


**U.S.  
AGRICULTURAL  
POLICY:  
THE 1985  
FARM  
LEGISLATION**

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# Commentary

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I agree with many of the points made by Tweeten. In particular, his message concerning fiscal policy is one that we should heed.

The foreign trade deficit and the federal budget deficit are two related and unsustainable trends. At some point, it will become financially painful to service the debt that is being incurred, especially the foreign debt. Servicing the debt will force reduction of government spending or of the quality of private living. The real debt service burden may also be reduced through price inflation.

It would be ironic if, at some future date, national defense is weakened in the course of coping with debt service burdens that arose, in part, because improved defense was financed by borrowing. Instead of raising taxes to pay for improved defense, large tax cuts were simultaneously voted. Tax rates were reduced, and additional opportunities were provided for the accumulation of tax-deferred wealth. Investors are locking in double-digit nominal interest rates, to compound tax deferred for up to four decades.

The public at large must service the public debt accumulating in these accounts. In nominal terms, the future obligations are mind-boggling and can perhaps be most readily understood by looking at data on issues of zero-coupon bonds. The Student Loan Marketing Association, for example, raised \$72.5 million in 1984 by selling zero-coupon bonds with a value of \$2 billion at maturity in 2014. Then it raised \$127.5 million by selling zero-coupon bonds with a redemption value of over \$5 billion in 2022. As such debt service burdens of our present spending tend to depress future spending, there may be great pressure for stimulative measures that coincidentally produce inflation that reduces the real burden of debt.

One other comment on macroeconomic policy. Both Tweeten and preceding speakers criticized the monetary policy of the 1970s. They seem to believe that lower and more stable money growth could have prevented inflation and "stagflation." They might rethink that conclusion, particularly because agriculture contributed to the price shocks of that decade.

When farm commodity prices soared (wheat tripled, corn tripled, and

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soybeans quadrupled from the spring of 1972 to the fall of 1973), transferring real income from the general public to the farm sector, should money growth have been held steady, so that other prices and wages would on average have to fall as necessary to keep average prices stable? Clearly, an immediate recession would have resulted if that type of adjustment had been forced. Rather than accepting their reduced real income, other sectors react by seeking price and wage increases in vain (on average) attempts to maintain real profits and income. So alternatively, should money growth have accommodated this inflationary spiral?

Neither of these alternatives is a tenable policy response to a major price shock. Rather, secondary and later price and wage increases must be accommodated as necessary to prevent depression, but then must be dampened to prevent runaway inflation and gradually restore price stability. Sectors losing the most real income to other sectors experience recession. The result of this policy was called stagflation. Those who lament the stagflation following the major price shocks of 1972-1974 (farm and oil) and 1980 (oil) should ponder the alternatives. The timing and degree of monetary restraint could have been better, as is always the case in retrospect, but some variety of stagflation had to occur.

The remainder of my comments deals with estimating the incidence of financial stress among farmers.

First, I have no problem with Tweeten's building on the estimates I made in November 1984, in the paper "The Incidence of Financial Stress in Agriculture." In presenting his results, however, he contrasted his estimate of the proportion of farmers in financial stress with my estimate of that proportion on all "farms," which is lower, rather than with my estimate of that proportion on family-sized commercial farms, which is higher. Thus he casts me, unfairly, as underestimating or minimizing the problem of farm financial stress.

Using, as the base, all 2.4 million operators whose units meet the Census Bureau's definition of a farm, I estimated, as Tweeten described, that 9 percent of them are financially stressed and that the stressed group owns 14 percent of operators' farm assets and owes 39 percent of operators' farm debt. I had also shown, however, that most of the operators with farm financial stress must be those with farms producing annual sales between \$40,000 and \$499,999. On average, the smaller farms have little or no net farm income, and did not have any during the farm boom. And, on average, the small number of very large farms with sales of \$500,000 or more have remained highly profitable, and so not many can be financially stressed. Thus, I concluded, about one-third of the operators of the remaining farms are relatively heavily indebted and likely to be experiencing financial stress. This is a very significant proportion, higher than Tweeten's 22 percent. Furthermore, I estimated that this third owes nearly two-thirds of the total debt of the operators of this group of farms. My estimates certainly did not minimize the

incidence or importance of financial stress.

Among possible policy responses to farm financial stress, Tweeten listed targeted credit assistance. On their face, such programs appear to be efficient ways to get assistance to those who need it the most. Providing money directly and only to those farmers in financial distress seems more efficient than attempting to raise farm income generally by amounts that would be meaningful to those in distress.

Experience with such credits extended in the late 1970s, however, indicates the problems they present. In particular, those farmers who made the most ill-advised or, in retrospect, uneconomic investments, or who are lacking in technical, managerial, or marketing skills, will appear to be the most in need. They will be at the top of the list for targeted assistance and will be difficult or impossible to sort out.

In addition, some of the farm investments made during the boom are not only uneconomic now, but have undesirable environmental aspects that, while tolerable during a period of acute need for more food, are now unsupportable. Farmers who plowed grassland subject to wind erosion or drilled wells to tap an irreplaceable aquifer now appear among the most needy, but these investments need to be reversed rather than perpetuated.

I will close with several comments on our perceptions and analyses, as researchers, of the financial potential and condition of farms. Reading Tweeten's paper reinforced my belief that we need to rethink our characterization of farms by size. Our classifications by gross sales tend to mislead in that many farms seem larger than they really are in terms of the net income they are capable of producing; in addition, we need to adjust our classifications to reflect the general price inflation that has occurred.

Net income averages about 20 to 25 percent of gross sales. Sixty-two percent of all farms have gross sales under \$20,000. On the very largest of these farms, therefore, one can net \$5,000 per year, or \$100 per week, \$15 per day. The earning potential of this enterprise is equal to that of a motorized paper route or some other way of earning \$15 per day—and this is the largest of this group. Twenty years ago, we were employing a useful category called noncommercial farms, which was based on multiple criteria involving the amount of off-farm work as well as the amount of farm sales. A category like that is still needed. In banking, there is now a category called nonbank banks. Perhaps these farms should be called nonfarm farms.

If \$15 per day is an appropriate lower limit for small farm-farms, where might we draw the line between small and mid-sized farm-farms? Perhaps at a net income equal to starting salaries for college graduates, say, \$20,000 to \$25,000 per year? So \$100,000 in annual gross sales is where we might reasonably separate small farms from mid-sized farms.

If that sounds too high, think again. That is gross sales of \$2,000 a week, \$300 a day. The earning potential of that farm is equal to that of a little

newstand in a hotel that also grosses \$300 per day and nets \$75 in labor and capital income. To avoid misleading ourselves as well as those who use our analyses, we need to use classifications that are consistent with modern connotations of the adjectives that we employ.

My final point concerns the identification of farms with financial stress. In work done about a year ago, I classified farms by debt-asset ratio and showed that the debt-asset ratio was probably highly correlated with difficulty in servicing debt from farm income. I was using 1979 census data that did not include income and interest payments and thus used the debt-asset ratio as a proxy for such direct data on financial stress. These are the same data on debt and assets from which Tweeten has derived additional estimates of financial difficulties.

For the debt-asset ratio to provide useful indications of the incidence of financial stress, we need farms to have the same relative profitability, interest rate, and debt repayment schedule. Among these, the profitability assumption is the most unrealistic. Profitability differs by size of farm and by type of farming. Prices on some products are far better than on others. There are also regional differences because of drought, floods, and freezes.

If one has information on income and interest payments, financial stress is measured directly rather than inferred from debt-asset ratios. Then, the debt-asset ratio takes its place, alongside profitability, interest rate, and other factors, as one of the variables that are important in explaining the relative degree of financial stress.

Ideally, to measure the effect of debt, one has data on net income before interest payments and on income remaining after interest is paid. With such data, one can far more confidently assess and compare the relative incidence and severity of financial stress on different types and sizes of farms than if one has data only on debt-asset ratios. One can also measure the effect of debt service.

The U.S. Department of Agriculture (USDA) has recently improved an annual survey to produce such income data but nevertheless has continued to couch its analyses in terms of debt-asset ratios. Reports on farm finance surveys conducted by universities have also emphasized debt-asset ratios. As a result, the analytical content of these surveys has not been fully exploited. The USDA has pointed out, for example, that poultry farms have a relatively high average debt-asset ratio, that this may mean that they have more severe financial problems than other farms, but that they may not be stressed because they produce larger sales and income per dollar of assets. Both analyst and reader are left hanging. When analysts already have, or can obtain, information on income received and interest paid, they should use that as the primary indicator of financial stress and then investigate the relative degree to which debt-asset ratio and other factors are responsible for such stress.