Historical pattern: High prices cause low prices and farm bankruptcies

In recent columns we have discussed the developing farm crisis with some farmers filing for bankruptcy and others renting out their ground because their bank would not provide them with an operating loan for the 2020 crop year. To put the beginning of this farm crisis into context and how it might develop we took a look at the farm crises of the 20th Century.

During the last century there were two major farm crises: the period following the end of WWI that continued into the 1930s and the one in the late 1970s and much of the 1980s that followed the export boom that began in 1972. Both farm crises were preceded by a period of high prices caused by events that were triggered by events beyond the shores of the US.

In both events, US Presidents and members of their administrations urged farmers to increase agricultural production to meet the need. Most famously Earl Butz, Secretary of Agriculture under Presidents Nixon and Ford, told farmers to “plant fencerow to fencerow” and “get big or get out.” During the runup to the country’s direct participation in WWI, farmers were urged to increase their production of foodstuffs that could be shipped to US allies in Europe.

Between the 1915 and 1916 crop years exports of corn increased by 87 percent while the price of corn increased by 54 percent. For wheat, the price increased by 74 percent. Farmers responded both to these sharply higher prices and governmental assurances of its support for higher production, particularly corn-fed pork. In the WWI period with cropping area and yield relatively fixed, farmers bought land they previously rented and purchased new farm equipment.

By 1921 wheat prices had returned to pre-war levels while corn prices were 26 percent below the 1915 price. With increased costs as a result of investments in land and machinery and prices at or below pre-war levels, farm areas of the US were in crisis nearly a decade earlier than the rest of the country.

The pattern for the export boom of the early 1970s was similar to the WWI period with exports of corn increasing by 56 percent between 1971 and 1973 while corn’s season average price increased by 136 percent. For wheat, exports increased by 100 percent between 1971 and 1973 and the price of wheat increased by 195 percent. These price increases resulted in a 40 percent increase in corn production between 1971 and 1979 and a 32 percent increase in wheat production over the same period.

With increased prices, farmers bought out their neighbors, driving up the price of land, and purchased new equipment. In 1971 the lending interest rate was 5.7 percent, by 1981 it hit 18.9 percent. During this period lenders were making loan decisions on the basis of farm assets which were increasing even though many farmers experienced a negative cash flow. With increasing interest rates on operating loans and relatively flat crop prices, when land prices began to decline many farmers were in serious financial trouble as the farm crisis of the 1980s set in. The crisis was exacerbated by the 1985 Farm Bill which set about lowering loan rates in a futile attempt to “recapture” US export markets for corn, wheat and other crops.

The crises of the 1920s and 1980s were similar in that they both followed a period of a sharp increase in prices that triggered an increase in land and equipment purchases. When lower prices or flat prices in a period of high inflation materialized, large numbers of farmers had trouble making their loan payments, resulting in a generalized farm crisis.

Like the two previous farm crises, the currently emerging farm crisis follows a period of high prices. Unlike the earlier crises where the high prices were brought about by external

events, this set of high prices was brought about by a combination of domestic policy—the Renewable Fuels Standard—and weather-reduced production levels (2020-2012).

In this crisis farmers are in a different situation with regard to their lenders because loans are no longer being made on an asset basis but rather on cash flow. As farmers have used up the cash reserves accumulated prior to 2013, lenders have been reluctant to continue making operating loans. That being said, there still has been an increase in farm bankruptcies over the last three years, especially among dairy farmers.

Another difference is that interest rates have remained low as the Federal Reserve Board has maintained a low federal funds rate which has resulted in stable commercial interest rates.

While net farm income has stabilized at a level well below its 2012 peak without the Market Facilitation Program (MFP) payments that resulted from the US trade dispute with China many additional farmers would be in serious financial trouble.

There was one period of high prices that wasn't followed by an immediate farm crisis and that was WWII. Based on their experience in the 20s and 30s, after WWII farmers lobbied for and achieved a continuation of a supply management program with high support prices. Though these programs were subject to a thousand cuts between 1954 and 1996, the slow decline in supports spared farmers the sudden crisis seen in the 1920s and the 1980s.

For us, this overview makes the case for the reinstitution of a supply management program based on the Agricultural Policy Analysis Center/Texas Farmers Union proposal which would set the loan rate at 95 percent of the full cost of production for corn and other crops at their historic price ratio to corn. The proposal also includes a working lands environmental acreage reduction program.

Without some intervention beyond the MFP the current low crop prices will force additional farmers into renting out their land or filing for bankruptcy.

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