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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS
OF THE
HOUSE COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS
ON THE
FINANCIAL CONDITION OF AMERICAN AGRICULTURE
AS OF DECEMBER 31, 1985

Mr. Chairman and Members of the Subcommittee:

We are here today at your invitation to discuss our recently issued report entitled Farm Finance: Financial Condition of American Agriculture as of December 31, 1985 (GAO/RCED-86-191BR, Sept. 3, 1986). The report updates selected information included in our earlier report entitled Financial Condition of American Agriculture (GAO/RCED-86-09, Oct. 10, 1985). Also, we will discuss some new 1986 information not included in our recently issued report.

In our October 1985 report, based primarily on calendar year 1984 and earlier data, we stated that ". . . the financial condition of farmers and their lenders has deteriorated rapidly since 1980 and that financial stress continues to grow." In our latest report, we provide information showing that the adverse economic and financial conditions facing agriculture continued in 1985. More recent data show that this trend has not abated in 1986.

Today, I will provide some brief background information and then discuss (1) the economic environment facing agriculture,

(2) the farmers' financial position, and (3) the performance of the financial institutions serving agriculture in 1985.[1]

## BACKGROUND

As you know during the 1970's, American agriculture experienced a boom with rapid expansion and growth caused by a variety of factors including rising export volume and value, a weak dollar, low real (inflation-adjusted) interest rates, high inflation, and relatively high commodity prices. These factors made U.S. products relatively inexpensive for foreign consumers, created cheap credit for U.S. farmers, and boosted the value of farm assets. However, the economic forces that led to that growth reversed in the 1980's, and, as a result, American farmers and their lenders began to experience adverse economic and financial conditions.

## THE ECONOMIC ENVIRONMENT: ADVERSE CONDITIONS CONTINUED IN 1985

The economic environment surrounding the farm sector continued to be adverse during 1985. American agriculture has traditionally produced a surplus, and since the early 1970's, it has relied heavily on foreign consumers for sales. In 1985 U.S. production of many key farm commodities, such as corn, soybeans, and wheat, increased. Although U.S. consumption also increased, the rate was less than the production increase.

In 1986 production and consumption of these key commodities, except wheat, is projected to continue to increase. In addition, the price farmers received for corn, soybeans, and wheat declined in 1985 and is projected to decline further in 1986.

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[1]Unless otherwise noted, yearly information presented is as of December 31 and all dollar values are nominal values.

While production increased in 1985, U.S. exports of agricultural products declined in both volume and value. For example, U.S. agricultural exports declined in value by 23.3 percent from $37.8 billion in 1984 to $29 billion in 1985--the lowest level since 1977. The U.S. agricultural trade surplus also declined to about $9.1 billion--a 51-percent drop from the 1984 agricultural trade surplus and the lowest annual level since 1972. Since 1981, both agricultural exports and trade surpluses have experienced declining values.

U.S. agricultural exports continued to decline in 1985 for a variety of reasons, including strong competition from other exporting countries, large production gains by traditional importing countries, a weak world economy, and high real interest rates. Although a strong dollar has also contributed to export declines, the dollar weakened throughout 1985 and during the first half of 1986. For example, the dollar's 1985 value declined from an index (March 1973 = 100) of 157 in the first quarter to 128 in the fourth quarter. In 1986 it has declined further--to 119 in the first quarter and 114 in the second quarter. Declines in the dollar's value could, in certain countries, improve the price competitiveness of U.S. agricultural commodities and may result in increased future foreign demand for U.S. farm products.

During the first 7 months of 1986, U.S. agricultural exports have declined over 15 percent, U.S. agricultural imports have risen over 7 percent, and the U.S. agricultural trade surplus has declined 64 percent, compared to the same period in 1985. Through July 31, 1986, the 1986 U.S. agricultural trade surplus totaled about $2 billion compared to more than $5.4 billion for the same period in 1985. In addition, data reported by the U.S. Department of Agriculture's (USDA) Foreign Agricultural Service showed that May and July 1986 both had monthly agricultural trade deficits--the first monthly deficits since August 1971.

## THE FARM SECTOR: ADVERSE FINANCIAL POSITION CONTINUED IN 1985

According to data we obtained from USDA's Economic Research Service (ERS), the adverse financial position of the nation's farmers continued in 1985. The value of farm assets declined by 9.9 percent in 1985 from 1984. Nationally, farmland values declined by more than 12 percent from April 1985 to February 1986 and are at their lowest level since 1980. Eighteen states had declines greater than the national average, with 3 of the 18 states--Minnesota, Iowa, and Louisiana--having declines of 20 percent or more. Further, ERS preliminary data showed that farmers' rates of return on assets and on equity remained negative in 1985 but improved slightly over those experienced in 1984.

Farmers' farm income also declined in 1985. Net farm income declined by 6.7 percent from the 1984 level. According to ERS, the 1985 declines were mainly attributable to low prices that resulted from an increase in farm output and a decrease in inventory values.

The decline in net farm income, however, was partially offset by a slight increase in farmers' 1985 off-farm income. Farmers' off-farm income has become increasingly important over the years and in 1985 was $40.8 billion, or 57 percent, of the $71.3 billion in total income available to farmers.

According to information compiled by ERS, 33.7 percent of 1985 farm debt was held by farmers who were financially sound (debt-to-asset ratio of 40 percent or less). In 1984, 38.0 percent of the farm debt fell in this category. Furthermore, a growing portion of farm debt--33.5 percent in 1985 compared to 29.0 percent in 1984--was held by farmers with serious financial problems (debt-to-asset ratio of 71 percent or more).

While national nonfarm employment grew in 1985, farm employment declined by over 4 percent, continuing a general declining trend that has been underway for many years. In addition, according to information reported by the Dun & Bradstreet Corporation, 35.6 percent more agricultural businesses failed in 1985 than failed in 1984.

## THE FINANCE SECTOR: FARM LENDERS CONTINUED TO EXPERIENCE FINANCIAL STRESS IN 1985

In 1985 an estimated $210 billion in farm debt was outstanding. Most of that debt--$167.6 billion--was held by five major institutional lenders: Federal Land Banks and Production Credit Associations in the Farm Credit System (FCS), commercial banks, the Farmers Home Administration (FmHA), the Commodity Credit Corporation (CCC), and life insurance companies. The balance of the outstanding debt was held by individuals, input suppliers, and others according to ERS estimates. The principal changes in 1985 reflect a declining share of the total debt for all major nonfederal lenders and an increase in the debt owed to FmHA and CCC.

Lenders with a high concentration of their loan portfolio in agriculture continued to exhibit financial stress in 1985. As of December 31, 1985, four of the major institutional lenders, excluding CCC, had about $33.7 billion in farm loans, or 24.9 percent of the total outstanding principal ($135.6 billion), that were nonperforming and/or delinquent in 1985. This was a $4.3 billion, or 14.6 percent, increase from 1984. The total quality of these lenders' portfolios is skewed by the poor condition of FmHA's portfolio. Excluding FmHA, the total nonperforming and/or delinquent loans held by the three nonfederal lenders was $15.1 billion, or 13.9 percent of their outstanding debt, a considerable increase from the $10.5 billion, or

8.6 percent of their outstanding debt that was nonperforming and/or delinquent in 1984. Furthermore, for the Federal Land Banks, Production Credit Associations, and commercial banks, the high amount of nonperforming and/or delinquent loans existed even though these institutions wrote off as uncollectible over $2.2 billion in farm loans during 1985.

Lenders' delinquency rates change during the year. Seasonal repayment patterns make FmHA's delinquency rate higher at year-end than at other times. For example, although FmHA had $18.6 billion, or 69.9 percent, of its outstanding farmer program loans delinquent as of December 31, 1985, it had $13.5 billion, or 48.5 percent, delinquent at June 30, 1986.

FCS, which is the largest institutional lender to the nation's farmers, had a $2.7 billion net loss in 1985. This was a significant change from 1984 when the FCS had a $373 million profit. Furthermore, the FCS continued to experience a rapidly rising trend in farm loan charge-offs--that portion of loans written off as uncollectible--and in property acquired through foreclosure or deed in lieu of foreclosure. In 1985, the FCS' Federal Land Banks and Production Credit Associations had charge-offs of $940 million--a $564 million, or 150 percent, increase from the $376 million in charge-offs in 1984. In addition, property acquired by Federal Land Banks and Production Credit Associations during 1985 increased about 125 percent from $532 million in 1984 to $1.2 billion in 1985.

Reacting to the increasing financial stress, the Congress enacted the Farm Credit Amendments Act of 1985 (Public Law 99-205, Dec. 23, 1985), which provided for a means to restructure the Farm Credit Administration (the federal regulator of FCS), established a mechanism for FCS to use its available resources to provide financial assistance to its member institutions, and gave the

Secretary of the Treasury discretionary authority to invest congressionally appropriated funds in FCS under certain conditions.

For the first six months of 1986, the FCS has reported a net loss of $968 million. In addition, Farm Credit Administration data showed that the value of property acquired by Federal Land Banks and Production Credit Associations totaled over $1.3 billion as of June 30, 1986--a 10.5 percent, or $126 million, increase since December 31, 1985.

Financial stress is also evident in commercial banks that are heavily involved in agriculture. According to the Federal Deposit Insurance Corporation (FDIC), agricultural banks--those having 25 percent or more of their portfolio in farm loans--comprised 25.9 percent of all commercial banks in 1985, but they accounted for 52.5 percent of all bank failures. In 1985 there were 437 agricultural banks, from a total of 1,098 banks, on the FDIC problem bank list, which classifies banks warranting more than normal supervision. Additionally, the Board of Governors of the Federal Reserve System has reported that 170 banks with above-average farm loan ratios are highly vulnerable to failure because their nonperforming loans exceed capital. Many of the banks that failed in 1985, and many of those that were vulnerable to failure at the end of 1985, were located in the Midwest.

Through September 15, 1986, 48, or 46.6 percent, of the 103 banks that had failed were agricultural banks. In addition, as of June 30, 1986, FDIC's problem bank list had increased to 1,321 total banks, with 524 of these problem banks categorized as agricultural banks.

FmHA services the weakest farm customers of any lender and its portfolio reflects its position as the lender of last resort.

As of December 31, 1985, FmHA borrowers were past due on almost $8.5 billion in payments. Over 67 percent, or $5.7 billion, of the past due amount was 3 years or more late. These loans had an outstanding loan balance of about $18.6 billion. Almost 70 percent of the outstanding balance on its farmer program loans was delinquent.

As of June 30, 1986, FmHA's borrowers were past due on $6.8 billion in payments. Almost 75 percent, or $5.1 billion, of the past due amount was 3 years or more late. These loans had an outstanding balance of about $13.5 billion. Over 48.5 percent of the outstanding balance on its farmer program loans was delinquent.

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This concludes my statement. We will be glad to respond to any questions.