Farm Talk

by

Jerry Webb

Prices and economic cycles

America's farmers are going through a very difficult period. There's no question about that. Evidence is everywhere. Farm foreclosures are on the increase. Money lenders are having trouble collecting from farmers. Farmers are spending less money for equipment, supplies, even family living expenses are being reduced. And the outlook calls for low farm prices, increasing bankruptcies, and a continuing struggle for American farmers during the months ahead.

Bin-busting harvest this fall have done little to ease the problem, as those yields have only depressed commodity prices further. And while everyone waits for the Russians or some other foreign buyer to bail out American farmers with big purchases, the realities of farming must be faced. It's a risky, difficult business, with plenty of opportunity for failure.

In general, farmers are in no need for a lecture. But there are lessons that can be learned from hard times, according to Dr. M. L. Walden, who is an extension economist at North Carolina State University.

He says farmers have faced hard times in the past and they'll probably face them again in the future. But a hard look at the current situation might ease the burden should such an economic squeeze occur again. Walden believes that high interest rates are a serious consideration in the present problem, and he says that the main cause behind those high interest rates over the past decades has been high and rising expected inflation rates.

In general, the economist says, the interest rate necessary to attract and loan money averages three or four percent a year. But when inflation is continually eroding the value of the dollar, the lender knows the dollars repaid to him a year or several years in the future will be worth much less. So he charges an inflation premium, which is simply added to normal interest rates.

If the lender expects the inflation rate over the loan period to be 10 percent, he just adds a 10 percent premium to the three or four percent normal rate of interest. That results in a 13 or 14 percent interest rate. As long as lenders expected high and rising inflation, they built in a margin that provided some protection.

Farmers themselves are very aware of this phenomena. Any of them with mortgages dated back 15 or 20 years know about four and five percent interest money. And yet, their current operating loans are made at 12 or 15 percent interest.

The inflation rate in the past couple of years has taken a decided downturn, and that has affected the cost of money. Here again, lenders anticipating a lower rate of inflation should be willing to settle for a lower yield on their money. Walden cautions farmers to be especially careful about borrowing at high, nominal interest rates during this time when federal economic policies are being altered to reduce inflation.

The economist believes there's a second lesson that farmers can learn from the current situation, and that has to do with the recession. He says inflation occurs when spending in the economy grows faster than the quantity of goods and services produced. Growth in spending is strongly related to growth in the amount of money supplied to the economy by the Federal Reserve System. So, when the money supply growth rate exceeds the growth rate for goods and services produced, inflation results.

Walden says to reduce inflation, the Federal Reserve must follow a policy that reduces the rate of growth of the money supply, and brings it more in line with the rate of growth of goods and services produced in the economy.

And that's where we get a recession. It occurs, he believes, when the output of goods and services does not increase for a substantial period. The slowdown in the money supply growth causes a reduction in the growth of credit, and this leads to higher interest rates and reduced business and consumer spending. Inventories increase above desired levels, resulting in production cutbacks, worker layoffs, and more weakening in consumer demand. And so the entire economy slows down.

Another predictable result is the strengthening of the dollar in exchange for foreign currencies. U.S. goods thus become more expensive to foreigners, and that slows down exports. Perhaps the only benefit that can be found in a recession is that inflation does in fact decrease.

The key to ending a recession and to economic recovery is for businesses and consumers to become convinced that inflation will be lowered in the future. And he says this happens only when there is a conviction that the Federal Reserve will not revert to policies that lead back to inflation.

In the simplest of terms, Walden says a recession is a transition period from high to low inflation rates. It is a painful period for many, including farmers, who usually find weak demand for their produce and low prices. And, of course, coupled with bumper crops, the results for some are devastating.

As in other periods of adjustment, the strong will survive to take advantage of the post-recession boom, the weak will be squeezed out. It may not be fair, but it's an economic fact of life.

There is some sentiment nationally that says a lot of farmers who are in trouble are the ones who tried to grow too fast. They're described as being greedy, gobbling up everything they could at a time when the economy was booming. In the process, they spread themselves too thin, became less efficient, borrowed too much, and overtaxed their managerial abilities. Now they are feeling the crunch and there is plenty of sentiment that those individuals who grabbed too much too quickly are getting just about what they deserve.

That's a harsh judgement, and it would be difficult to say who deserves to go bankrupt and who doesn't. But as long as there are tremendous opportunites with associated high risks there will be those who succeed and those who fail.