I am honored to have this opportunity to discuss the state of southern agriculture. My remarks today will be somewhat broad in scope because I don't think we can understand the situation of farming in this region without viewing it from a national, and even a global, perspective. Moreover, we can't really devise strategies for future improvement without understanding all aspects of today's agricultural problems, including financial ones. I'll begin by reviewing the historical context, going back to the 1970s when the fundamentals of today's agricultural situation were set. Next I'll examine, in turn, the major problems faced by farmers and their creditors. Finally, I'll venture some idea of where American agriculture, and with it, farmers in this region seem to be headed.

**Background.** Farmers have been experiencing low incomes, high costs, declining asset values, and shrinking markets for the past several years. Delinquency, liquidation, and bankruptcy rates have all risen over the early years of this decade. Agricultural equity in constant dollars has been reduced by about 40 percent since the beginning of this decade, and farm equity has yielded a negative rate of return. Nationwide, about 5 percent of all farmers went out of business during the year ending in June 1985, and another 4 to 5 percent probably underwent the same fate by this time in 1986. Farm lenders have also experienced considerable stress.

How did U.S. agriculture, which is favored by a strong record of productivity and distinct comparative advantages, find itself in such difficulties? Current agricultural
problems can be traced to a boom-bust pattern originating in the 1970s, when farmers first responded to dramatic increases in demand and then suffered the consequences of overproduction as demand faltered and commodity prices fell sharply. Demand rose initially as the result of crop failures in the Soviet Union of such magnitude that virtually the entire U.S. farm stockpile was absorbed in a single year. Subsequently, the United States suffered drought and associated shortfalls in major crop production, further spurring demand. Also, around this time the sudden, apparently permanent, depletion of anchovies off the coast of Peru created worldwide demand for an alternative protein source for animal feed. That need was met to a considerable extent through increased soybean production. As demand and farm profits rose, farmers and investors began to bid vigorously for land, triggering sharp price increases. Optimism, fed by high crop prices, continued throughout the 1970s, and purchases of land and equipment were facilitated by liberal use of debt at bargain interest rates.

In the early 1980s, however, the situation reversed. Growing government deficits, combined with tight monetary policy, raised real interest rates and, subsequently, the value of the U.S. dollar. The resulting 20 percent decline in U.S. exports, combined with recession and increased foreign competition, took a great toll on agricultural prosperity. Moreover, the slowdown in inflation, which was generally such a boon, actually exacerbated the farmer's plight. In the late 1970s farmers had high and, as it turned out, mistaken inflationary expectations, which encouraged them to incur ever higher debt burdens. When inflation began to abate dramatically, farmers could no longer rely on price increases to ease the burden of future loan repayments.

Of course, many farmers did not borrow heavily, and others reduced their indebtedness. Typically their net incomes have been fairly well maintained with the aid of government programs for major crops. Farmers who have experienced the most
severe financial problems in the 1980s are largely those who undertook sizable debt near the end of the boom period. When crop prices fell, the debt service requirements of these farmers soared far above their stagnant income flows. Many have had to sell some of their assets to pay down loans. For numerous farmers, moreover, even this medicine has proven ineffective to cure their ills: rapid declines in farm land and machinery prices have frustrated their efforts to reduce debt loads by selling assets. Following the virtual tripling of farm land prices in the previous decade, prices began a downward adjustment in 1981 just as returns on such competing investments as bank deposits and government bonds rose substantially. Farmers who possibly could have extricated themselves from financial difficulty by selling assets found the market for these to be weak or nonexistent.

**Dimensions of the Problem.** To understand why these problems have advanced to this stage, we need to look at certain factors peculiar to agriculture. One involves farm cost structures. Fixed costs constitute a high proportion of total costs in farming, and in most cases returns from additional output exceed the variable costs associated with them. In order to minimize losses, therefore, farmers will continue producing as long as returns exceed out-of-pocket costs at the margin (and creditors forebear). This production characteristic means that it is difficult to reduce farm supplies.

Aside from this cost feature, however, a much more fundamental factor—extensive government support programs—explains why farmers face such dismal prospects today. Despite their positive intentions, both price support and set-aside programs have the effect of postponing adjustments to underlying market realities. These work in much the same way as protectionist measures on behalf of industries like steel, textiles, and autos in that they only defer changes which inevitably must be made if companies are to survive in today's global markets. While these farm programs have
been intended to help preserve or maintain income levels of farmers at some minimum level, the price mechanisms by which they operate tend to result in excess supplies. Given the extent of these programs, which are typically not limited to farmers at the lower income scale but available more or less across the board, it is not surprising that output is likely to continue surpassing demand, keeping prices under downward pressure.

Since the trend in farm profits is therefore likely to be flat, potential purchasers of farm assets are placing a lower value on those assets. Asset values in 1986 are predicted to be 25 percent below their $1 trillion-plus peak in 1981. This decline is primarily a result of falling land values. Although the decline in asset values has increased the rate of return on farm assets to its highest level since 1979, for those contemplating investing in farm assets now the return is still not competitive with alternative investments. Consequently, farm asset values will probably fall further.

Lower land prices are not, then, just a temporary result of financial stress. Rather, they represent a major long-term adjustment to the changed farm outlook. This decline, though, has by no means been uniform, from region to region or within individual states. For example, the average decline exceeded 25 percent last year in Illinois, while Texas land appreciated by 10 percent. In Georgia, land values declined 50 percent or more in areas of concentrated row-crop production while values increased on the periphery of metropolitan areas and in the hilly regions where broiler production is profitable.

The decline in land values has led to a continuing reduction in the net worth of farmers, which stood at $605 billion in 1985 compared with $833 billion in 1980. With land values expected to drop further, the trend in falling net worth will continue, especially in the Midwest and Plains states. This decrease in net worth has created
immense problems for some farmers and lenders in cases where total debt exceeds the value of collateral. A study completed in 1985 by the U.S. Department of Agriculture classified commercial farmers into four basic groupings—good, fair, stressed, and vulnerable—according to various measures of financial condition. Overall, 70 percent of commercial farm operators were classified in good condition. At the other pole, 10 percent were classified as vulnerable. This group owned 10 percent of the operator-owned assets of commercial farmers and owed 23 percent of total debt. With the continuing deterioration in financial conditions of farmers, those classified as vulnerable in 1985 are probably in serious financial trouble now, and those previously classified as stressed are probably headed for such trouble over the next few years.

Farm Creditors. Given the financial plight of many farmers, it is not surprising that the condition and outlook for agricultural lenders is not favorable. The distress of most lending institutions is directly related to the proportion of loan portfolios in agricultural interests. Commercial banks have the strongest portfolios, followed by the Farm Credit System (FCS) and the Farmers Home Administration (FmHA). Although agricultural loans and FCS security holdings represent only 3 to 4 percent of the total assets of the commercial banking system, in states where agricultural loans make up the majority of commercial lending at most banks the situation is more serious. Banks throughout the Plains and Cornbelt regions are experiencing high delinquency ratios and rising losses on agricultural loans.

The disparity between the conditions of agricultural and nonagricultural banks helps to illustrate the farm lenders' crisis. As of September 1985, delinquency ratios for agricultural banks—defined as those with around one-fifth of their assets in farm loans—stood at 6.9 percent compared to 4.6 percent for nonagricultural banks. Non-performing loans at agricultural banks were 4.7 percent versus 2.7 percent at other banks. The rate
of return on assets of agricultural banks was .5 percent in 1985 compared to about 0.7 percent earned by banks of comparable size. The number and proportion of problem agricultural banks has increased dramatically, especially in the Plains states, where three-fourths of the nation's 241 bank failures occurred between 1983 and 1985. Incidentally, only two agricultural bank failures were recorded in the southern states of the Sixth Federal Reserve District during this period.

Because of its complete dependence on agriculture, the Farm Credit System has been in a potentially serious position marked by substantial losses. The Farm Credit Administration Act of 1985 provided the necessary steps to maintain the soundness of the FCS. This legislation authorized financial assistance, rechartered the FCS Capital Corporation to allow the purchase of loans and property from all FCS entities, and strengthened the regulatory role of the Farm Credit Administration. Internally, the FCS has taken steps to correct potential weaknesses in its operations. For example, it is enforcing more stringent accounting standards to help identify debt problems earlier. Assets are being revalued as soon as a problem is recognized, and provisions for losses are being made earlier. Also, mergers of individual associations have become common in order to achieve greater efficiency and maintain financially strong associations. Whether these measures prove successful remains to be seen. Preliminary second quarter are not encouraging, but these figures could reflect the new accounting standards.

As the lender of last resort, the FmHA has the most troubled loan portfolio of all lenders. It has approximately twice as many borrowers with negative cash flows or debt-to-asset ratios exceeding 70 percent as the FCS and commercial banks. During the 1980s, its delinquency ratio rose from 17 to 36 percent of total loans and from 5 to 23 percent of outstanding principal. This rising trend is expected to continue for some time to come as troubled farmers and lenders turn to the agency for help.
Lenders and borrowers are trying desperately to avoid foreclosures. Farmers are attempting to reduce financial burdens by selling assets and cutting costs wherever possible. Most lenders have shown forbearance and adjusted loan terms in efforts to render a farmer's debt more manageable. Yet in some instances foreclosure is inevitable. As of June 1985, the farm foreclosure rate stood at 6 percent of the total value of loans. The dollar amount of farm foreclosures during 1984 totaled nearly $300 million; during just the first half of 1985 it amounted to almost $250 million. With the recent lifting of the moratorium against FmHA foreclosures, future reports are sure to indicate further increases.

U.S. Farm Outlook. Is there any relief in sight for U.S. farmers and their creditors? Despite the passage of farm legislation that supports prices and incomes of farmers, overall prosperity does not appear likely to return soon. Indeed, such programs aggravate problems over the long run. The chief difficulty remains an oversupply of products in the face of reduced export market shares for grains, soybeans, and cotton—the products that have been most dependent on foreign demand in recent years. Farm products displaced from international markets have flooded domestic markets and storage facilities, depressing prices. By taking the edge off these market effects, though, government programs to aid farmers have actually caused many to delay necessary adjustments.

Market prices of grains recently averaged 10 to 29 percent below year-ago levels, which were already depressed compared with prices at the beginning of the decade. These problems do not confront farmers across the board, however. Those who are participating in government programs are not bearing the full brunt of the most recent price declines. Producers who have agreed to idle a portion of their acreage, for instance, qualify for income maintenance payments. In addition, they will be eligible for
Commodity Credit Corporation (CCC) price support loans on crops grown on remaining acreage. What's more, in an effort to facilitate movement of commodities into international markets at competitive prices, the CCC will allow these loans to be repaid at less than the face amount.

Although the survey of planting intentions for this season suggests that farmers' participation in acreage retirement programs during 1986 is substantial, total production may not decline significantly. Farmers can select the land that is left idle, and experience has shown that they usually choose to leave out the least productive acres. In addition, since they will qualify for attractive income support payments, efforts are sure to be made to increase yields on remaining acreage. Since support payments, beneath certain maximum limits, rise in direct proportion to output, larger and more efficient farmers are likely to fare best under current farm legislation.

Some producers in the livestock sector are also doing well this year despite the dismal picture for agriculture as a whole. Broiler producers appear to be in the most favorable economic position. With the shift in consumer preferences from red meats to chicken and fish, broiler producers have been enjoying an expanding market for their product. At the same time feed costs have fallen by 10 percent, thanks to the drop in grain and soybean prices. In contrast, prices for beef have recently averaged from 10 to 16 percent below last year's comparatively low levels. The dairy industry is burdened with supplies of milk products that are far in excess of market needs, and incomes are unlikely to improve until a correction occurs. In order to achieve this balance, dairy farmers have been offered the option of selling their whole herds to the government. In addition, the government is subsidizing exports of dried milk powder to dispose of accumulated supplies.
Southern Agriculture. What is the picture for southern farmers? Overall, prospects for agriculture in this region are mixed. The 1985 farm bill will provide increased income supports, but market prices of most products are declining. Severe drought in some regions has damaged crop production prospects and will leave farmers with sharply curtailed output to sell at reduced market prices. Forage supplies for grazing livestock have also been diminished by the lack of rainfall, forcing cattlemen either to liquidate herds or make huge outlays for feed expenses. On the other hand, broiler and turkey producers will be favored by growing markets, strong prices, and reduced feed costs.

Farmers here responded to poor 1985 returns, continued weak prices, and a comprehensive farm program by sharply reducing acreage this growing season. In fact, since the peak year of 1982, farmland planted to major crops in the portion of the South with which I am most familiar—Alabama, Florida, Georgia, Louisiana, Mississippi and Tennessee—has fallen by 30 percent. Soybean acreage has nearly been halved. Market prices for most southern crops will likely be near the price support level for the balance of this year. Heavy involvement of the region's farmers in national farm programs, however, will provide additional income. Still, if the current drought persists and substantially lowers yields, even participation in the farm programs will not avert losses.

Beyond 1986 there are some indications that crop prices may finally turn around. Large production declines in the South for food grains, oilseeds, and cotton, together with a pickup in demand for wheat, should permit some rise in prices. An equally positive factor has been the decline in operating costs, particularly fuel and interest expenses, since last year. While lower crop prices have offset much of the immediate benefit of reduced costs, crop farmers are at least in a potentially favorable position if and when commodity prices rebound.
Conditions in the region's livestock and poultry industries parallel those of the nation. Plagued by poor returns and low prices, production of pork and beef has fallen substantially since the first half of 1985. Cattlemen in the Southeast are unlikely to rebuild herds for some time to come, and beef supplies will probably decline over the next two or three years. Substantial losses among hog producers during this extended down cycle may permanently reduce the importance of this farm sector in the region. It may be years before swine inventories regain the levels of the late 1970s. The broiler industry represents the bright spot in southern animal agriculture as favorable prices and low feed costs have enhanced profits for these farmers. Continued moderate expansion and growing competitiveness with other meats suggests a successful year, although there is some risk of overproduction, which would drop market prices.

**Conclusion.** In conclusion, I see the outlook for agriculture, both nationally and to a lesser extent in the South, as clouded by excess supplies and a series of problems associated with this surfeit, including low prices and a heavy burden of debt. These problems can be surmounted, but they will not be corrected overnight, and they will not be solved with painless remedies. To be successful, strategies for improvement must address the fundamental problem of oversupply. For example, policies must have carefully designed incentives that foster farmers to operate as businesses, and as businesses capable of competing in international markets. Measures intended to provide relief to farmers in distress should be targeted to reach just these groups, not all farmers or disproportionately large and already efficient farmers as some programs currently do. These programs should not only provide short-term relief but, in the case of marginal farmers, may also have to provide training and incentives that would facilitate their move into specialty crops or livestock or even into other economic activities.
American and southern agriculture is blessed by tremendous natural advantages, and farmers have an enviable record of productivity gains. With such assets, together with a keener appreciation of markets and the innovative ideas developed in forums like this, I'm sure farmers can meet the challenges they face today and regain the financial stability and prosperity commensurate with their contribution to our economy.