FARM PROFITABILITY: From Boom to BUST

September 2017
U.S. agriculture enjoyed an economic boom from 2011 – 2013. It was a time of high commodity prices and strong agricultural exports. Part of a 6-year super-cycle in farm income, the spike in commodity prices benefited farmers in the Northern Great Plains (Kansas, Nebraska, South Dakota and North Dakota) and in the Corn Belt (Iowa, Illinois, Indiana, Minnesota and Michigan). A thriving farm economy typically draws a lot of attention; the impression lingers that farmers continue to profit.

In REALITY, the U.S. farm economy continues a steep four-year slide which began in 2013. Net farm income is down 50% in the past four years. Land remains expensive. Farm input costs are not falling at pace comparable to the decline in farm income.

This white paper details the economic and policy factors contributing to the flagging farm economy as well as needed policy changes to restore prosperity to the economic sector that puts food on our tables and provides 21 million U.S. jobs.
Net farm income is the single most watched indicator of farm sector well-being. Net U.S. farm income peaked in 2013 at $123 billion. A number of economic factors contributed to the robust farm economy in the years leading up to 2013. They include the following:

- High demand for farm commodities
- Increased production levels of corn-based ethanol
- Low worldwide commodity supplies following difficult production years outside the U.S.; e.g. drought in Australia, and unfavorable weather in Ukraine

Sound federal policy also contributed to the strength of the farm sector leading up to 2013. Specific policies included the following:

- Renewable energy policy: Increased requirements for renewable fuels through the Renewable Fuel Standard (RFS), which drove demand for corn and set a new short-term price floor
- Trade Policy: Improved access to growing international markets via progress in trade agreements including GATT and NAFTA

The economic picture for farmers has changed drastically in recent years. Row crop farmers’ income continues to fall due to lower crop prices and persistently high input costs. Among Midwestern states, Illinois has been especially hard hit given farmers’ dependence on grain and oilseed crops.

Between 2013 and 2015, ILLINOIS dropped from 3rd to 50th in the U.S. for net FARM INCOME at -$145,658 MILLION.

Source: USDA Economic Research Service Farm Income and Wealth Statistics
The U.S. Department of Agriculture in early 2017 reported farm income is falling more quickly than at any time since the 1970s. For 2017, U.S. net farm income is projected to be $62.3 billion, down nearly $6 billion from last year and about one-half of the record earned in 2013. If projections are accurate, 2017 would mark the fourth consecutive year of decline in net farm income. As in the case of the record farm economy just four years ago, both world economics and U.S. policies impact the current difficult financial position for farmers. (See Fig. A)

Near record crop production has maintained large global stocks for many commodities including feed grains and soybeans. Other regions of the world, including Black Sea/Russia/Ukraine and South Africa, are increasing production of feed grains. The same is true of soybean production in South America.

RENEWABLE FUELS
Legislation mandating inclusion rates for renewable fuels produced from agricultural sources like corn-based ethanol greatly improved market demand for corn. However, RFS is currently capped at a 10 percent blend rate for ethanol, limiting future growth. In addition, other nations have similar caps at or near 10 percent, limiting additional ethanol exports in the future.

TRADE
U.S. exports of feed grains and soybeans are on the decline. The decrease can be attributed to: 1) the shrinking transportation advantage of the Midwest compared to South America; 2) South American farmers’ ability to expand production due to lower land costs; 3) the strength of the U.S. dollar compared to our competitors’ currencies; and 4) the lack of progress through trade agreements to gain improved access for U.S. agricultural products in global markets. The U.S. is the only major world exporter that has lost market share of world exports of corn, soybeans and wheat over the past 15 years.

It has been six years since approval of the last major trade agreement (Free Trade Agreements with Panama, Colombia and South Korea) between the U.S. and other nations. The U.S. withdrawal from the Trans-Pacific Partnership (TPP) in January 2017 means trading opportunities between the U.S. and eleven other nations will not materialize. The American Farm Bureau Federation estimates TPP would have meant another $4.4 billion in agribusiness each year. The U.S. is not involved in negotiating any new trade agreements which could open new markets for exports of commodities produced here.

INFRASTRUCTURE
Having access to modern and efficient inland waterways and ports is vital to producing, marketing and shipping agricultural products. In 2015, 72 percent of U.S. agricultural exports – valued at $128 billion – traveled via waterways.

A lack of investment in the nation's failing infrastructure systems is costly for agriculture.
For years, U.S. transportation infrastructure has provided farmers and agribusinesses with a strong comparative advantage against foreign competitors. The infrastructure now lags behind. Most locks and dams in U.S. inland waterway systems have surpassed their planned 50-year lifespan. Illinois receives a grade of “D-” from the Illinois Section of the American Society of Civil Engineers. Further, U.S. ports need to accommodate larger vessels traveling through the reopened and expanded Panama Canal.

**INPUT COSTS**

Input costs, including land costs, have not fallen as far or as quickly as commodity prices. As a result, farmers who have capital reserves are relying on them. Credit reserves have fallen 70 percent since 2012. A rise in farm debt to $305 billion (+5 percent) was expected to result in a rise in the debt-to-asset ratio to 13.9 percent, the highest level since 2002.

“Prices for most crop commodities have fallen more than 50% since 2013. At the same time, input expenses have declined at a much slower rate – maybe 10%.”

- Lynn Paulsen, Senior VP, Bell Bank
  Firmly State Bank of Fargo

Illinois farmers are drawing down working capital at an alarming rate. Having sufficient working capital ensures that farmers can repay operating loans. Farmers’ ability to repay loans is a growing concern among the banking community in Illinois. (See Fig. C)

“Lower commodity prices are affecting some of our agribusiness borrowers, which is starting to impact credit quality in that portion of our loan portfolio. Further modest deterioration in credit quality is anticipated as long as commodity prices remain low.”


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**Fig. C**

**Indexes of Agricultural Credit Conditions in the Seventh District**

*Includes areas of IL, IN, IA, MI and WI*

Low commodity prices – and the resulting drop in farm income – are impacting farmers’ credit quality. Ag lenders predict 6 percent fewer farmers will post a profit in 2017 compared with 2016. An American Bankers Association/Federal Agricultural Mortgage Corporation survey found
nearly 90 percent of ag lenders reported a decline in farm profitability from May 2016 to May 2017. The portion of profitable farmers could slip to 54 percent in 2017 due in part to lower commodity prices and high input costs. Segments creating the most concern for lenders include grains, beef cattle and dairy – all commodities grown and raised in Illinois.

Chapter 12 bankruptcy protection filings – designed to protect family farmers – doubled in the 7th District U.S. Court between 2014 and 2016. The 7th District includes Illinois. (See Fig. D)

"The (agricultural machinery) industry’s overall performance in recent years has struggled, owing to declining commodity prices, inconsistent government support for infrastructure investments, and declining exports."

- IHS Economics

The forward years to come – 2017-2018 are critical for farmers’ survival, given that most farms have seen operating capital evaporate and credit become harder to come by after the past 3 years of negative income.

All of this translates into a period of high financial stress for family farmers given the limited policy and market solutions on the horizon.

Farmers’ worsening financial picture hurts other sectors of the farm economy. Industrial production of ag machinery declined by nearly 18 percent from 2014 to 2016 as farm income also declined.

Moline, Illinois-based John Deere expects flat sales of tractors and combines this year in the U.S. and Canada, which accounted for 70 percent of its farm equipment sales last year. Deere’s farm equipment sales fell 36 percent to $18.5 billion in 2016 from a peak of $29.1 billion in 2013.
POLICIES
Policies must be enacted at the federal level to return the farm economy to profitability. Illinois Farm Bureau\textsuperscript{®} calls on members of Congress to increase the farm bill budget, work on increased trade opportunities, reduce burdensome regulations, and enact tax reform.

IFB members believe the next Farm Bill must be WTO-compliant, provide price and revenue protection for farmers, and link nutrition and commodity programs. Within the Farm Bill, crop insurance remains our top priority. It must be kept as the core risk management tool for farmers. We support maintaining the current level of federal risk premium support. The bill must continue to feature commodity program choice – revenue and price – and encourage production and stewardship decisions that attract public support.

TRADE
We support a fully funded Market Access Program (MAP) and a fully funded Foreign Market Development (FMD) program in the next Farm Bill.

The U.S. has traditionally been the world’s leading exporter of corn, soybeans and related products. The top 3 markets for U.S. agricultural exports are China, Canada and Mexico. Such exports are projected to account for 33.4 percent of gross cash earnings in 2017. Strong trade policy is crucial in helping the farm economy to rebound.

NAFTA and other trade agreements have been good for American farmers. (See Fig. B) NAFTA’s bad image is largely undeserved; American consumers have benefited by lower costs for goods they can buy here as well as increased exports to Mexico and Canada. NAFTA renegotiations should protect these important markets while also addressing issues that have limited trade potential for U.S. farmers. NAFTA’s current benefits to U.S. agriculture must be protected.

REGULATORY REFORM
Farmers and ranchers believe regulations are needed to protect public health, food safety, worker safety, environmental quality and market fairness. They also believe the regulatory system needs to be fair, transparent and faithful to the will of Congress, cost-effective and respectful of freedoms. The voices of those affected by rules should be heard and respected in the rule-making process. Reform is long overdue.

TAX POLICY
Overall, taxes make it harder for farmers to respond to changes in consumer demand and markets. Farmers and ranchers get pushed into higher than usual tax brackets when they sell farm assets. USDA reports that 40 percent of family farms

Fig. B

Trade Agreements Create Opportunities for U.S. Agriculture

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<th>Year</th>
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General Agreement on Tariffs and Trade (GATT)
Trade Act of 1974
tokyo Round of GATT
Kennedy Round of GATT
Japan: Beef and Citrus
Uruguay Round of GATT
Trade Act of 1988
Doha Development Round
China in WTO
AFTA
Korea, Columbia, Panama Trade Agreements
CAFTA-DR
Korea, Columbia, Panama Trade Agreements

Source: USDA-FAS Global Agricultural Trade System (GATS) United States Department of Agriculture Foreign Agricultural Service

www.fas.usda.gov
report some capital gains or losses, compared to just 13.6 percent of individual taxpayers. Land and buildings account for 79 percent of farm and ranch assets. Reduced capital gains taxes could mean the start of aligning the nation’s tax code with our goal of encouraging economic growth and transferring farm assets to the next generation.

Given the struggling farm economy, farmers and ranchers need the economic benefits that will follow tax reform. A number of factors make taxation important to farmers. They include high debt service, a lack of liquidity, and the difficulties of passing on land from one generation to the next. We ask legislators to ensure that tax reform results in lower effective tax rates for small and family-owned farms and ranches.

INFRASTRUCTURE

Maintaining and modernizing our nation’s network of roads, railways and waterways is critical to ensuring that agricultural goods move quickly and efficiently. A 21st century infrastructure system is also crucial to expanded trade capacity driven by growing populations and economies outside the U.S. These systems must be upgraded to handle larger ships and increasing volumes of trade. Without infrastructure improvements, American farmers’ competitive advantage will continue to decline in both domestic and export markets.