

Federal Reserve Bank of Dallas August 1985

Increased Agricultural Imports Lead To Protection For Domestic Producers

President Reagan's recently announced proposal to increase tariffs on a variety of agricultural products has drawn attention to growing levels of agricultural imports. The action was prompted by complaints that foreign producers were receiving unfair subsidies, and that foreign governments have put restrictions on imports of U.S. agricultural products.

Initially, tariffs or quotas raise prices by reducing competition. This may protect domestic producers in the short run, but the higher price encourages the use of substitutes. This substitution further reduces the quantity demanded which, in time, will at least partially reverse the benefits of the import tariff for producers.

Growth of Imports

The value of agricultural commodities imported into the United States in 1984 was a record 19 billion dollars, which should be exceeded in 1985. The value of U.S. agricultural exports is still greater than that of imports but the gap is narrowing.

Despite the growth, agricultural imports have not risen as much as other merchandise imports. There are two important reasons for this. First, there are protective barriers against some products. The most striking example is sugar, whose domestic price is currently about six times the world price. Second, the high transportation costs for bulk commodities retards the growth in imports. Not surprisingly, the major exporters of agricultural goods

are countries that are relatively close to the United States, such as Brazil, Mexico and Canada.

Effects of Import Restrictions

Import restrictions lead to an increase in the domestic price of an agricultural commodity, either by reducing competition or by allowing higher-cost producers to stay in business. This initially may help agricultural producers but can lead to problems. These restrictions encourage importation of processed goods. This circumvents the import restriction on the bulk commodity by taking advantage of the cheaper costs of transporting manufactured products. As a consequence, however,

food processing moves overseas, reducing both U.S. employment and the demand for domestic raw agricultural products. In general, the categories of imports with the fastest growth have been processed goods rather than raw agricultural commodities. The most dramatic example of this has occurred in response to the quotas on sugar. Because of sugar quotas, imports of prepared products, such as cookies, skyrocketed. Recently, quotas on prepared products were imposed in an attempt to maintain high domestic sugar prices. A similar example has occurred with pasta and noodles. The U.S. price for wheat is above the world price. The higher
(Continued on back page)

Agricultural Bankers Suffer From Farmers' Woes

Agricultural banks' rural location and small size make their financial performance very sensitive to changes in farm income conditions. During the 1970s, agricultural banks benefited from the general prosperity of the farm sector and achieved high rates of profitability. During the 1980s, however, low commodity prices and high real interest rates have severely diminished the debt servicing capacity of many farmers. The result has been an increase in problem loans at agricultural banks. In addition, financial deregulation has resulted in higher costs of funds to rural banks. Both factors have adversely affected the profitability of Texas agricultural banks.

Agricultural banks feel pinch

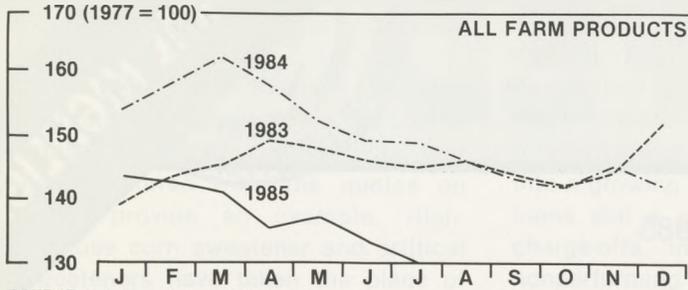
In recent years, the deteriorating financial condition of U.S. farmers has had a strong impact on the performance of agricultural banks, here defined as banks with 25 percent or more of their loans out to farmers. For example, in 1984, when farm banks made up 29 percent of all U.S. banks, 41 percent of all bank failures were agricultural banks.

Agricultural banks in Texas have been suffering from steady declines in profitability since 1981. Several factors have contributed to this development. First, many farmers and ranchers are in precarious financial condition.

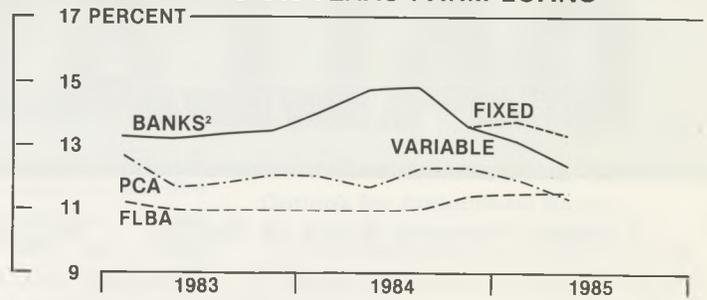
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PRIME INDICATORS OF THE TEXAS AGRICULTURAL ECONOMY

INDEX OF PRICES RECEIVED: TEXAS

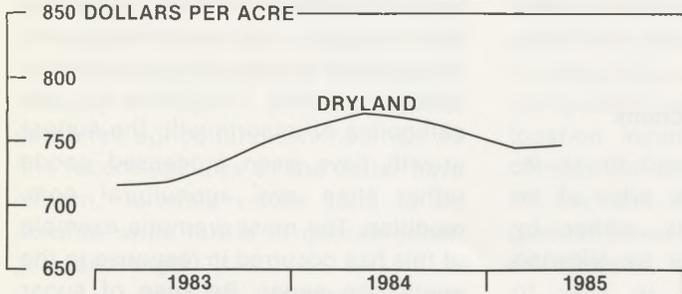


INTEREST RATES ON TEXAS FARM LOANS¹



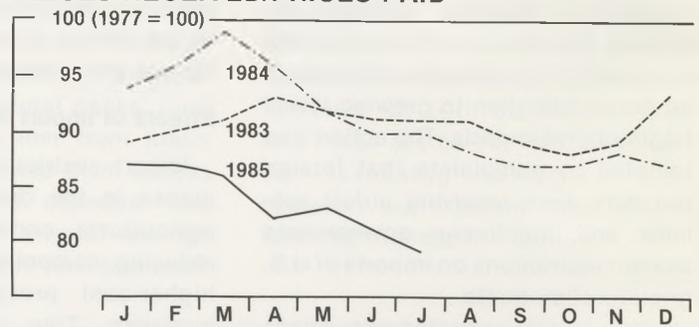
1. PCA: Production Credit Associations.
FLBA: Federal Land Bank Associations (Real Estate Rate).
 2. Starting first quarter 1985 bank rate is decomposed into fixed and variable rates.
- SOURCES: Quarterly Survey of Agricultural Credit Conditions,
Federal Reserve Bank of Dallas.
Federal Credit System.

TEXAS FARM REAL ESTATE VALUES¹



1. 3 quarter centered moving average.
- SOURCE: Quarterly Survey of Agricultural Credit Conditions,
Federal Reserve Bank of Dallas.

PRICES RECEIVED/PRICES PAID¹

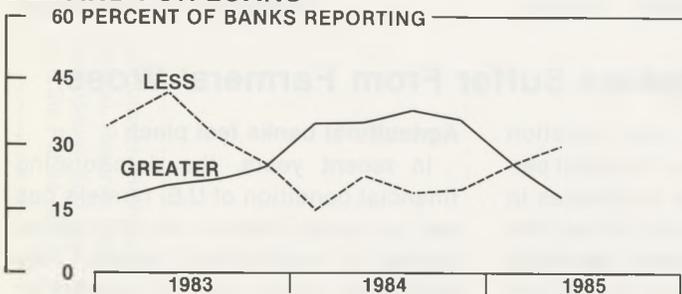


1. Prices received by farmers in Texas divided by prices paid by farmers nationwide (No separate series exists for prices paid in Texas).
- SOURCES: U.S. Department of Agriculture,
Federal Reserve Bank of Dallas.

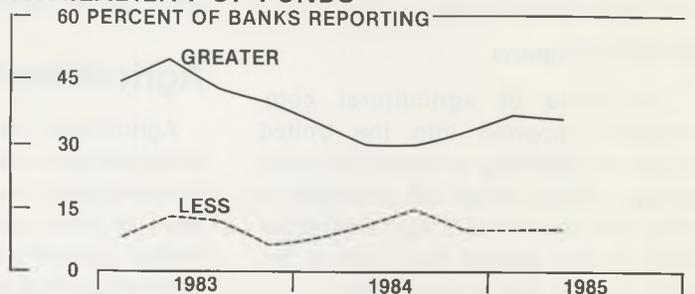
ELEVENTH DISTRICT AGRICULTURAL LOANS

Bankers report whether the variable is "greater," "the same," or "less" than a year ago. Percent reporting "greater" or "less" are depicted below.

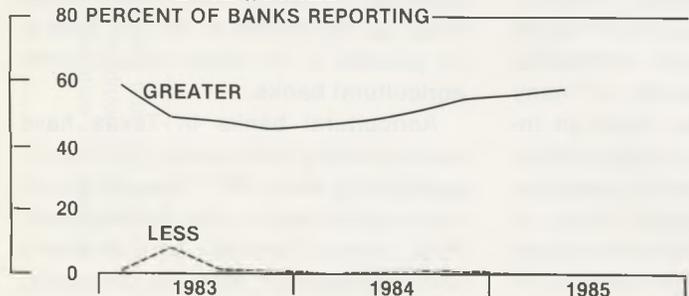
DEMAND FOR LOANS*



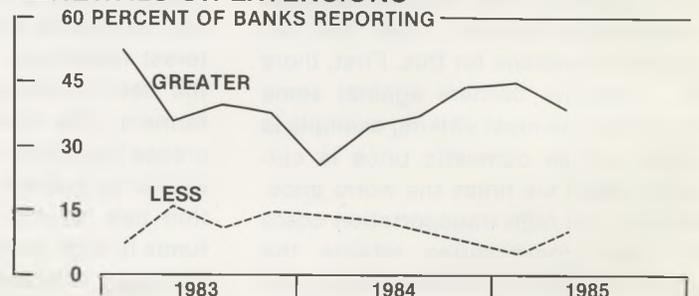
AVAILABILITY OF FUNDS*



COLLATERAL REQUIRED*



RENEWALS OR EXTENSIONS*



* SOURCE: Quarterly Survey of Agricultural Credit Conditions,
Federal Reserve Bank of Dallas.

AGRICULTURAL BRIEFS

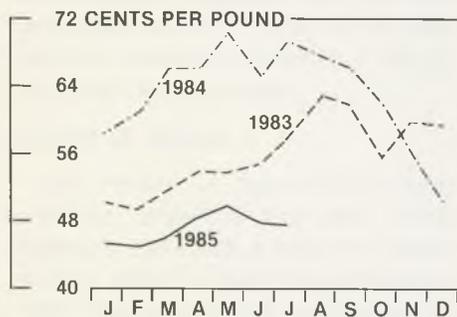
- Following trends in the national credit markets, average interest rates on agricultural loans by Eleventh District banks declined in the second quarter of 1985. Short-term fixed-rate operating loans dropped by 0.42 percent to 13.41 percent; those with variable-rate provisions fell 0.69 percent to 12.45 percent. Longer-term loan rates also declined. Fixed-rate farm real estate loans moved down 0.22 percent to 13.41 percent and variable-rate farm real estate loans dropped 0.63 percent to 12.55 percent.
- Preliminary estimates show that *average* agricultural land values in the District stayed fairly constant during the second quarter of 1985 compared with the large declines in value during the previous quarter. Ranchland did drop 2.1 percent to \$586 per acre, but dry cropland held steady at \$745 per acre, while irrigated cropland inched up a few dollars to \$1,004 per acre. Lower agricultural land values for the second quarter were reported by eight out of 13 District regions. Nonagricultural demand for land is holding up average land values.
- Cash receipts for Texas beef cattle are likely to be much lower in 1985 than last year's level. Because of increased production nationally, 1985 beef-cattle prices to date are far below

1984 levels. Texas commercial cattle slaughter in 1985 is running slightly below the pace of last year. Total revenues have declined sharply, although partially offset by lower feed and interest costs. The forecast for the rest of the year calls for smaller-than-seasonal increases in beef-cattle supplies in Texas, while nationally the prospect is for larger-than-seasonal marketings. The resulting lower prices suggest that 1985 Texas cattle producers' revenue will not reach 1984 levels.

- Texas' total planted acreage in crops increased 522,000 acres during 1985, despite greater participation in government acreage reduction programs and sharply reduced major crop prices. This conundrum can be explained by examining individual crop statistics. Acres planted to the major Texas income-producing crops, except winter wheat, did fall: cotton, sorghum, and corn all down 6-11 percent. Offsetting that has been an increase in winter wheat planted acreage of 9.4 percent (because the wheat program attracted acres out of other crops) and a boom in the minor crops. Sunflower planted acreage increased by 80,000 acres. Plantings of crops such as hay, barley, and rye for animal fodder and forage have also increased significantly.

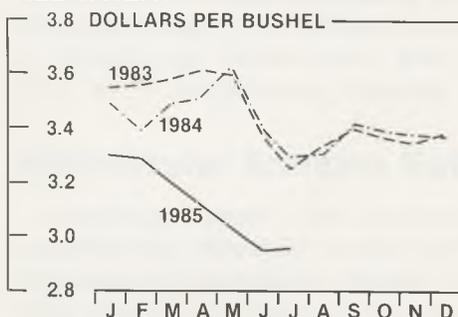
TEXAS COMMODITY MARKET PRICES

UPLAND COTTON



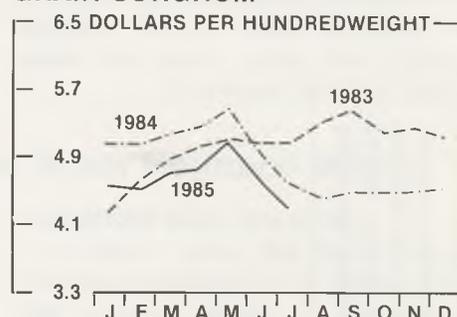
SOURCE: U.S. Department of Agriculture.

ALL WHEAT



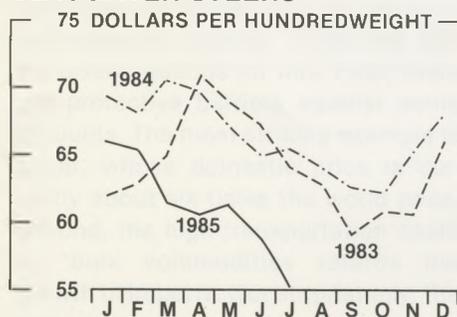
SOURCE: U.S. Department of Agriculture.

GRAIN SORGHUM



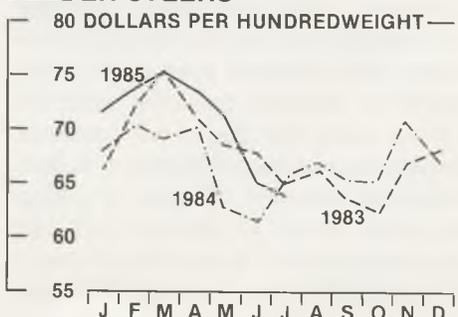
SOURCE: U.S. Department of Agriculture.

SLAUGHTER STEERS



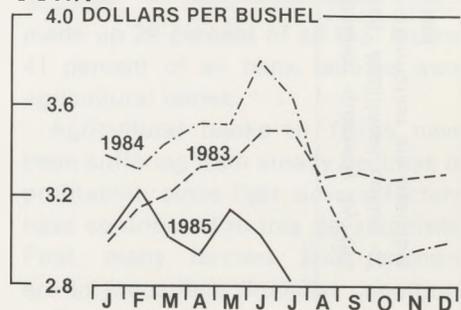
SOURCES: Texas Department of Agriculture.
Federal Reserve Bank of Dallas.

FEEDER STEERS



SOURCES: Texas Department of Agriculture.
Federal Reserve Bank of Dallas.

CORN



SOURCE: U.S. Department of Agriculture.

Imports (cont.)

wheat price is one factor that has encouraged imports of pasta and noodle products.

The higher price induced by import restrictions also promotes the use of substitutes. Again, the effects that have occurred from the quotas on sugar provide an example. High-fructose corn sweetener and artificial sweeteners have taken the place of sugar in many products.

Import restrictions do not address the major reason for the increase in imports—the appreciation of the dollar relative to other currencies. This appreciation makes goods denominated in foreign currencies cheaper in the United States. Obviously, this affects virtually all imports and exports, not just a few agricultural commodities. As the recent declines of the dollar have shown, currency values tend to be volatile while tariffs or quotas generally last longer.

—Roger Dunstan

Farmers' Woes (cont.)

According to the U.S. Department of Agriculture, nearly 16 percent of the region's farm operators may be experiencing some financial stress. Many farmers thus have been unable to service their debts. This translates into a growing percentage of past-due loans and a greater volume of loan charge-offs. In the last two years, nonperforming loans and charge-offs as a proportion of total loans outstanding at agricultural banks have increased 31 and 55 percent, respectively.

A second factor affecting the profitability of agricultural banks is the closer integration of local farm credit conditions with national financial markets. Before the advent of financial deregulation, agricultural banks' rural location insulated them from major competition and allowed them access to low-cost demand deposits. The gradual phaseout of interest ceilings on deposits, however, has prompted

many rural residents to transfer their funds into higher yielding instruments. The net result has been an increase in the cost of funds to agricultural banks and, in many cases, smaller profits margins.

Outlook for Agricultural Banks

In the near future, agricultural banks in Texas are unlikely to experience the high rates of profitability obtained during the 1970s. Financial deregulation has resulted in a more competitive environment and many agricultural banks have been forced to accept lower profit margins. In addition, agricultural banks will suffer from falling levels of farm income. Current net farm income forecasts for both the United States and Texas are below 1984 levels, and an increasing number of farm operators are expected to experience financial distress in 1985.

—Eric Weigel

The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Dallas or the Federal Reserve System.

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