U.S. Agriculture: The Difficult Adjustment Continues

By Mark Drabenstott

U.S. agriculture endured a difficult year in 1985. Farm income dropped and farmland values fell further. But the most striking toll of 1985 was the mounting number of financially pressed farm businesses, rural merchants, and farm lenders. Farm business failures and farm lender closings occurred at a rate not witnessed since the Great Depression.

Another difficult year lies ahead in 1986. Farm income probably will worsen modestly in the coming year. With a normal growing year, crop stockpiles will grow bigger. Thus, weak crop prices likely will more than offset some improvement in livestock prices. Farm credit conditions will remain troublesome in 1986. While the 1985 farm bill promises to keep government farm payments large, fundamental recovery for U.S. agriculture still awaits lower real interest rates and improved export markets.

This article reviews farm events in 1985 and then examines the austere outlook for 1986. Areas of focus include farm credit conditions, farm income, the farm bill, and crop and livestock market conditions.

The year in review

The year began with concern over crop prices but with hopes that livestock profits would bolster farm finances. The year also began amid hopes that the worst farm financial problems might be nearly finished. Many hoped that a weaker dollar would turn around sagging farm exports. All of these hopes soon faded as 1985 wore on.

The farm economy deteriorated throughout 1985. Large spring plantings and excellent growing weather soon led to large crops that began depressing crop prices. Despite continued growth in the U.S. economy and consumer spending, red meat prices fell sharply in 1985, eliminating the comfortable profit margins producers and lenders had expected. The widespread spring credit crunch that many predicted was largely avoided. But farmland

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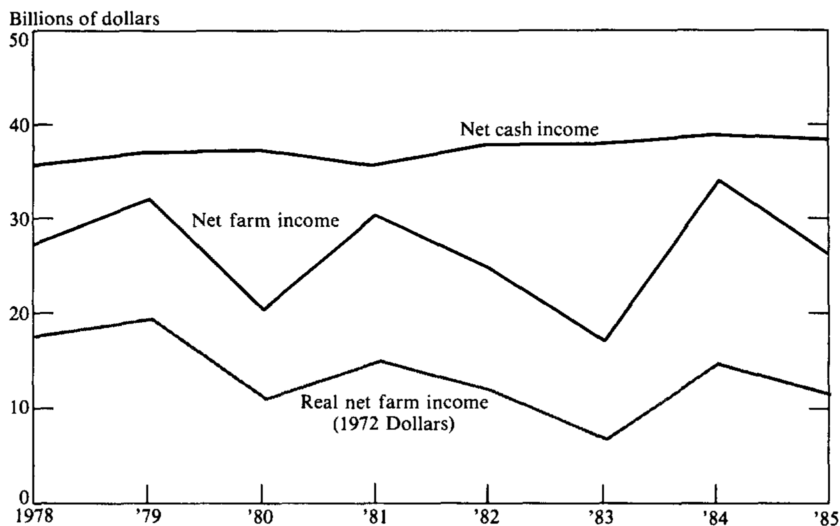
CHART 1
Farm income



Source: U.S. Department of Agriculture

values fell dramatically throughout the year while farm loan problems grew bigger and more vexing to farm lenders. The dollar did weaken more than 20 percent during the year, but U.S. farm exports remained captive to the stagnant Third World economy.

Farm income

Net farm income declined sharply in 1985. It is currently estimated at about $27 billion, 22 percent less than the revised $34.5 billion in 1984 (Chart 1). In real terms, net farm income was only an estimated $12 billion (1972 dollars), nearly a fourth less than in 1984 and far less than in the 1970s. Weaker crop prices and disappointing livestock prices account for much of the decline. Large government payments, however, added some resilience to farm income. Direct payments totaled an estimated $9 billion, up slightly from 1984 when crop prices were stronger. Continued strength in the general economy kept off-farm income at $41 billion, a little higher than in 1984. Most of that income goes to smaller farmers.

Net cash income data suggest a somewhat brighter picture for farmers. Net cash income is estimated to have remained unchanged in 1985 at $39 billion. Total cash receipts fell slightly, to $138 billion. Livestock cash receipts declined markedly, while crop cash receipts were unchanged from 1984. Cash expenses also declined, to $110 billion. Farmers apparently were careful about purchases because of their strained finances.

Government commodity support programs provided strong cash flows to some producers in 1985. Corn growers in many parts of the Corn Belt enjoyed record yields. Those that participated in the feed grains program (70 percent of all corn producers) had very good 1985 revenues. Participants received a loan rate on corn of $2.55 a bushel plus a deficiency payment based on the target price of $3.03. Thus, some producers with superior

TABLE 1
Farm balance sheet excluding operator households on December 31
(billions of dollars)

	1982	1983	1984	1985p	1986f
Assets					
Real estate	745.6	736.1	639.6	575-625	555-620
Nonreal estate	232.2	220.4	216.5	200-230	190-235
Total assets	977.8	956.5	856.1	790-840	770-830
Liabilities					
Real estate	101.2	103.7	102.9	96-101	93-99
Nonreal estate	102.4	98.8	96.0	98-102	99-105
Total liabilities	203.7	202.5	198.9	195-202	194-201
Proprietors equity	774.2	754.0	657.2	595-635	570-630
Debt-asset ratio	20.8%	21.2%	23.2%	23-25%	23-26%

p = preliminary
f = forecast

Source: U.S. Department of Agriculture, 1985 Agricultural Outlook Conference.

yields received an equivalent market price well above $3.00 for their base acreage.

Farm input suppliers generally posted profits in 1985 on the basis of modest gains in sales. Large spring plantings helped bolster demand for fertilizer, seed, and chemicals. But again, demand for farm machinery and equipment remained extremely weak. Depressed farm earnings, still high debt-carrying costs, and a large supply of used equipment for sale resulted in further stress for the equipment industry. Reflecting that stress, three long-standing hallmarks in the farm equipment industry were merged with other firms—International Harvestor joined J. I. Case, Allis-Chalmers merged with Deutz, and New Holland was purchased by Ford.

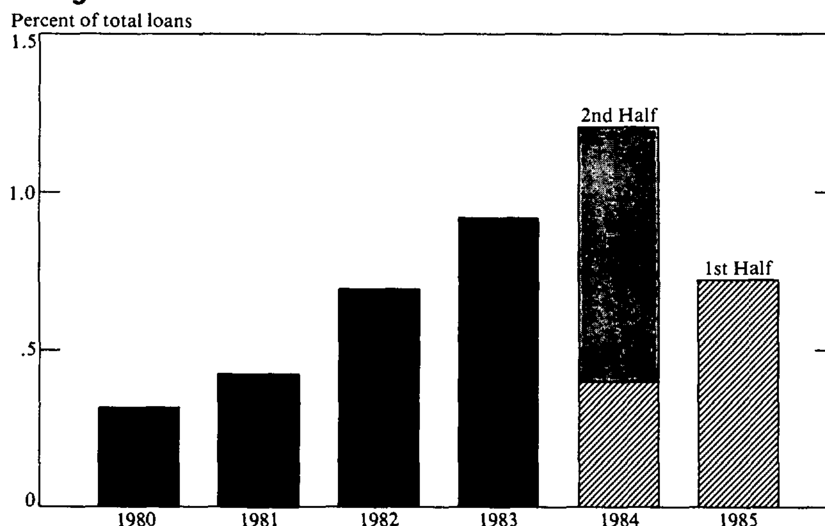
Farm credit conditions

The focal point of U.S. agriculture in 1985 was its deteriorating credit conditions. Farmers and ranchers throughout the country underwent far more financial stress than normal, and more than in 1984. Farm loan problems intensified for farm lenders—a fact highlighted by deepening financial pressures for the Farm Credit System and commercial banks that lend to agriculture. The weak farm economy also manifested itself in a growing number of nonfarm rural business failures.

The farm sector balance sheet deteriorated further in 1985. The statement for December 31, 1985 is expected to show a 2 to 8 percent decline in total farm assets, marking five straight years of decline (Table 1). Total liabilities probably will decline slightly as producers trim long-term debts somewhat. Based on these changes, proprietors' equity probably will decline sharply to about $615 billion, 6 percent less than the previous year. The debt-asset ratio is expected to increase slightly.

The administration's Debt Assistance Program was a much heralded effort to slow the

CHART 2
Loan loss rate at agricultural banks



Source: Board of Governors of the Federal Reserve System

deterioration of farm credit conditions. That program offered government loan guarantees in exchange for lenders writing down interest rates enough to make a loan cash flow. Lenders made relatively little use of the program. Instead, nearly $3.6 billion in direct operating loans were extended by the Farmers Home Administration (FmHA). Those direct FmHA loans and steps lenders took on their own to extend credit proved to be the main safety valves this past spring. The FmHA did approve $1.1 billion in loan guarantees, but almost all of this was outside the Debt Assistance Program.

According to a survey of agricultural banks in the Tenth Federal Reserve District, farm liquidations were much higher than normal in 1985. For the 12 months ended October 1, full liquidations were 6.7 percent of all farms and ranches, a rate bankers considered nearly two and a half times normal. Partial liquidations during that period totaled 7.3 percent, almost six times normal. Although financial stress may be most intense in the western Corn Belt and Great Plains states, the problem appears national in character.

Farmland values continued their sharp decline in 1985. With weak commodity markets, relatively high farm mortgage rates, and uncertainty surrounding farm and tax legislation, potential buyers of farmland remained on the sidelines. And even though the amount of land actually trading hands remained small, a large supply was poised for sale just off the market.

In the Tenth District, farmland values fell throughout the year. Values have been declining at an annual rate of 20 to 25 percent for nearly two years. At the end of the third quarter, district land values were 44 percent below the market peak reached in 1981.

With declining farm asset values and a weak farm economy, farm loan problems multiplied for the nation's agricultural banks (Chart 2). Loan losses at these banks totaled 1.1 percent of total loans for the first nine

TABLE 2
U.S. farm product price projections

Crops	Marketing Years 1984-85	Marketing Years 1985-86	Percent Change
Wheat	$3.38/bu	$3.00-3.20/bu	-8.3
Corn	$2.65/bu	$2.35-2.55/bu	-7.5
Soybeans	$5.85/bu	$5.00-5.30/bu	-12.0
Cotton	.59/bu	N/A	N/A

Livestock	Calendar Years 1985	Calendar Years 1986	Percent Change
Choice steers	$57-59/cwt	$62-67/cwt	11.2
Barrows & gilts	$43-45/cwt	$45-50/cwt	8.0
Broilers	$50-51/lb	$48-52/lb	-1.0
Turkeys	$75-76/lb	$60-66/lb	-16.6
Lamb	$69-71/lb	$70-75/lb	3.6
Milk	$12.75/cwt	$12.15-12.65/cwt	-2.7

Source: U.S. Department of Agriculture, 1985 Agricultural Outlook Conference

months of the year, twice the loan loss percentage a year earlier. Furthermore, sharply higher volumes of past due and nonaccrual loans in 1985 indicate that problems are still coming. Total past due loans at the nation's agricultural banks ran about 20 percent higher than in 1984. Even more disturbing, nonaccrual loans ran almost 50 percent higher than in 1984. Nonaccrual loans point to further potential loan losses in the future.

Crops

U.S. farmers harvested record and near-record crops in 1985. Planted acreage was very large, despite farm programs aimed at reducing wheat acreage 30 percent, feed grains 10 percent, and cotton 30 percent. Growing conditions were excellent in nearly all portions of the country, although wet weather hampered harvesting in some regions. Only two years after the Payment-in-Kind (PIK) program, carryover stocks are rapidly approaching the levels that spawned the program.

Wheat production was relatively large in 1985 due to large acreage and good yields. Total production was 2.4 billion bushels, 8 percent less than the year before. But reduced consumption and surplus stocks kept prices low all year. The nationwide average price was $3.38 in the 1984-85 marketing year, 5 percent less than in the previous year (Table 2).

Feed grain producers harvested record crops in 1985. On the strength of large plantings and a record yield of 117 bushels an acre, corn production exceeded 8.7 billion bushels, the largest corn harvest ever. Corn prices trended down all year, staying 20 to 25 percent below 1984 prices. For the 1984-85 marketing year, corn prices averaged $2.65 a bushel, nearly a fifth lower than the 1983-84 average.

Soybean production also was very large in 1985. Output totaled 2.1 billion bushels, second only to the 1982 crop. The national aver-

age yield set a new record. Soybean prices sagged all year under the weight of the large supplies. Farm-level soybean prices averaged just $5.85 in the 1984-85 marketing year, a fourth less than in the previous year.

Cotton production also increased in 1985. Record yields raised output to 13.8 million bales, up slightly from 1984. Export demand proved very weak, and with large competing supplies from other exporters, cotton prices generally declined throughout 1985. Prices averaged 59 cents a pound in the 1984-85 marketing year.

Overall, crop producers gathered a harvest of plenty in 1985. But swelling stockpiles and dormant export markets sharply reduced prices. And the supplies being carried over into 1986 suggest prices could weaken even more.

Livestock

Livestock producers surprised everyone again in 1985. Meat production was expected to decline 2 percent. Instead, it increased 1 percent to another record level. While not large in percentage terms, the increase led to dramatically lower prices, especially for cattle. The economy enjoyed its third year of economic expansion, but consumers still appeared to be shying away from meat purchases. Soft consumer demand appears to be one main reason for the disappointing red meat prices in 1985.

Beef production was unchanged in 1985, even though a 2 percent decline had been forecast. The numbers of cattle slaughtered fell 2 percent, but slaughter weights increased a substantial 4 percent. The result was a net increase in pounds of beef produced. Producers held cattle off the market in the spring, expecting higher prices in summer months. Weather was mild, allowing rapid feed conversion, and the net effect was heavier cattle going to market. Thus, the large supply of beef and relatively weak consumer demand led to a sharp fall in cattle prices. A widening spread between retail and market prices also dampened the stimulative effect of lower market prices. Many analysts had forecast $70 a hundredweight finished steer prices by midyear. Instead, prices dipped to almost $50 in midsummer. Prices did rally in the fourth quarter, but for the year prices for choice steers at Omaha averaged an estimated $58, down substantially from 1984.

Pork production also was unchanged in 1985. Financial stress for Corn Belt producers may have contributed to higher than expected slaughter rates. Canadian and Danish pork imports were a significant supply factor again in 1985, amounting to 7.5 percent of U.S. production. Despite cheap feed, most producers were kept below breakeven profit levels by low hog prices. Prices for barrows and gilts at the seven regional markets averaged $44 a hundredweight, down a tenth from 1984.

Broiler production rose 4 percent in 1985 as the industry continued its expansion. Low feed costs and strong consumer demand encouraged the growth in output. Nevertheless, large red meat supplies helped push broiler prices slightly below year-earlier levels. The 12-city price averaged 50 cents a pound in 1985, down moderately from 1984. Turkey production, meanwhile, shot up 9 percent in 1985. Strong profits throughout the past two years have encouraged strong growth in turkey production. Turkey prices averaged 75 cents, up slightly from 1984.

Lamb and mutton production fell 6 percent in 1985, continuing the industry's long-standing downward trend. Despite lower production, profit margins were bolstered by low feed grain prices and excellent range condi-

tions. Slaughter lamb prices averaged $70 a hundredweight, up sharply from 1984.

Dairy producers increased output again in 1985. Total milk production was a record 143 billion pounds, 6 percent more than 1984. The number of dairy cows was slightly higher than 1984, and milk per cow ran about 4 percent better. Because of weak consumer demand, government purchases rose sharply to an expected 13.5 billion pounds, 57 percent greater than in 1984. Due to the large purchases, the Department of Agriculture lowered the milk support price 50 cents to $12.10 a hundredweight on April 1 and then to $11.60 on July 1. Because of large dairy surpluses and the reduction in the support price, producer milk prices averaged an estimated $12.75 a hundredweight.

The year ahead

U.S. agriculture faces another difficult year in 1986. Farm income is expected to weaken further due to weak crop prices and sluggish exports. Credit problems will remain widespread and highly visible, and land values can be expected to continue their decline. Attention will again focus on farm lenders, and possible government assistance to these lenders will continue to be debated. Overall, the year begins with some deep concerns about further weakening in the farm economy.

Farm income and financial conditions

Farm income is expected to weaken somewhat in 1986. Stronger livestock profits probably will be more than offset by weak crop prices and a possible reduction in crop production. Livestock prices are expected to increase in the first half of the year as supplies decline. Red meat prices in particular should benefit. In addition, livestock profit margins will be helped by cheap feedstuff prices. Crop prices likely will remain weak throughout the year, although prices may not decline much further from current levels due to the large amount of stocks held under Commodity Credit Corporation (CCC) loan. Still, huge carryover stocks will be the major factor depressing prices. The weaker dollar may lead to some improvement in farm exports, but sales are expected to remain sluggish due to weak economies in the developing world. Overall, farm income may decline $2 to $5 billion in 1986. Net cash income may be unchanged. Adjusted for inflation, farm income probably will be in the $9 to $11 billion range (1972 dollars).

Financial stress is almost certain to mount with that level of farm income. Stress will remain concentrated among commercial scale farms that are highly leveraged. In particular, many farmers and ranchers with debt-asset ratios over 40 percent will continue to have serious difficulty servicing their debt.

By any measure, the farm credit problem has significant dimensions. Two recent studies further clarify the amount of farm debt that is troubled. The U.S. Department of Agriculture (USDA) estimated in July that 129,000 commercial farms—a fifth of all farms with annual sales over $40,000—began 1985 under serious financial stress.[1] These were farms with both negative cash flows and debt-asset ratios of more than 40 percent. These producers were estimated to owe about 39 percent of farm operator debt, or about $46 billion.[2] Of the

[1] Source: U.S. Department of Agriculture, *Financial Characteristics of U.S. Farms, January 1985*, Agriculture Information Bulletin, No. 495.

[2] Farm debt of about $120 billion was reported by the 1.7 million farm operators covered by the Farm Costs and Returns Survey. The remaining $93 billion of farm sector debt—as based on reports by lenders—presumably is in the hands of landlords, is owed by the surveyed farmers for nonfarm purposes, or is in the hands of the 700,000 small farms not covered by the survey.

129,000 farms in this category, 54,000 were severely stressed—debt-asset ratios of more than 70 percent and negative cash flows. They owed nearly a fifth of the farm operator debt, or about $23 billion.

Other estimates also suggest that a considerable farm loan problem still lies ahead. Using the same USDA survey data, Emanuel Melichar recently classified the financial position of farm operators according to debt-asset ratio, amount of equity, return on assets, and return on equity.[3] His results also suggest that a substantial portion of the nation's farm assets will move from weak to stronger hands. He concluded that about 10 percent of commercial farms, or about 63,000 farms, were "vulnerable" at the beginning of 1985. These are farms that might be thought of as in peril of failing within the next year or two. Interestingly, he estimated that these farms owed about $23 billion to all farm lenders, the same amount the Department of Agriculture found for their worst borrower category. Melichar also estimated that another 44,000 farms were "stressed," or headed for trouble in the next few years. These farms, 7 percent of U.S. commercial farms, owe another $10 billion to farm lenders.

Thus, comparison of USDA estimates for farms with negative cash flows having debt-asset ratios over 70 percent and Melichar's "vulnerable" category suggests that 55,000 to 65,000 farm operators are in danger of failing in the near term. These farm businesses appear to owe about $23 billion to all farm lenders.

With low farm income projected for 1986, therefore, the stage appears to be set for a period of significant financial stress and reckoning. Lenders reluctantly have renewed many farm loans in recent years—and especially last spring—because they were unwilling to force settlement of loans when faced with losses from the sale of acquired assets. Increasingly, however, lenders lack the freedom to renew troubled loans. Stockholders are worried about bank earnings, and in some cases bank soundness. Regulators continue to voice concern over the deteriorating quality of farm loan portfolios. Thus, farm liquidations, both full and partial, can be expected to run well above normal in 1986, particularly in the early spring, when most credit decisions are finalized.

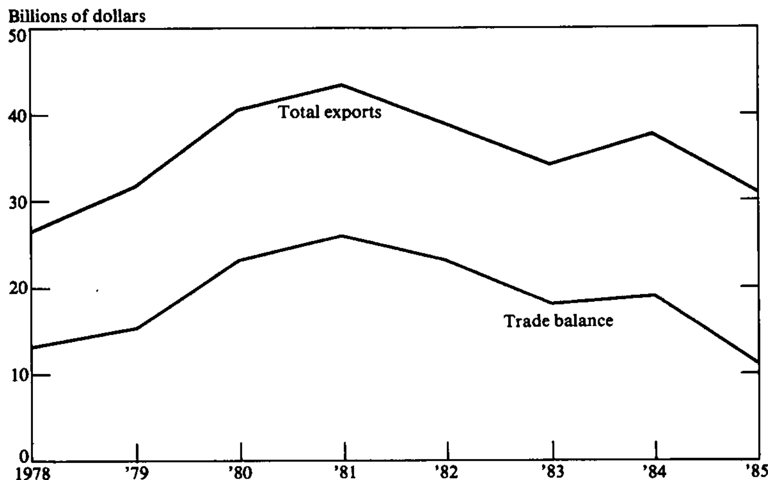
With many farm assets for sale and the outlook bleak for the farm economy, farm asset values will remain under downward pressure in 1986. Inflation-adjusted interest rates for farm real estate likely will remain relatively high, contributing to lower land values. Many are now asking how far land values could fall. The answer is uncertain at present, but two key factors will govern the outcome.

The first is net cash returns. Most observers agree that a positive cash flow given a reasonable debt level is the market fundamental that will eventually support values. With land in some parts of the country now 60 percent off the market high, a positive cash flow for some producers is not far distant. Uncertainty about future farm programs has made cash flow projections difficult for potential land buyers. Final passage of a farm bill will help to eliminate some of that uncertainty.

The second key factor is the rate at which land is put on the market. Even though rural asset markets have been strained by a relatively large supply of land for sale, agriculture's painful adjustment has remained relatively manageable thus far. That is, the decline in land prices has—for the most part—been orderly. But if troubled farm loans are settled at a faster rate, for whatever reason,

[3] Source: Emanuel Melichar, "Farm Financial Experience and Agricultural Banking Experience," Testimony before the House Banking Committee, October 23, 1985.

CHART 3
U.S. agricultural trade



Source: U.S. Department of Agriculture

that could still lead to disorderly markets and precipitous declines in values. Thus, there remains a need to assess the role for public policy in moderating asset market adjustments.

In other respects, agricultural credit conditions in 1986 will mirror those in 1985. Agricultural banks will have ample funds, and creditworthiness will be the critical factor in loan decisions. Farm loan interest rates could decline somewhat as rural banks adjust to the lower money market rates that prevailed in the second half of 1985. Nevertheless, high farm loan losses can be expected to add upward pressure to farm loan rates.

The coming year promises to be another challenging one for the Farm Credit System. Depending somewhat on the outcome of federal assistance legislation, Wall Street likely will remain skittish about FCS bonds, and the spread over Treasury securities probably will remain historically high. Structural change in the system will continue. Production Credit associations and Federal Land Bank associations are likely to merge into fewer local associations, thereby allowing consolidation of capital and earnings within Farm Credit districts.

Export outlook

Farm exports resumed their downward trend in 1985. The value of U.S. agricultural exports was $31 billion in fiscal 1985, down 19 percent from the previous year (Chart 3). Export volume also declined, to 126 million metric tons, 13 percent less than in 1984. The agricultural trade balance dropped sharply to $11 billion, a move that also reflected much higher food imports.

Exports fell in the face of two positive market developments in 1985. First, the trade-weighted exchange value of the dollar declined more than 20 percent from its February peak. Second, for much of the year U.S. commodity prices were as much as 25 percent below 1984 levels. But despite lower prices

and a weaker dollar, U.S. farm exports failed to respond.

Several market factors contributed to weak exports. First and foremost, economic and financial problems persisted in many developing countries, notably such middle income countries as Mexico, Brazil, and Indonesia that remain our best potential markets. World grain supplies were very large, and competitors were anxious to market their stocks. Finally, while the Soviet Union bought a record amount of grain from the United States, it still did not fulfill all the conditions of the U.S.-U.S.S.R. long-term grain agreement. The Soviets apparently were unwilling to honor the wheat portion of the agreement when U.S. prices were well above world prices.

Current global supply and demand forecasts suggest that U.S. agricultural exports could weaken still further in 1986. World grain trade is not expected to grow in the coming year, and competing supplies will be large. Commodity prices likely will average lower than in 1985, while export volume declines modestly. Thus, the value of farm exports may decline to perhaps $29 billion in 1986.

Over the next few years, the overriding concern for restoring U.S. farm exports will be the strength of trading partner economies. A weaker dollar does make U.S. producers more competitive, but it does not generate stronger income in trading partner countries. And that essential buying power is what is scarce in the current world food market. Reductions in U.S. federal budget deficits that would lead to lower interest rates here and abroad would be beneficial in stimulating economic growth in Third World countries. In addition, a long-range strategic plan for expanding exports and reducing government grain stocks would bolster the U.S. position in the world food market.

Farm policy outlook

The 1985 farm bill debate has been long and labored, dominated by two approaches to the farm problem. First, the administration advocated a rapid move toward a free market farm policy in a proposed bill unveiled in March. That proposal, coming in the middle of the spring credit crunch, quickly met strong opposition from many quarters. Opponents argued that the farm sector was under too much financial stress for a sudden removal of government income supports. Instead, opponents proposed a second approach—continuation of current policy with only minor adjustments. The administration has voiced concern about the high cost of this approach.

Congress passed the farm bill on December 18. The final bill reflects efforts to maintain farm income while allowing market forces to influence farmer decisions to a greater extent. The president had not yet signed the bill at the time of this writing.

The final bill has four important provisions. First, the bill allows loan rates for major crops to move toward world market prices. Loan rates would be set at 75 to 85 percent of average market prices for the preceding five years, except that prices could not decline more than prescribed limits, usually 5 percent a year. The Secretary of Agriculture, however, would have discretionary authority to lower loan rates another 20 percent a year, 10 percent mandated for 1986. Most analysts agree that lower loan rates are needed to make U.S. farm products more competitive in world markets.

With very large carryover stocks of major crops, the Secretary likely will exercise his authority to lower loan rates further, quite possibly by the full 20 percent. But if that happens, the bill exempts from the current $50,000 payment limitation any additional deficiency payments that might result from the

reduced loan rate. That is, producers would receive target price deficiency payments based on the loan rates set by Congress up to a maximum of $50,000 per farm. Then, if market prices remained low, producers would receive additional deficiency payments based on the loan rate set by the Secretary of Agriculture. For some large farmers, that second payment might well exceed the initial $50,000 payment.

The second important provision of the bill is a freeze on target prices. The bill freezes target prices on most program commodities for two years. Wheat and feed grain target prices are frozen for two years, and then allowed to decline 10 percent over the next three years. Cotton and rice targets are frozen in 1986 and then decline 10 percent in the next four years. With current surplus commodity stocks and a bleak outlook for exports, a two-year target price freeze will almost certainly lead to large government payments, quite possibly much larger than current expenditures.

A third major provision is an attempt to expand exports. The bill would bolster credit and other programs to increase exports. Commodity Credit Corporation export credit guarantees would be increased to at least $5 billion in each of the fiscal years from 1986 through 1989. The intermediate export credit program, which guarantees loans of three to ten years, also would be strengthened to at least $1 billion per year. The bill also would extend and enhance the Bonus Incentive Export Program (BICEP), sometimes called the export PIK program. Finally, Congress would extend P.L. 480, the Food for Peace Program, with improved steps to make sure American food reaches the needy abroad.

A fourth major provision is a long-term Conservation Reserve. Advocated by Secretary Block, this provision would idle as many as 45 million acres of marginal cropland. The program would target lands subject to high rates of erosion. Producers would contract with the USDA to shift such acreage to less intensive use, such as grass or forest production, for a period ranging from ten to 15 years. The provision also would discourage further "sodbusting" by making those who so engage ineligible for commodity program benefits.

In short, the bill essentially maintains current farm policy with some fine tuning. Loan rates are allowed to move toward market clearing levels, but within limits. Target price protection remains generous. Export promotion is bolstered. A Conservation Reserve that hearkens back to the 1950s Soil Bank was established. Taken together, these provisions will make the bill very expensive.

Two farm credit policies will be important in 1986. First, FmHA loan programs will remain a key source of credit to financially stressed farmers. Currently, it appears that about $4 billion will be made available for all FmHA programs in 1986. Half of that amount will be for direct operating loans, the other half will be for loan guarantees. While FmHA will stress the guarantee program, direct loan programs probably will remain important for the next few years.

A second farm credit policy issue is government assistance to the Farm Credit System. Legislation to provide assistance moved rapidly through Congress. The final bill—likely passed just before Congress adjourned—contained three basic elements. First, the legislation would establish a back-up line of credit for the system with the Treasury. The amount of assistance is not specified, but would be supplied only when the system had used all of its nonstock capital. Second, the legislation gives authority to the Farm Credit Capital Corporation to marshal capital resources within the system. Troubled loans would be

TABLE 3
U.S. agricultural supply and demand estimates
December 10, 1985
(millions of bushels, bales, or metric tons)

	Corn (bu) Oct. 1-Sept. 30		Feed Grains (mt) Oct. 1-Sept. 30		Soybeans (bu) Sept. 1-Aug. 31		Wheat (bu) June 1-May 31		Cotton (bales) Aug. 1-July 31	
	1984-85	1985-86	1984-85	1985-86	1984-85	1985-86	1984-85	1985-86	1984-85	1985-86
Supply										
Beginning stocks	723	1,379	31.5	49.9	176	318	1,399	1,425	2.78	4.10
Production & imports	7,659	8,718	237.1	271.5	1,861	2,129	2,595	2,427	12.98	13 81
Total	8,382	10,097	268.6	321.3	2,037	2,447	4,003	3,852	15.78	17.94
Demand										
Domestic	5,165	5,420	162.7	169.7	1,121	1,157	1,155	1,110	5.55	6.00
Export	1,838	1,625	56.0	48.9	598	675	1,424	1,000	6.22	3.10
Total	7,003	7,045	218.7	218.7	1,719	1,832	2,579	2,110	11.76	9.11
Ending Stocks	1,379	3,052	49.9	102.7	318	615	1,424	1,742	7.07	8.97

Source: U.S. Department of Agriculture

channeled to the corporation to be serviced and worked out, and the corporation would fund the acquisition of those loans by assessing transfers of capital from all banks in the system. Finally, the legislation strengthens the regulatory authority of the Farm Credit Administration, making it a true arms-length regulator.

Crop outlook

The crop outlook for 1986 is not bright. Carryover stocks are huge, nearly as big as in 1983. Current signals concerning administration commodity programs suggest that production cutbacks probably will not be big enough to curtail the 1986 crop significantly. Meanwhile, export markets hold forth little promise of renewed vigor. Thus, crop prices can be expected to remain soft all year, and prices will trend even lower if another large crop takes shape and if loan rates are cut for the 1986 crop year. With government stocks very large, however, market prices will find some support at loan rate levels.

Although total wheat supplies will be less than in 1985, a sharp drop in demand casts shadows on the outlook for wheat. Because of 1985's smaller crop, total supplies will decline 4 percent to 3.8 billion bushels (Table 3). At the end of the 1985-86 marketing year, however, carryover stocks are expected to exceed 1.7 billion bushels, 22 percent more than in the 1984-85 marketing year.

Weak domestic and foreign demand is the main problem in the wheat outlook. Feed use will decline in the United States as livestock feeders shift back to cheaper corn. World consumption also appears weaker than expected. The Soviet Union and Brazil, two major importers, have cut back substantially on their plans to buy wheat. Total world wheat trade may fall 13 percent in 1986. That coupled with record world stocks will keep U.S. prices low. Farm-level prices are expected to average $3.00 to $3.20 a bushel, down moderately from 1985 and the lowest since 1975.

Even larger supplies encumber the feed grain outlook. Feed grain supplies will total 321 million metric tons, up substantially from last year. Corn supplies, the major feed grain, will approach 10 billion bushels, the largest in many years. Corn carryover stocks will more than double in the coming marketing year, reaching 3.1 billion bushels, second in size only to the carryover in 1983.

Feed grain demand is expected to remain unchanged in 1986. A small decline in exports probably will be offset by greater domestic feed use. Farm-level corn prices may average $2.35 to $2.55 a bushel, just below the loan rate and down moderately from 1985. Grain sorghum prices are expected to average $2.15 to $2.35 a bushel, also down from the previous year. Barley prices also are expected to decline, to a range of $1.95 to $2.15 a bushel.

The large 1985 U.S. soybean crop points to a weak profit picture for soybean growers in 1986. Supplies in the upcoming marketing year will top 2.4 billion bushels, a fifth more than the previous year. Carryover stocks will nearly double, reaching a new record of 615 million bushels. A record world oilseed crop also will exert downward pressure on U.S. prices, especially for soybean oil.

Soybean demand will improve in 1986, but not enough to soak up the large supplies. Domestic crush is expected to be steady, and exports may improve slightly. A large Brazilian crop, however, could dissipate any improvement in U.S. exports. With another large U.S. crop expected, farm-level soybean prices may average only $5.00 to $5.30 a bushel, the lowest price since 1976.

Cotton supplies also will be very large in 1986. U.S. supplies may increase to nearly 18.0 million bales, while world stocks will be record large at 40 million bales. Intense competition from other exporters, such as China and the Soviet Union, will cut U.S. exports nearly in half. Domestic mill use is expected to be steady in the coming year. But total cotton use will be only 9.1 million bales, the lowest this century. As a result, cotton prices will be at or below the 57 cent loan rate for most of the year.

Overall, crop supplies likely will grow bigger in 1986. As in 1985, many producers will look to government programs to market their crops. And even though loan rates could decline sharply in 1986, stable target prices will offer generous benefits to those who participate. In short, government programs will be the market for many crop growers.

Livestock outlook

The livestock industry looks forward to improved profits in 1986. Red meat supplies are expected to decline 5 percent, led by a 5 percent reduction in beef supplies. Total meat production, however, is forecast to be only 2 percent less than 1985 as the poultry industry continues its expansion. Continued growth in the U.S. economy will help strengthen prices, but the pattern of the past few years suggests that the livestock industry cannot look to consumers to bring higher prices. Low feed costs, however, should lead to wider profit margins throughout 1986.

Beef production is expected to decline 5 percent in 1986. Both fed and nonfed marketings should decline through the first half. Feed yard placements in the third and fourth quarters of 1985 were down from the previous year, pointing to lower fed marketings in the first two quarters of the coming year. In addition, dressed weights should return to normal, contributing to lower beef production compared with 1985. The cattle inventory likely will decline again in 1986.

Choice steer prices at Omaha are expected to improve markedly in 1986. Prices should

trade in the mid-$60 a hundredweight range for much of the year. By midyear, the industry might see $70 for the first time in a couple of years. Poultry supplies will be large, but total meat supplies should favor beef prices more in 1986. Declining corn prices and prospects for improved finished cattle prices should lend strength to feeder cattle prices in early and mid-1986. Prices could be near $70 in the second quarter before declining somewhat in the second half as competing meat supplies increase.

Pork production is expected to decline 1 percent in 1986. Producers retained fewer sows than expected in late 1985, probably due to ongoing financial stress in the Corn Belt. Cheap feed likely will stimulate increased production in the second half. Although still important, pork imports may moderate somewhat in 1986. Imposition of countervailing duties will temper Canadian imports.

Barrow and gilt prices at the seven regional markets are expected to average $45 to $50 a hundredweight in 1986. Lower red meat supplies should bolster first half prices. Prices could be near $50 by midyear. Prices may weaken in the second half when pork supplies could be increasing.

Broiler producers look forward to another year of strong profits. Cheap feed will keep breakeven prices low, while consumer demand keeps market prices up. Total broiler production could rise 4 percent in 1986. The 12-city broiler price is expected to average about 50 cents a pound for the year.

Turkey supplies also may increase 6 to 7 percent in 1986. Solid profits should continue, encouraging the expansion. Turkey prices are expected to average about 63 cents a pound, down from 75 cents in 1985.

Dairy output probably will increase in 1986. Dairy cow numbers in late 1985 were the highest in over a decade. Production also will be enhanced by technology and genetic advancements. Milk per cow could increase 1 to 4 percent. Total milk production, then, is expected to increase 2 to 5 percent. With that record output, government purchases would again be very large, perhaps approaching 16.5 billion pounds.

The chronic dairy surplus may abate somewhat in 1986 because of a new dairy buy-out program that will be implemented. The program will attempt to cut dairy output 7 percent a year by encouraging the slaughter of 600,000 dairy cows. Producers would contract with the USDA during the next 18 months and agree to slaughter their entire herd. In exchange, they would receive subsidies based on the contract bid for each gallon of milk the herd would have produced. The program will be financed through a 40 cent a pound assessment on all dairy producers beginning April 1, 1986, and a 25 cent a pound levy in 1987. Finally, the bill freezes dairy support prices at $11.60 a hundredweight in 1986, but allows prices to drop as much as 50 cents if the dairy surplus remains large.

Conclusion

U.S. agriculture continued its difficult adjustment in 1985. That story was written in slumping farm income, declining farm asset values, and mounting numbers of farm liquidations, rural business failures, and rural bank closings. Record large crops raised crop carryover stocks to levels that will concern commodity markets throughout the coming year.

But despite all the troublesome problems in 1985, a few bright spots did emerge. Farm legislation took shape that does move U.S. agriculture toward global market realities, albeit at a slow pace. Government commodity programs, while expensive, helped stabilize income for some producer groups. Corn growers, in particular, enjoyed healthy reve-

nues in 1985. Finally, agriculture has demonstrated remarkable resilience. There is no question that great financial pressure has been exerted on the industry. Yet, in retrospect, agriculture has adjusted at a fast but even pace. Precipitous adjustments have, for the most part, been avoided.

The year ahead will challenge agriculture's resilience again. Although livestock profits likely will improve, huge crop supplies probably will depress crop prices all year. Farm income may decline modestly in 1986. Farm financial stress will remain highly visible and widespread across the industry. But when 1986 draws to a close, the most difficult portion of agriculture's adjustment may be nearly finished. The prolonged drop in farm asset values could be nearly complete. And if some life begins to return to world food trade, the agriculture that emerges from the current adjustment will be more able to compete in that world market.