out of business, about 90,000 commercial farmers would exit farming over three years starting with 1985. This is about 15% of the commercial farmers. Unless farms get bigger to absorb all of this, 90,000 new commercial farmers would have to be financed by lenders.

Our guess is that this is not feasible. The discussion over the next year will be focused on how to keep some of these 90,000, probably about half of them, in business while reducing their debt loads to manageable levels. From an economic standpoint, some of the 90,000 can't be saved without massive infusions of taxpayers' money and probably should not be saved. Those that should be helped are those that lenders can work with with limited taxpayer assistance.

It is customary, these days to tick off the various reasons as to how we got into the financial problems we are in. The "big four demons" -- national debt, interest rates, export policy and the strong dollar -- are condemned widely by economists and noneconomists alike as being the primary roots of our present evils. But if commercial agriculture has to base its survival upon early correction of these intensely complicated macro-economic issues, armageddon may arrive first.

Moving ahead in production agriculture will mean that we learn from our mistakes. Regardless of the macro-economic climate served up by the federal government and the Federal Reserve, we must remember that net returns or gross profit on revenues must take precedence over balance-sheet lending and the tendency to define farming success by owning land, buildings and equipment.

The main focus of this paper has been to estimate the number of farmers to be impacted by the debt adjustments that are underway and the lender losses associated with these adjustments.

As an economist with Farm Bureau, an overriding concern is to preserve the economic health of the farmers who are not in financial difficulty. The only way to do this is to keep markets growing. Policy failures on the market side will translate into failure to cope with the debt issue as more farmers slide into financial trouble.

The market issue is vital to all farmers. Without growing markets no part of agriculture will prosper. All farmers must produce and sell. In 1986, production agriculture has some important market things going that were not evident over the past five years. World economic growth is stronger. There are fewer incentives for competition to produce. Interest rates are lower. Foreign currencies are stronger.

In the short run, farm programs must be aimed at: (1) reducing existing stocks and not encouraging future stockpiling; and (2) price competitiveness.

Reducing existing stocks and avoiding future stockpiling must be achieved in order to position U.S. farmers for market income opportunities in future years. Essential to short-run farm program operation are voluntary acreage reduction programs coupled with an effective conservation reserve. These programs can help keep stocks from rebuilding.

Four years of declining export market earnings is ample evidence that our products are simply not price competitive. Swift and decisive action must be taken to stop the export market slide. Loan rates are strategically important to short-run price competitiveness.

While everyone is dwelling on the 1985 farm bill, the markets, in general, have already discounted the fact that little change in the status quo is likely. Until there is a new farm bill, those who are interested in markets know that immediate action must be taken to improve the situation. Loan rates must be adjusted and grain not allowed in the farmer-held reserve.

For the longer run, there seems to be general agreement in Congress that farm program pricing in the future must be tied to market prices. If the federal farmer-held reserve is not eliminated -- or drastically limited in size and operation -- tying loan rates to market prices will be a policy exercise in futility. Market-based loan rates are incompatible with the farmer-held reserve when used to try and prop up prices in the face of quasi-limits on federal farm program spending.

In closing, if market issues are not addressed quickly, managing the debt problem will fast become a policy impossibility.