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# ADJUSTMENTS IN BUSINESS AND PRACTICES: HOW FARMERS CAN IMPROVE THE BOTTOM LINES IN TODAY'S FARM ECONOMY

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## Introduction

Good afternoon! I appreciate the opportunity to be with you today. In the time I have allotted I would like to share with you some of the responses I have seen to the low commodity prices and some possibilities that I am recommending to Iowa farmers.

I am an Extension Economist in farm management at Iowa State University. The examples that I will use come from Iowa. However, I think that they will be similar to the situations and responses seen in other Midwestern states.

One of my jobs for ISU Extension is coordinating the Farm Financial Management Program which started in Iowa in 1983 as a response to the farm financial crisis that was occurring at that time. We have kept the program active and today it represents one of ISU's primary responses to the current farm financial situation.

The Farm Financial Planning Program consists of trained Extension associates who work one-on-one with individual farm families and use the computer program FINPACK. However, the Farm Financial Planning Program is more than a simple computer analysis of the farm finances. The associates are also trained to work with the families in helping to identify alternatives, seek out other sources of information and help and, in general, provide a neutral third party to work with the farm family.

Currently there are 15 of these associates throughout Iowa. In addition to their part-time work with Extension, the associates are also active farmers. Some of the associates have been with the program since the beginning and others are new this year.

My work with the associates and their comments will form the basis for some of what I want to share with you today. Their insights often help me as I work with the broader issues facing the agricultural community.

Before discussing some of the business and farm practice adjustments that we are seeing, I would like to share with you some observations on the situation and where we stand currently. Although the low commodity prices affect everyone, it is apparent that some are being more adversely impacted than others. As one of the associates commented, "there are haves and have-nots".

Two important factors influence the impact and adjustments to the current financial situation. First, the past few years have been very good income years. High corn and soybean prices and the passage of the Federal Agriculture Improvement and Reform (FAIR) Act led to a general feeling of euphoria throughout Iowa. There was a feeling that "with the government off our backs" and the unveiling of major trade opportunities, agricultural fortunes were going to improve substantially. A second factor that influenced the adjustments to this period is the rapidly changing structure within the production sector. This is especially true in pork production but there also are changes in cropping due to genetic alterations, grain contracting and other events.

These two factors caused a more pronounced reaction to this downturn in production agriculture. The bubble burst very rapidly and many producers are asking themselves if they even want to be participants in the new environment.

The current downturn in the farm economy first surfaced during early to mid- summer 1998. One indication was land values. In May, participants at the 72nd ISU Soil Management and Land Valuation Conference projected a 15 percent increase in land values for the year 1998. For the past ten years, the participants' prediction has been within 3 or 4 percent of the values reported in the ISU Land Value Survey. This year the ISU survey showed a 1.9 percent decrease in values, rather than the 15 percent increase that had been projected.

The mood of farmers at ISU Experiment Station field days at the end of August was very somber. However, record or near record yields, coupled with the extra government payments, helped improve the mood, at least for the cash grain farmers. For farmers with swine the situation deteriorated throughout the year, ending with the lowest hog prices ever seen.

The collapse in the farm economy led to questions about the failure of FAIR and whether we were returning to a situation similar to the 1980s. There also has been considerable bantering about how serious the situation is and what, if any, should be the appropriate response at both the state and federal levels. There were emergency funds provided to agriculture and there have been many proposals for helping the farming community in general and swine producers in particular.

One ISU study by Jolly and Vontalge, based on data from the Iowa Farm Business Association, used farm level data and a ranking scheme that looked at both the cash flow and the return to equity. This study showed that as many as one-third of Iowa's farmers could go out of business within the next two to three years. The Association mainly represents Iowa's full-time family-sized farms. It doesn't have the very large farms, but it also does not have the small farms.

In spite of this study, it is difficult to ascertain the extent of the financial problems caused by the current situation. One of the associates likened the situation to a "deer in the headlights", that is, people are just kind of paralyzed. They aren't seeking help or taking any action because they just aren't sure what to do or how serious the situation really is at this time. Some land auctions reports that there is still a strong demand for farmland. This would indicate that there are still farmers and investors who have money and believe in the capacity of farmland to generate an adequate return.

Regardless of how serious you think the situation is today, the key is going to be how long the low commodity prices last. If the current low prices persist for the next year or so, the number of people severely impacted will continue to rise.

## Adjustments

Four categories of adjustments are occurring. I will discuss each of these categories separately, but I do not have an estimate of the percentage or number of farmers falling into each category.

Some farmers are simply quitting and they can be divided into several different groups. Some are quitting simply to preserve the equity they have left. For a variety of reasons these farmers do not see a future in agriculture, or at least not a future for them. Rather than continue to farm and lose equity, they are choosing to exit now and pursue other employment alternatives. These are either middle-aged farmers with other alternatives or older farmers at retirement age.

Another group quitting farming are those who have acquired debt loads that their current operation is not able to support. This debt could have been incurred due to expansion, inefficient operations, or a variety of reasons. Regardless of the source of the debt, the farm simply cannot continue to operate.

A second response category contains farmers making major changes in their operations by dropping or adding enterprises. This is characteristic of swine producers. The months of red ink and the less than rosy prospects have made a number of swine producers look carefully at their position and interest in remaining in the swine industry.

It is very difficult to make general statements about who is exiting and who is staying in the swine industry, at least at the level we would normally consider as family farms. Three examples illustrate this point, and these are all people with whom I have worked in the past two or three months. One was a middle-aged producer with low cost of production in old, unconventional facilities. He had many other opportunities, and he viewed his choices as staying with the pigs and losing money until the price improved and then spending the rest of his career getting back to where he was today, or quitting now and keeping the crops while doing something else. That was the path he chose. Another instance was a young couple who wanted to stay with the swine industry, primarily through producing specialty pigs. They chose to delay purchases, maintain existing facilities, basically trying to ride out this period of low prices. Finally, the third producer was a younger man who had within the past three years invested considerable money into expanding his hog facilities. He was simply trying to persuade his lender to stay with him until things improved.

There are many other examples of people who dropped particular enterprises in response to the current farm economy. Some producers are eliminating the farrowing and simply using their existing facilities for contract finishing of someone else's pigs.  Some are trying to direct market or market their products through joint enterprises.

As noted earlier, another response category of farmers are those who are simply not doing anything and hoping that the situation will improve or that they will be able to survive the current round of low prices.  It is important to remember these categories of farmers when thinking about a "sitting tight" strategy and what it foretells.  Many farmers are part-time or retired farmers, other farmers are in a very strong equity position.  As long as the price is above the cash cost of production, they will keep producing and not be too concerned.  Problems may arise when they have to replace equipment or when they realize they are not earning a competitive return on their equity, but they simply enjoy farming and will continue to do so as long as it doesn't cost too much.  The fourth category of farmers is trying to make adjustments in their production practices and in their financial arrangements to help them survive this current period.

A common reaction has been to "rebalance the balance sheet".  For a variety of reasons, including an increase in credit card use and credit purchases, farmers today find themselves with a substantial amount of short-term debt. In other instances, rolling debt is accumulating because prices don't even cover the cash costs of production.  This debt is not on any fixed type of payment schedule. Regardless of the source, many farmers are scheduling debt on a note to reflect the actual position and obligations of the farm.  This debt is often secured with intermediate-term assets.

There are many other adjustments occurring in production practices, one of which is the number of trips across the field.  For a variety of reasons, there has been a decrease in the use of conservation tillage.  Reducing trips not only saves the soil; it saves expenses as well.

Pest management options are another area where farmers are adjusting their practices. Over the past few years, we have seen a dramatic drop in the use of row cultivation as a weed management option with herbicides used as a substitute.  In times of low prices, the ability to decrease cash costs often outweighs the desire to save labor.

Farmers are doing less of their own spraying.  In 1996, over 40 percent of Iowa's corn and soybean farmers did not apply any herbicides themselves and used custom applications. There are a variety of reasons for this, and while it may be the best approach for some people, it does represent an area where there is room for savings.

Fertilizer use is another area where considerable savings can be achieved.  Over 80 percent of the corn acres receive phosphorus and potassium.  However, two-thirds of the soils tested in the Iowa State Soil Test Lab rated high to very high in P and K.  Research has shown that there is no yield response to adding P and K to these soils.  By use of soil testing, farmers will be able to determine the level of nutrients available and whether or not P and K applications will be cost effective.

Planting rates is another area for savings.  The recent trend, especially in soybeans, has been to narrower rows or drilling along with higher plant populations.  Again, research has shown that regardless of the row spacing, there is a level of maximum plant population above which there is no yield response. Many Iowa farmers are using planting rates above these levels.

In addition to the typical types of adjustments that can be made to reduce the costs of production, farmers are also increasing their use of the risk management tools. Today there are a variety of new insurance programs that were not available to farmers just a few years ago.

## Conclusions

The severity of the current situation is being debated. However, for some producers, the situation is very serious. The key to how widespread the problems will become is how long the current round of low commodity prices lasts. The longer it lasts, the more people that will be drawn into the serious financial situation.

Farmers are responding in different ways. For some, simply fine tuning their operations appears to be the best approach. However, for others, the situation has deteriorated to the extent that their ability to continue in production agriculture is doubtful.

Some farmers are responding with fairly drastic changes in their farming operations. They are dropping enterprises or changing the way they market their products. Others have yet to make changes for a variety of reasons.

Over the past 45 years, there has only been one year (1981) where the average management return for the highest one-third profit group in the Iowa Farm Business Association was negative. That year was believed by many to be the start of the farm financial crises of the 1980s. Initial results from the Association for 1998 show that there is a strong likelihood that the year's average management return will be negative. The 1998 Iowa State Land Value Survey showed the first drop in land values in 11 years. Only time will tell whether or not these indicators presage another widespread financial crisis. Regardless, farms will have to make adjustments and one of the biggest is the change in attitude. We must start using the good times to even out the bad times. Farmers must also begin making adjustments based on their individual circumstances. There is no one "best" way to do something, and each individual farm has its own unique set of goals and resources. We must use this knowledge to make our decisions and adjustments.