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RECOVERY IN THE FARM ECONOMY

There are a number of indications that economic and financial pressure in the farm sector is easing. Five such indicators are summarized here. First, a combination of farm liquidations, repayment of debt, and a decline in the rate of borrowing has reduced the level of outstanding farm debt by 25 percent since the third quarter of 1984. Second, the slide in farm real estate values that began in 1982 and continued through the spring of 1987 has apparently ended. The USDA's annual report of farm real estate values to be released next spring is expected to show that, on average, values increased during 1987. Third, there has been a significant decline in the production costs of major grain and livestock commodities. Data from Illinois Farm Business Records show a 17 percent reduction in the per acre cost of growing corn and soybeans since 1981. The cost of producing hogs declined by 19 percent from 1983 to 1986. Fourth, the quantity of corn, wheat, and soybean exports has rebounded from the lows of two years ago. Fifth, net farm income has been increasing since 1984. Projection for 1987 put the net farm income figure (in constant dollar terms) at the highest level since 1975.

Despite the large number of positive developments in the agricultural economy, the prospects for continued recovery are much less certain. There is some concern that the farm economy is not as healthy as it appears on the surface. Three factors can be cited in support of this concern.

First, is the cyclical nature of livestock profits. Livestock prices, particularly hog prices, were well above average from June 1986 through September 1987. High prices in combination with low feed costs resulted in a long period of record or near record profits for hog producers. Based on Illinois records, for example, income of hog producers was 3.2 times the income of grain farmers in 1986. In recent months, however, hog prices have declined by about 30 percent. Since the summer of 1986, broiler and turkey prices have declined by about 30 and 40 percent, respectively. Feed costs are also on the rise. Only cattle prices remain relatively high.

Second, is the sharp decline in capital investment in production agriculture. USDA figures indicate that from 1982 through 1986 depreciation of the capital stock, on a replacement-cost basis, was more than double the value of new capital purchases. The average age of the machinery inventory in U.S. agriculture has increased significantly. The inventory will eventually have to be updated, creating the potential for additional financial pressure if net incomes do not continue to grow.

Third, and perhaps most significant, is the continued heavy hand of federal government in the crops sector of the farm economy. The USDA has financed massive acreage reduction programs that idled an estimated 74 million acres in 1987. The USDA is also financing a very aggressive export bonus program and a commodity certificate program.

There are two significant implications of government dominance of grain markets. First, much of the improvement in net farm income since 1984 represents direct government payments, not necessarily an improvement in the market. Direct government payments to farmers totaled nearly $12 billion in 1986, and accounted for about 35 percent of U.S. net farm income. The second implication is that grain markets may not be as healthy as statistics indicate. Wheat exports are increasing only because of heavy subsidies through the export enhancement program. Corn exports are rebounding primarily due to the commodity certificate program, which has kept corn prices low for the past 18 months. Domestic processing use of corn has increased, at least in part, because of a protective sugar policy and subsidies for ethanol production. Only the soybean market is recovering without major government involvement.

Balancing supply and demand at acceptable prices in the grain markets will continue to require government involvement. A major weather problem could temporarily alter the situation, but the basic structure of the U.S. crops economy is one of surplus. Prolonged periods of profitability do not typically occur in competitive industries with idle capacity--U.S. agriculture is such an industry.

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