

Farm Management and Marketing Newsletter

Vol. 16, No. 2

June 2008

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Grain Basis Information Available On-line

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Basis - Basis is the difference between a cash or local price for a commodity and the futures price of a particular commodity on a given futures exchange.

Tracking basis at local elevators can be useful to producers in managing basis risk. Area and regional basis information is available from the University of Arkansas Cooperative Extension Service and the USDA Agricultural Marketing Service. Using information from these sources is an excellent way to evaluate basis contract offers or basis-lock decisions on hedge-to-arrive contracts.

Basis information provided by the University of Arkansas Cooperative Extension Service can be found at the link below under the heading "cash market prices".

<http://www.aragriculture.org/marketing/default.htm>

New crop and three-year average basis information is available for corn, rice, soybeans, and wheat. North Delta cash basis information is

available for cotton. Information on this site is updated biweekly and generally provided for four (4) delivery locations.

Basis information provided by the USDA Agricultural Marketing Service can be found at the link below under the heading "custom reports". Grain basis information is located in the drop-down menu box.

<http://marketnews.usda.gov/portal/lg>

Both current and historical new crop and cash basis information is available for soybeans, corn, grain sorghum, and wheat. Basis information is provided for fifteen (15) locations in Arkansas and Memphis among others. Data from this site can be downloaded in Excel format.

Basis is having a dramatic effect on producer income. Producers should spend some time analyzing the dynamics and fundamental factors at work in individual commodity markets. As in the past, changes in the cost of transportation, demand, and availability of storage will affect basis bids. But, the emergence of commodity investment by index funds adds a new variable to basis determination.

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There are marketing tools available to help manage basis risk. Forward cash contracts, basis contracts, and hedge-to-arrive contracts are some examples. With current new crop basis levels being greatly below historic levels, producers may at least find value in following historical basis trends and seasonal tendencies in basis movement. This could assist producers in making better use of the marketing tools and products available.

Is Another Agricultural Finance Crisis Looming?

Bruce L. Dixon and Bruce L. Ahrendsen, Professor and Interim Head and Professor Department of Agricultural Economics and Agribusiness, Division of Agriculture University of Arkansas, Fayetteville

There has been some speculation that agriculture may be headed for another financial crisis parallel to that experienced after the boom of the mid and late 1970s. The aftermath of that debacle was many farm families buried in debt whose only recourse was default. The reverberations from that bust included an unusually high proportion of agricultural bank failures and a rescue plan and changed procedures for the Farm Credit System (FCS).

The Current Situation

Currently revenues for crop producing farms are about as good as anyone could have imagined. Crop prices are soaring and even though petroleum-based inputs are rising in cost, these costs are more than offset by rising commodity prices. The USDA's Economic Research Service is forecasting net farm income for 2008 at \$92.3 billion which would exceed the preliminary value of \$87.1 billion for 2007. Animal based agriculture is not experiencing this boom since animal producers have to compete with food and energy demand for crops.

There can be no denying that crop agriculture is currently in a boom phase. In the 1970s and 1980s, U.S. agriculture went through a boom, bust and recovery cycle. Net farm income was relatively stable in the 1990s starting 1990 at \$46.3 billion and

ending in 1999 at \$47.7 billion. Net farm income started its ascent in 2003 at \$59.7 billion and has continued upward to the current \$92.3 billion 2008 forecast with the exception of 2006 at \$59 billion.

Demand Shift

The rising price of oil is central to this upward surge in crop prices. The use of land resources to grow feedstock for fuel is probably the biggest change in the composition of demand since World War II. It is the rising oil price that makes using crops for fuel feedstock profitable. There is no doubt that the rapid Asian economic growth, particularly in China and India, has been part of the increased crop demand. In addition to bidding up oil prices, increased incomes in those countries are increasing meat demand which means greater demand for feed grains. This, of course, also increases the demand for petroleum since modern crop production requires energy intensive inputs.

The fuel feedstock increase in crop demand does not have a parallel to the 1970s agricultural boom. Russian crop failures and easing exchange rates fueled the 1973-1975 boom. The aftermath was a classic situation of higher prices curing high prices. Yields kept increasing and so did harvested acres, the latter peaking in 1981. The 1970s boom was fueled more by supply shocks than a permanent increase in demand. The current situation looks to have a much more permanent demand shift although there is no guarantee that the shift is permanent. With fuel prices so high, numerous entrepreneurs are seeking to cash in by any number of avenues including solar, wind, bio-mass, algae and other methods of extracting usable energy. A major breakthrough that is substantially less costly than crop land-based methods would sharply decrease crop demand and crop prices with it.

Interest and Exchange Rates

An additional demand driver in the 1970s was export demand for agricultural products. This was fueled by low interest rates which, other things equal, lead to a depreciation in the value of the dollar. This makes U.S. exports cheaper vis-à-vis

other countries' products. The decline in exchange rates began in the early 1970s and persisted through the rest of the 1970s. In the recent past, interest rates were very low in the first part of the 2000s and then began to increase in 2004 until the fall of 2007 and early winter of 2008 when they declined abruptly. But exchange rates for the 2000s have generally trended to a weakened dollar versus the Euro and, to a lesser degree, the yen. Right now the exchange rate and interest rate configuration favors U.S. agriculture.

An argument can be made that the precipitating event that led to the financial crisis in agriculture was the abrupt raising of interest rates. This rate elevation is generally attributed to Paul Volker taking charge of the Federal Reserve with the goal of lowering the then comparatively very high rates of inflation. The federal funds target rate, currently at 2%, rose to 19.1% in June 1981! It is not hard to envision the impact of this on indebted farmers. Especially knowing that five years earlier, the federal funds rate was at 6.92%. Of course such tightening of interest rates made the dollar appreciate so that farmers were hit both with higher debt service and less foreign demand for exports. In deflated (2000 = 100) dollars, agricultural exports in 1980 were about \$76 billion and in 1982 they dropped to \$58 billion not to rise above this number in real dollars until 1996. In 2007 agricultural exports were \$75 billion in real dollars (\$90 billion nominal).

Asset and Debt Levels

Farmers continued to bid up land (farmers' primary asset) prices well beyond the peak in net farm income growth in the mid-1970s. In 1972 average farm real estate value per acre was \$219 per acre and in 1982 it peaked at \$823 not surpassing that *nominal* level again until 1995. So the average annual growth rate was 14% per year from 1972 to 1982. In three years, 2004-2007, average farm real estate values have gone from \$1360 to \$2160, an annual growth rate of 16.7%. So the farm real estate market is responding to the increased levels of farm income.

The paramount questions for a farm debt (financial) crisis are: (1) how are newly acquired land and equipment being financed, and (2) for farmers financing acquisitions by borrowing, how vulnerable are they to a downturn in farm income and a rise in interest rates? The Economic Research Service (ERS) projects farm business debt (real estate and non real estate) to rise 3.7% in 2008 to \$228 billion. Real estate debt is expected to account for \$121 billion of the 2008 debt. These debt figures may seem high, but when adjusted for inflation and compared with values in the 1970s, they pale. In constant dollars (2000 = 100), the highest year of farm indebtedness is 1981 at \$301 billion and the ERS projection in comparable dollars for 2008 is \$185 billion as displayed in Figure 1 below. So to date, the debt situation of the current boom is not as high as in the past boom.

Assets are a much different matter. In constant dollars assets peaked at \$1851 billion in 1980 and did not surpass this until 2007. As a consequence the debt to asset ratio has dropped by more than half since its peak in the 1980's debt disaster. Moreover, agricultural lenders do not appear to be strongly fueling the current boom. Agricultural debt increased by 5.7% per year from 2004 to the ERS forecast for 2008. While clearly greater than the inflation rate, this does not seem excessive. Assets grew an annual 12.2% over this same period. So from this perspective, the debt to asset ratio is declining in this boom whereas it stayed constant in the past boom. Lenders are likely being more cautious than in the buildup to the 1980s crisis.

Lender Positions

Among the five primary sources of farm credit, the Farm Credit System (FCS) and commercial banks are the largest suppliers of additional debt. From 2004 to 2006 FCS and commercial banks increased their agricultural debt positions by about \$12 billion and \$11 billion, respectively. As annual growth percentages, these are about 10% and 7%. The other traditional lenders (Farm Service Agency, life insurance companies and individuals) have not increased their debt positions substantively in the present boom.

What we do not know at this point in time is if there are a number of agricultural banks who are lending heavily into agriculture and a segment of commercial farmers who are heavily indebted. It seems likely that bankers themselves as well as bank regulators will not allow banks to become as concentrated in agriculture as thirty years ago, although they have allowed concentration in the housing mortgage market. ERS estimates indicate that fewer than half of small-scale family farms had some debt in 2004. Such farms are going to be insensitive to adverse interest rate and price movements although such events would clearly reduce returns to equity and land values. However, about three-quarters of large-scale family farms had some outstanding loans.

Conclusions

The current agricultural boom has some similarities to the boom-bust cycle of the 1970s and early 1980s. The parallels are the sudden surge in agricultural crop commodity prices and the consequent increase in land prices. Interest rates were comparatively low in the 1970s as they are now. The biggest difference is that the initial boom was induced by a supply shock and the current boom is more influenced by a demand shift. This shift appears to have more permanence about it although it depends on oil prices. Billions of venture capital dollars are seeking ways to produce cheaper energy. If some of these succeed and are non-agriculturally based, the air would go out of the current crop commodity boom. Net farm income would plummet. This drop would be partially offset by declining input costs.

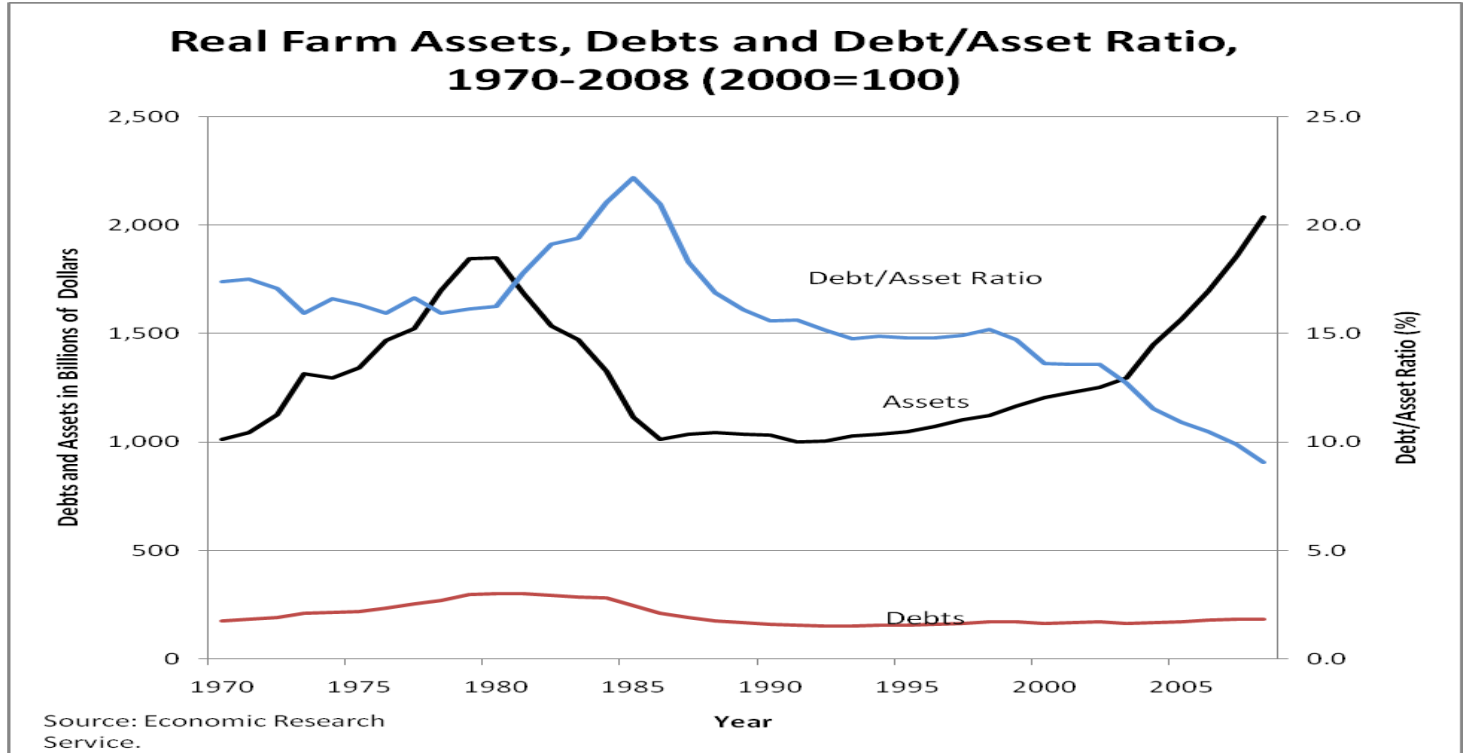
Would such a decline cause a debt crisis and result in producer bankruptcy, bank failures and systemic FCS stress? Certainly there would be agonizing individual foreclosures and bank failures. But at current debt levels, asset values would have to drop more drastically than before. However, farmers and

other investors who buy in at the top of the boom using debt will be devastated as is true with anybody buying into a boom with borrowed capital.

It should also be remembered that the really high income years for the boom were 1973-1975 and it was not until the early 1980s, particularly with the abrupt increase in interest rates, that the bust began. At most, we are currently four years into a new boom. Most producers and lenders seem to be reluctant to plunge headlong into deeper debt. But just as the equities boom and bust of the latter 1990s brought forth ideas about a "new economy", so might a few more years of high agricultural income. In addition, the current farm bill still has not been finalized. There will likely be a better safety net than what existed in the early 1980s but better benefits are likely at least partially capitalized into land prices.

Our general sense is that a *debt* crisis is not currently present, although livestock and poultry *incomes* are under stress. An abrupt economic policy change caused the bust in the early 1980s. A technological breakthrough making energy cheaper could be a catalyst for a bust. Once financial markets recognized the validity of such a breakthrough, oil prices would plummet since a cheaper energy substitute would be on the horizon. Then farmers would be back to producing food and fiber. A dramatic increase in interest rates and strengthening of the dollar would also hurt, but given that domestic demand now includes fuel, it is unlikely the reverberations would be as large as the early 1980s. Of course, a currently unpredictable event could occur that would severely rock markets. So nothing is certain.

The research assistance of Monica Foianini and Diana M. Danforth is greatly appreciated.



2008 Farm Bill: Specialty Crop Provisions

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On Wednesday, June 18, the full 2008 Farm Bill was enacted into law when both the House and Senate voted to override the President's veto. As a result of fierce lobbying by specialty crop producers who demanded that their programs be included, for the first time, the federal government will provide financial assistance to growers and producers of specialty crops as well as to organic farmers under a specific title—Horticulture and Organic Agriculture. Specialty crops received a number of provisions directed at improving research, exports, consumption and competitiveness.

The 2008 Farm Bill is the first legislation to include a title for fruit and vegetable production. Fruits, vegetables and nuts account for almost one-third of

all cash crop receipts in the United States and the 2008 Act provides for these specialty crops as well as organics. A major win for these producers is the money set aside in the nutrition title for fruit and vegetable purchases for school lunches. The 2008 Farm Bill's Horticulture and Organic Title provides new resources for fruit and vegetable producers in the following ways:

- Expands access to locally grown foods,
- Provides organic farmers funding support for cost share program and marketing data collection/publication,
- Assists producers with addressing food safety, pest and disease management issues,

- Continues support for beekeepers and prioritizes research on Colony Collapse Disorder,
- Funds the Specialty Crop Block Grant Program, which is operated through state departments of agriculture, at \$466 million over a 10 year period,
- Establishes and funds a National Clean Plant Network

Efforts to expand access to locally grown food are being made through an expansion of the Farmers' Market Promotion Program. Farmers markets provide an excellent opportunity for consumers to purchase locally grown products and for growers to capture direct sales. Grant funds are available to improve and expand farmers' markets as well as other direct market opportunities. Specifically, the bill will allow for an increase in the use of EBT systems at farmers' markets and the creation of a Healthy Urban Food Enterprise Development Center. These efforts should facilitate the delivery of fresh foods to individuals often marginalized from local markets. Monies will also be available to expand the marketing of various direct producer-consumer markets.

The organic industry received substantial support as well. This industry is often cited as one of the fastest growing sectors of American agriculture with annual growth of approximately twenty percent over the last decade, but many producers face challenges as they try to transition to organic production. Twenty-two million dollars were allocated for a cost-share program aimed at helping organic farmers go through USDA's organic certification process. Funds (\$5 million) were also allocated to enhance organic marketing data collection efforts and the publication of collected data.

The bill also focuses on detection and control of pests and diseases by providing for joint programs between Federal and State governments. Funding will also be set aside for research on food safety hazards in the specialty crop research initiative.

An expansion of the Specialty Crop Block Grant Program will aid states in providing funds to support various projects on production, food safety, pest and disease management, marketing, education and general research. Similarly, a National Clean Plant Network will be developed in order to maintain plant stocks that are deemed free from pests and disease. The Network will become a national source for plant stocks for horticulture crops.

Finally, Beekeepers will continue to receive support through honey market loans as well as through the allocation of funds for research on Colony Collapse Disorder. This is a particular concern for those farmers relying on bees to pollinate their crops.

The specialty crop provisions in this farm bill are different from other program crops (corn, rice, wheat, cotton and soy) in that they do not guarantee a price for producers, or provide payments based on the amount of goods produced, or control imports from other countries. Therefore, the provisions cannot be deemed as trade distorting and are not likely to be vulnerable to a legal challenge at the WTO.

The support for research, food safety, assistance to farmers to export or get certified is a good investment in the future of specialty crops. For more information on the specialty crop provisions or other titles of the 2008 Farm Bill visit the House Agriculture Committee website at <http://agriculture.house.gov/inside/FarmBill.htm>.

We hope you find our newsletter useful. If you have any comments or questions regarding these articles, or would like to make suggestions for future articles, contact the editor.

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