USDA: 214,000 farmers are unable to pay debts

FARMLINE NEWS SERVICE (USDA)

WASHINGTON — Some 214,000 American farms began last year unable to pay the previous year's bills, according to a study by economists of USDA's Economic Research Service. That's the bad news.

This figure represents around 12 percent of the farms that were covered in a major survey by the Agriculture Department early this year. The brighter side is that the majority of farms — 88 percent — had either a positive cash flow or were not overburdened by debt.

The 1984 Farm Costs and Returns Survey provided detailed financial information applicable to 1.7 million of the nation's 2.3 million farms — in other words, all but the smallest farms. Economists say that this survey, considered to be the most comprehensive to date, can help pinpoint financially stressed farms by type, size, and geographic distribution.

While current financial stress is not limited to any particular class or size of farm or sector of agriculture, says USDA economist Jim Johnson, some groups have been harder hit than others. Johnson is quoted in a recent issue of the department's FARMLINE magazine.

"The survey's results enabled economists to get a better grip on the number of farms affected and a clearer understanding of the types and sizes of farms experiencing financial stress," he says. Among the survey's most important findings, Johnson adds, is that, "many more commercial-size operations are in financial trouble than most analysts previously thought."

Commercial-size farms — those selling $40,000 or more a year in farm products — form the backbone of American agriculture. Although they represent only a little more than one-third of all farms, they account for 90 percent of all farm sales. "We found that at least one in five commercial operations was experiencing some degree of financial stress," Johnson says. These farms were carrying high debt loads and were unable to generate sufficient cash to pay their bills. Specifically:

- Almost 129,000 commercial farms (20 percent of all farms with annual sales of $40,000 or more) were under financial stress because they had both negative cash flow and a debt-to-asset ratio of more than 40 percent.
- Another 68,000 commercial farms showed the potential for financial stress because their debt-to-asset ratios exceeded 40 percent, even though their cash flow was positive.

Perhaps even more significant, Johnson says, the results of the survey showed that midsize commercial farms (those selling between $40,000 and $99,999 a year) were more financially stressed than farms in any other sales class. Of the 214,000 financially stressed farms, Johnson says, 62,000 — or 29 percent — fell into the midsize category. This figure is particularly telling, he says, because the farm in this class account for only 18 percent of the 1.7 million farms covered in the survey.

Degrees of Stress

Just how heavily leveraged an operation is and what kind of cash flow it can generate are two measuring sticks that can be used to determine the financial health of a farm business.

First, survey data were used to estimate how much cash from farm and nonfarm income was available to cover production expenses, the interest and principal on outstanding debt, and family living needs. Researchers divided farms into two cash flow positions: negative and positive. A negative cash flow alone is not enough to signal severe financial stress, Johnson says, because a farm that has a strong net worth position would probably be able to weather agriculture's current economic crunch. How? By temporarily leveraging some assets. If assets are too heavily leveraged, however, net worth declines to dangerously low levels, giving the operator little or nothing to fall back on if cash flow is already a problem.

Debt-to-asset ratios — the most owed to creditors as a percentage of the value of the operator's assets — were calculated from survey responses. Using current prices, input costs, and asset values, researchers defined four categories of debt-to-asset ratios: 0-to-39 percent, 40-to-70 percent, 71-to-100 percent, and over 100 percent.

According to Johnson, farms with ratios of 0-to-39 percent are in strong net worth positions and generally have few financial problems. It's the 40-percent mark that's the critical point, Johnson says. "That's when substantially higher rates of return to farm assets are necessary to maintain a positive cash flow, or farmers begin to have some difficulties."

Farms in the next category of 40-to-70 percent still have fairly strong net worth positions. But, unless they have a large, positive cash flow, they will probably begin having some difficulty meeting the principal repayments on loans, according to Johnson.

When debt-to-asset ratios fall into the 71-to-100 percent category, farms are likely to have trouble meeting their current interest payments as well as their principal payments. For most of these farmers, net worth is declining, Johnson says.

And when debt-to-asset ratios exceed 100 percent, he continues, the farm is considered technically insolvent. "The sale of all the farm's assets would not be sufficient to pay off its debts."

In which categories do most American farms fall?

The majority — 88 percent of those covered by the survey — remained financially sound. Their debt-to-asset ratios were in the 0-to-39 percent range or they showed positive cash flow. This is encouraging news, Johnson says, in view of the varied problems facing agriculture in recent years — depressed commodity prices, dwindling farm exports, and plummeting farmland values.

These factors, however, have taken a harsh toll on some operations, he adds, pointing to the flip side of the survey's results. Three percent — or 51,000 of the 1.7 million farms — were technically insolvent.

Most of the farmers who faced some degree of financial problems fell somewhere in between.

Farmers In Between

The survey found about 196,000 farms (11.6 percednt of the 1.7 million farms) with debt-to-asset ratios of 40-to-70 percent. Another 72,000 farms (4.2 percent) had debt-to-asset ratios of 71-100 percent.

Again, Johnson points out, a large debt-to-asset ratio alone does not necessarily mean that a farm is in financial distress. He explains:

"Farms that have less than $40,000 in sales usually earn a large share of total income from nonfarm sources, and often qualify for and repay their loans on the basis of this income. Very large flarms with sales of over $500,000 tend to be highly specialized and typically can carry relatively high debt-to-asset ratios because of their positive cash flow positions."

On the other hand, it's a sure sign of trouble when cash flow is low and debt levels are high, Johnson says. These are the farms researchers consider financially stressed, and this was the case for about 214,000 farms. All of these farms had negative cash flow and debt-to-asset ratios of 40 percent or more.

Certain types of farms in certain regions were most affected, Johnson says. Cash grain, general livestock, and dairy farms accounted for more than three-fourths of the 214,000 financially stressed farms.

And several geographical regions were also most affected. Sixty percent of the financially stressed farms were concentrated in the Corn Belt, Lake states, and Northern Plains. A contributing factor to this concentration is the steep drop in farmland values in those regions — down more than 20 percent in 1984 alone, compared with a national decline of 12 percent. When a farmer leverages his or her land to borrow operating capital, the land declines in value, the net worth position also drops, Johnson says.

New study will test current status

WASHINGTON — A lot of farms started 1985 with financial troubles. And developments since then — still lower crop prices, declining exports, and further drops in farmland values — have not helped matters for many farmers. Exactly how much worse has farming's financial situation gotten during the year?

USDA analysts are going to try and find out with the 1985 Farm Costs and Returns Survey. But they'll need the help of farmers. Here are some details on the survey:

- If your farm is chosen by USDA's random sampling procedures, you'll be contacted by an interviewer to set up a convenient time to visit your farm. Interviews will take about an hour.
- Participation is voluntary, but remember that each farm represents many other similar operations. For each farm selected, no one else can take its place.
- If you're chosen to participate, you'll receive a notification by mail in early January. Interviews will be conducted between mid-February and early March.

"The response rate to the 1984 survey was tremendous," says economist Jim Johnson of the Agriculture Department's Economic Research Service. "That's why the results were so revealing." But the next survey may actually be more important to the nation's farmers and ranchers than last year's survey, according to Johnson, because with the ongoing collection of data, "we'll be able to make a comparison, to see how the problems have changed. We'll know what's getting better and what's getting worse."

The 1985 survey will be almost identical to the one farmers and ranchers answered about 1984 income, receipts, expenses, debts, and assets. And, just as they were last year, all answers are completely confidential, says USDA. After questionnaire data (without names) are fed into a computer, the questionnaires are destroyed so there is no record of any individual's answers. Questionnaires are not sent on to USDA in Washington, nor are they shared with any other government agency.

Again, Johnson stresses the importance of the survey. It's the only way policymakers, farm groups, and the public can be accurately informed of how changing regulations, input costs, returns, and technology affect the agricultural economy, he says.

"The last survey provided the foundation," Johnson adds. "The next one will help us better understand the magnitude of financial problems in the farm sector."