Escaping 1980
Episode 4 – Bottoming Out

David Widmar: We saw in 1972, they bought as much as they could as quickly as possible so that way no one knew how bad the situation was.

Brent Gloy: This changed the tone from the “sky is the limit” to the “sky is falling overnight.” We had people walking into banks and shooting loan officers and bank presidents, because they'd lost their family.

David Widmar: Every farm boom ends. It's how it ends that's the difficult part.

Sarah Mock: Where the 1970s might've been a little before Brent's time. The 1980s were not.

Brent Gloy: I grew up on the farm and, you know, Husker football is a big thing, of course, in Nebraska. So, in 1983, we should have won the national championship that was devastating. I always think of Journey and Van Halen, and that was kind of my era - Guns and Roses toward the end of the 80s. Wall Street – “Greed is good.” I don't remember when that movie came out [in 1987]. The original with Charlie Sheen and Gordon Gekko, “Greed is good.”

Sarah Mock: Brent, as is clearly evidenced by the story, has been a documented econ and finance nerd since at least 1987. For the rest of his generation these years were about Ferris Bueller's Day Off and the Breakfast Club, Michael Jackson's We Are the World broadcast at Live Aid, and a lot of spandex, Doc Martins, and heavy metal. Even beyond the cultural milieu, Brent and David also have particular memories from the fallout of the Chernobyl disaster to the ongoing Cold War.

David Widmar: We boycotted the Olympics in 1980, because…

Brent Gloy: Oh, that was a big deal.

David Widmar: It was in Moscow.

Brent Gloy: Like I can't, I just, I'm young, I'm not quite remembering exactly what was going on in 1980, but I do remember sitting on my grandfather's couch and talking to him, he was, he was a banker. And this would have been probably later in mid-80s. And several of his friends had had banks that failed in the farm crisis.

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Sarah Mock: Oh yeah. And the farm crisis. This is Escaping 1980 - the farm crisis that was, and what we can do to avoid the next one. I'm Sarah Mock. Today, we're talking about the very worst of the crisis in the 1980s. The moment that it bottomed out. In my mind, the first few years of the 1980s and 1983 in particular is one of those moments in history best expressed by one of those old-fashioned clips of a spinning newspaper and a splashy headline like, "Bank Seize Farms at Record Rates" or "Farms Fail, Farmers Fight Back!" David and Brent have their headlines too.

David Widmar: The headline would be the 60% collapse in farmland values. That was just a huge, devastating blow to the farm economy that was really difficult to get around. There was the, there were a lot of elements, right. But I think the blow in farmland values that went straight to the balance sheet and really blew up the equity position of a lot of producers.

Brent Gloy: If you want a headline, you can say, "Farmland Values Fall Another 20% Off, 60% from the High, Farm Bankruptcies Increase Again." There were a lot of farm protests and Willie Nelson had the Farm Aid program. There was just a lot of trauma at that time. And I think the key to all of it was the excessive leverage. It was just way too much financing taking place. And so, the trigger, the thing that really unwound it rapidly was when interest rates spiked. And I think they got to the point where an operating loan would probably carry somewhere around a 20% interest rate. And that was just completely unsustainable.

Sarah Mock: Declining farmland values were a key part of the overall equation in the darkest years of the 1980s. And we'll talk a lot today about what was happening in farmland markets, how we price farmland today, and how farmland can variously create balance sheets security and insecurity, depending on outside factors. But let's ground this moment historically. Some of the worst effects of the farm crisis were already starting to be felt as early as 1978 and 1979 when farmers from across the country drove their tractors to Washington D.C. to demand higher government support prices for commodities. By 1983, falling commodity prices, uncertainty elsewhere in the economy and all the various hangover effects of the 1970s' boom, were bearing down on the farm balance sheet. And in particular, the two big factors we've discussed - interest rates and inflation - were decimating the value of farmland many farmers, most valuable asset. It's almost hard to imagine the heights to which interest rates got during the worst years, even 8 or 10% seems high compared to today's rates and 20% seems astronomical, but that wasn't the ceiling either.

Brent Gloy: I have a friend here that sold center pivot irrigation systems in that timeframe. And he told a story of a guy who came in and signed a contract for 30 of them, because this was also back in the heyday of Nebraska when we were rapidly developing the groundwater resource. And then in the 1980s - so 70s and 80s - there was center pivot irrigation systems became much more workable. And so, people would come in and develop a lot of groundwater resources.

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And this guy had come in to buy something like 20 or 30 of them. And he said, “I'll never forget.” He signed the contract, and he was financing them through the manufacturer and the interest rate was something like 26%. And he said, “The guy signed it.” He walked into his boss and he said, “This guy's broke. I don't know how on earth he's ever going to pay for this. It's never going to work.” Within about three years, they were all for sale because it wouldn't work. It was impossible. Nobody can make that work.

<u>Sarah Mock</u>: The 1980s level of price inflation is hard to comprehend especially because most of our recent experience in the U.S., especially since 2008, has been of slow economic growth with low levels of inflation.

<u>Brent Gloy</u>: I think most people, they have a hard time even thinking about what even 8 or 9% inflation, annual inflation would mean in the economy as we haven't seen it. We just have not seen anything like that. It's been much more team for the last 30 years. So, it's hard to get your head around. But if you think about, if it were a 7% inflation rate, prices would roughly double every 10 years. So just think about the price of your car or something, if it's a $50,000 car today, 10 years from now, it'd be a $100,000 if you're growing at 7%. These were just really kind of crazy times. I think most of us who haven't experienced it would have a hard time, but if people are listening in other countries where they've had more inflation, probably understand that it's just a very different environment than most of us experienced here in the United States.

<u>Sarah Mock</u>: As we're wrapping our minds around the impact of inflation rates and interest rates, it's worth keeping in mind where those two intersect. Interest rates are always relative to inflation rates, which means that though the 10% for interest rates seems high now, if inflation is 15%, it's actually lower than today's 2% interest rates in relative terms because there's so little inflation today. The other key factor around inflation rates is that they affect the whole economy and not just farmers.

<u>Brent Gloy</u>: At the time interest rates weren't necessarily low by today's standard, real interest rates were low. So, real interest rates are just what you, when you subtract the inflation rate off of the interest rate you’re paying – it’s what's left over - and they were quite low and, in fact, sometimes negative. But what that brought about was a period of rapid price inflation in the general economy. So, it wasn't just in farming. There was inflation everywhere in the economy, and we didn't have a lot of economic growth either. And so, people were getting really frustrated with the amounts of inflation. And the Federal Reserve decided that it was going to stop inflation and bring it under control. And when it did that, the way the Federal Reserve usually handles that process is to slow down the amount of credit being used in the economy and the way they do that is increase the interest rate. So, they increased interest rates dramatically, and that put the brakes on the economy and it really hit the farm economy.

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Sarah Mock: We're familiar with this work from our study of Paul Volcker last episode, but we haven't looked closely at what exactly his policies meant for farmers.

Brent Gloy: So as the federal reserve is trying to reign in general price inflation with higher interest rates, oftentimes a side effect of doing that is to put the economy in recession. Well, it did, but it put the farm sector in a depression. So, it really hammered the farm economy - those interest rates went up because we were leveraged very highly.

David Widmar: So, for context, inflation spiked in 1974 at about 11%, and then spiked again in 1980 at about 13.5%, and if you look between the 1970 and 1982, 83 we pretty much spent the entire period near or above 5% and quite a bit of the time, about 7.5%. It was that, those double-digit increases are what was really putting a lot of pressure into get inflation under control. And so, after we raised interest rates - Paul Volcker was at the helm of that. Inflation rates came back down. We only, once again, in 1990, saw CPI inflation get above 5%. And in recent years, we've kind of struggled to see anything above 2.5%, right. It's a very different environment today. So, we spent a lot of time in the 70s with very high inflation. So not only was the rate high, it was high for more than a decade or right at a decade, and that's what really starts to compound that issue. The political pressure or the desire to reign that in came into really full effect there in the early 1980s.

Sarah Mock: the crippling amount of debt on farm balance sheets was exasperated by other factors as well, including loan terms and repayment requirements and the combined impact of all these issues completely undermined the financial position of many farms leading demand for farmland to dry up and causing farmland prices to plummet. This is critical because in many cases, farmland is the equity backstop on farm balance sheets, loans and financing are allocated in part based on how much equity usually in farmland a farmer has. So, when farmland begins to lose its value in a big way, the bottom tends to fall out of farm businesses.

David Widmar: There was a lot of debt out there in the farmer economy in the early 1980s and interest rates made it difficult to service that debt. But we also had short financing terms relative to today’s standards. And so not only was that at a 26% interest rate, it was a short repayment cycle and so the debt servicing for that on an annual basis would have been very, very high. It would have been a very hard hurdle to clear it. I think the biggest challenge to the interest rate hike, there is the debt service element, but I think the biggest blow to the farm economy was actually the impact it had on farmland value. So, Purdue [University] does a great job of following Indiana farmland - average quality Indiana farmland, and these are in 2019 dollar, so the inflation adjusted dollars, - average farmland in Indiana would have been about $5,500 in the late 1970s. And then by 1986, 1987 it had fallen about $2,000, so that's about a 63% adjustment. And in fact, we didn't get back to that $5,000 level until around 2009, 2010. And so, it was a very big adjustment in the farm economy, and it was, it came out of the

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balance sheet. So now you have really high debt levels going into the decade of the 1980s, and then all of a sudden, a huge part of that balance sheet, which is tied up in farmland values, collapses and it puts producers in a spot where there's not enough assets to cover the liabilities.

Brent Gloy: So much of that decline was driven in part by the rapid change in the interest rate regime. So, before that we had inflation rates that were clipping along in the high single digits to [maybe] occasionally hit in the double digits at that time period. And lenders at that time were very willing to lend on the basis of equity and farmland. And it was easy to generate equity in farmland so if you bought something five years ago and it appreciates at 10%+ for five years, it's worth a lot more than you paid for it. So, all of a sudden you had a lot of equity on the balance sheet and the lenders were willing to lend against that. As the income crashed because of the grain embargo, you combine that with all this debt service and it just threw the whole system into panic.

Sarah Mock: Though these big shifts in the wider economic picture were well beyond farmers' control that wouldn't stop them from hitting home in a way that ate up farmland equity. It made it almost impossible for a farmer to get out of farming with even the shirt on their back.

Brent Gloy: All the sudden, not only could you not service the debt on your farm - in a normal situation [when] land values were holding up, well, you could just sell one of those farms and move on and keep farming the rest of it. But it was cratering so bad you'd have to sell the whole farm and then on top of it, you had to find somebody else that wanted to buy it. And nobody else wanted to buy it because if you didn't have the cash to buy it going out and borrowing it at those interest rates was just prohibitive. So, it just changed the tone from "The sky is the limit" to "The sky is falling" overnight. And when that happened, when you go from an environment where before nobody wanted to sell, everybody wanted to buy, to an environment where everybody wants to sell or has to sell, and nobody wants to buy. Because nobody else wanted to take a risk either, at that time. They're seeing their neighbors selling their farm and that's really traumatic. This isn't like the online auctions of today where you can sit there and watch a retirement auction on your computer and, you don't know the people and you can bid on this stuff. This was back when we had lots of farms, almost twice, as many as we have today. And they were all over in your community, you saw these people all the time and you had to go to an auction and watch them sell off everything they owned. It was just really hard cause nobody else wanted to be in that position either. And so, I think the demand just completely dried up.

Sarah Mock: How could this demand have dried up so completely when just a few years prior farmland prices had been sky high? We'll dig into how farmland is priced and how it became such a problem right after this.

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Here's David.

<u>David Widmar</u>: One of the things that we set out to achieve was making a big impact for our audience, however big that audience was, and we knew that we were never going to have 10 million page views per month. That was never the goal. So, we were thinking about how do we build a business around this? If you're seeking the sponsorships or the advertisements in this content space, you build a model that's focused on how do we get more views? And so, we realized early on that there's a difference there. So, it's a paid for subscription. And then we started building. We started with the blog AEI, which was the free weekly blog, and then the Ag Forecast Network. And then [what] we realized is we need to provide even more content to help those following the Ag Forecast Network questions. So, the AEI Premium content not only helps you in what you're reading, but it also helps you think about the uncertainties, and helps tighten in your expectations, and helps you again, sort through all the noise and find the relevant signals.

<u>Brent Gloy</u>: And that's why I think the Forecast Network is so powerful because it's a framework for the questions that we think are most important in agriculture. And then what you'll see on the other side, where the content is, our analysis that are related to those questions. So, we're trying to find information and do analyses that we think are relevant to those questions and forecasting what we think are important questions in agriculture. And again, it's not this kind of clickbait, advertising-driven content. It's for people who really want to make themselves better professionals. And I think that's one of the things that we had always said as we thought about what AI Premium was, and who's it for? It's for people who want to be better in their careers, by learning more, improving their thinking, improving their thought processes, and gathering information that's relevant to that.

<u>Sarah Mock</u>: To learn more about joining the community and gaining access to those tools to help you grow as an ag professional today, visit AEI.ag. AEI premium - be your own guru.
And now, back to the show. It's worth taking a detour here to understand how farmland is priced. Why? Because if stable farmland prices are a relatively good indicator of stability in the farm economy, then understanding what factors can make prices stable, or not so stable is key to understanding how our modern farm economy is fairing. In other words, it's not enough to know that farmland prices are high or low or somewhere in between. We need to know why to be able to use that information to evaluate the market.

<u>Brent Gloy</u>: So, farmland values are driven by two key fundamentals. What the earnings from the farm are, not just today, but what we expect it to be into the future. So, if we have a net

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income or a net profit of operating that farm and we expect it to grow, you can think of the farmland prices should be increasing. But if all of a sudden, our expectations for the profitability of operating that farm declined substantially, then those land prices will fall. But the other key thing is those future earnings are really uncertain, so we have to discount them. We have to, we think about those as an opportunity cost. So, if you could invest your money today in a different kind of asset, what would that earn you? And you have to compare farmland to those other assets.

Sarah Mock: This next part gets a little complicated and we'll need two new tools in our economic tool belt to tackle it. The first is the idea of opportunity cost. It's a pretty intuitive idea and one that's common within economics and without. The idea that when we choose to do one thing, or to spend our money on one good, or service, or asset over another, we're not simply paying the dollar cost of that transaction. We pay another cost, the opportunity cost - or the cost of not doing all the other things, or buying all the other goods, services, and assets, that we might've bought with that same money. It can feel foreign to think of farmland as a financial asset that can be compared with stocks or bonds, but it is, and has been treated that way since long before the 1980s by individuals, corporations, investors, even governments. And that means farmland prices are tied to the prices of other asset classes in the wider economy.

Brent Gloy: So, when interest rates are really low, the net impact is that those future earnings don't get discounted very much. So, if I can only take my money and put it in a treasury bond today that pays 1% interest, and I compare that to farmland, and I think those future earnings are only going to earn me 1% invested in the bond market well, I don't discount my future earnings very much, so the present value of that farmland is very, very high. So, as interest rates go up, it tends to pull asset values down. So, we had two things going badly in the 1980s. One was that interest rates were going up rapidly. Those interest rates kind of pulled asset values down. And the second was that the earnings from farmland were going down at the same time. So, in the 1970s, we were thinking, you know, we're going to be exporting all these grains forever. We were in a period of shortage and there's just going to be a lot of profitability for operating a farm. And then the 80s come along with the grain embargo and other things and, all of a sudden, all that scarcity went out the window to abundance. And so, all of a sudden, the commodities that farmers were growing weren't worth much. And pretty much the only thing that was keeping the farmers afloat financially was government program payments. And so, those earnings kind of disappeared. At the same time, the interest rates were working against us in terms of valuations.

Sarah Mock: This builds right into the second economic tool we'll need, something called "The time value of money." Basically, this is the idea that a dollar you have today is worth more than a dollar you'll have tomorrow, and further, a dollar you have tomorrow is worth relatively more

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than a dollar you have in a year. There's a lot of reasons this is true many of them having to do with risk and uncertainty. Here's Brent with a simpler explanation.

Brent Gloy: One of the best professors at Purdue was a guy named Bob Taylor and he was a great teacher. He used to tell the story of the goose that laid the golden egg and say, "Well, suppose, … I have a goose and that goose a leg golden egg, every day, how much would you pay for that goose?" And everybody's, you know, immediately like, "Oh my gosh, I'd pay a ton." In fact, at the start of the pandemic, this was the homework assignment I gave it to my kids, because they wanted to learn about investing and I'm like, "Well, tell me how much you would pay for this goose?"
And, at first, they're like, "I don't get it. Whatever." And they started thinking about it a little more and then they come back, and they go, "How much do I have to feed the goose? How big is the egg? And how much does it weigh?" Kind of stuff. So, they just started to figure it out and they're like, "Well, how long is it going to live?" And see, I said, you got to figure all this out and you're bidding against your siblings, so you have to have a competitive bid if you want to own the goose. But the thing that they have, everybody has a hardest time understanding is that those eggs that are laid, let's say three, four years from now in today's dollars, aren't worth what an egg is today. You don't know what the price of gold is going to be, but if you held it constant, that golden egg a year from now, if you help prices constant, that isn't going to buy as much, necessarily as it does today. Interest rates are the reason for that. And as they go up, those dollars in the future are not worth near as much as they are today. So, you pay less for it.

Sarah Mock: To really stick a pin in what this meant for farmers during the worst days of the 1980s, farm income had fallen a lot and interest rates were way up. So, at a time when farmland was earning less and less, land buyers were expecting it to return more and more. The combination pushed farmland prices down fast. So, farmers who previously had had strong income and high value assets, suddenly had neither.

David Widmar: So, one element is how much rent can this farm generate? Or how much income can I generate from owning this piece of farmland? And when commodity prices fall, that declines. And so, all else the same, lower rent means lower farmland values. Okay. That was one element that led to the collapse in farmland values. The second element is, if this farmer is going to generate a $100, an acre in cash rent, what am I willing to buy that farm for? Am I willing to pay today to get $100 in cash rent into the future? And when interest rates started higher, all of a sudden, my willingness to pay for that $100 cash rent into the future decreases a lot. Warren Buffet likes to talk about how interest rates are like gravity to asset values. And so, when you turn up [00:27:00] interest rates or you turn up the gravity, the values fall, and that is an important lesson for farmland. And so, during the 1980s, there were two things that were happening unrelated, but yet at the same time and lower earning potential from the farmland. And "Oh, by the way, I needed a higher rate of return for my investment."

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And when you combine those two, they were both going in a direction that was pushing farmland values lower. So, it was the combination of those things moving at the same time.

Sarah Mock: So, this was it - interest rates were high, debt levels were high and suddenly farmland values were crashing. Not unlike the 2008 housing crisis, overleveraged farmers were suddenly underwater owing more on farmland in particular than the farms themselves were worth. And at the same time, having high interest payments on equipment and other investments coming due. As these issues started to mount towards a crisis, Brent says, it took time for bankers and others in the financial sector to realize what was happening, how bad it was getting.

Brent Gloy: Loan documents were documents. I mean, it wasn't electronic records, these were files, and they weren't updated all that often. People might make a loan and it goes in a file and it's a paper file. And, if you wanted to see how many of your farms hadn't made their loan payment, because almost all the loan payments were on annual basis. So, you could be looking at a serious, serious problem as a lender in those day and not even really - it would be hard to even get a good grasp of [it]. It's not like a computer where we can pull it up and say, "Okay, how many loans are due this next month?" But you had to go to the files and pull it all out and start working through it. So, it was a real different environment, I think on the lender side and so all of a sudden you had community banks all over the Midwest that were in serious financial trouble. They had been lending money on variable rates on farmland and had people that couldn't pay. So, they're in trouble. They're getting wiped out. The farm credit system was in serious financial trouble at that time. So, you know, you just had chaos. It was absolute chaos everywhere you looked.

Sarah Mock: The level of chaos brought on by the 1980s farm crisis does not bear many similarities to the current economic cycle. Though there has been some limited hardship in the ag sector in recent years, it's been nothing approaching the nearly 20% insolvency among farmers four decades ago. And we understand why there's those differences.

David Widmar: Without a doubt. If we would have experienced a large interest rate increase over the last three or four years in the farm economy that would have spelled a lot more challenge and difficulties to the farm economy today, due to the fact that farmland values would have adjusted even lower. And that would have put some challenges on the balance sheet, because right now we're using the balance sheet to help manage our way through lean income years. And so, we're adding debt and we're using up working capital. And if we would have lost even more of that asset on the farmland side, it would have been a big challenge.

Brent Gloy: I think is hard to comprehend just how tough those times were for everybody involved. You had people walking into banks and shooting loan officers and bank presidents,

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because they'd lost the family farm and it was bad, bad stuff. And it was really, really tough times and that's how widespread that kind of financial stress was. And I think these were really, really tough times.

Sarah Mock: So, what does that mean for today?

Brent Gloy: When people ask why haven't farmland values reacted the same as they did in say the 1980s? And in the answer is kind of nuanced because if you look at the Indiana data, farmland values have actually fallen for five straight years. I think they went up or are slated probably to go back up a little bit this year, but actually five years of decline is pretty unique in farmland value kind of data. The only other time we saw five straight declines was the 1980s. Now the differences are the magnitude of the decline is nothing compared to what it was in the 80s. And so, why hasn't that happened? And when I think back to the 80s, we had two things going against us - incomes were falling and interest rates were rising rapidly, not a little bit, a lot of bit. And when you think about today, incomes have fallen dramatically, almost on par with the income declines we saw in the 1980s. So, what's the difference? Well, interest rates instead of going up, have gone down and that's a big impact. If you were to take interest rates to a level like an increase that happened relative to the 1980s and increase them by that much, I think we see huge declines in farmland prices. But that's of course not what happened or what has happened so far. Interest rates have actually fallen. And so, to me, the whole interest rate story is the really big piece of why this time has been better.

Sarah Mock: But interest rates are only part of the story here. The effects of interest rates, whether they're high, low, or unstable are relatively predictable in an economic sense. What's much less predictable - the actions of humans involved, especially in the short term. These animal spirits, the emotional reactions of market actors also had a hand in lowering farmland prices.

Brent Gloy: The other reason they went down so much in the 1980s was because of panic and the panic as brought on by financial crisis. And so, just like in the housing market, when all of a sudden people realized, “I can't pay for five houses, I have no intention of paying for five houses and I need to sell it.” And they all wanted to sell them at the same time [so] who's left to buy them? Well, there's not nearly enough people to buy them. So, there was panic and all of a sudden, the banks are left in big trouble. And they don't have enough reserves to cover all these bad loans. And so, there's a huge financial crisis component to it. And we don't have any of that right now in agriculture… They call that like systematic risk - everything goes bad at the same time and then everybody's in trouble. As long as you don't have systematic failures, like we had in the 80s where there were just way too many loans out there on farms that people couldn't pay back. So, you've got all this land back on the market that the market doesn't want

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it. Nobody's there to buy it. Who's going to buy it? So, we haven't seen anything close to that today, and that's why the behavior has been very different.

David Widmar: So, if anything, interest rates have actually ticked lower, especially in the last few months and maybe over the last few years. And so, that's been on the positive side of the ledger. It's also worth noting that interest rates are at very low levels. And so, when we get to these really low, low levels - 1 percentage point or a 100-basis point movement in interest rates when you're at lows is a big relative movement. And so, we're at lows and we've been moving a little bit, but they're relatively large moves and put yourself in a lender’s seat, right. All of a sudden, you're looking at all of the farms that you're working with, and now they have loans on these farms, and now the debts are bigger than the assets, and how do you go about managing that? And you got to try selling them, and it's not just one farm. It's that systemic risk that's across a bunch of farms in your region. So how are you going to move all these farms at one time?

Sarah Mock: But it's not just differences in the wider economy that have led to different outcomes in recent years, changes in perceptions of agricultural land, mainly in terms of how it can be used and at the points where farming crosses over with other sectors, including oil and gas, recreation, even development have also left their mark.

David Widmar: One of the big differences is that in the 1980s, there was nobody very excited about buying farmland. And I think today there is some interest out there and some of it might be from farmers and some of it might be from other investors. I think that the biggest difference is just the general appetite in that. And in early 1980s, there was almost zero interest, very little interest in making those investments. And when they were making those investments, they needed to bid in a high rate of return, which was a low asset value. Today there's actually a lot of people looking for attractive rates of return. And so that sometimes makes ag a little more appealing.

Brent Gloy: if you go back, pension funds, insurance companies, were big investors in farmland in the 70s. They had some large portfolios of ag real estate. And then you had private individuals, and speculators, and a hot market will attract a lot of people to it. There was a lot of interest in farmland, but when the economic turmoil hit, it wasn't just the farm sector it was all over. That economic turmoil caused lots and lots of problems. And so, you know, you went from an environment where everybody wanted in, to everybody, [was] “Just give me my money and just get me out.” And we haven't had the, “Just get me out” moment in farmland right now. We had a huge run-up in farmland prices in the United States, but the kind of, there hasn't been that trigger that causes the panic to get everybody out of the market. I think there's always been development markets. There's always been the markets for hunting lodges and all that kind of stuff throughout history. So, I don't know that there's a huge difference in that

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framework today, as opposed to the 70s. I think it's just the overall climate of the market is much more orderly.

Sarah Mock: We've talked before about whether farm income comes more from commodity prices or from overall employment. The answer is employment, because of the 2+ million people defined as farmers in the U.S. most of them earn most of their household income off the farm. In other words, farmers farm, but most of them do something else too. But everything we've learned about farmland prices today suggests that commodity prices also play second fiddle here - not to employment figures, but to interest rates, another factor not tied directly to the farm economy. What does that mean? It means that farmland is an asset in the wider economy, used to harvest financial returns and grow wealth comparable to stocks, bonds, other financial instruments. In that way farmers don't just earn income from selling crops. They gain wealth over time through the appreciation of farmland, just as commodity prices have declined over the last century farmland values have risen consistently over the same period. In other words, farmers may farm, but those who own farmland are also investors.
Again, the idea of farmland does investment tool clashes magnificently with our preexisting ideas about farmers and land. Every story we've ever been told tells us that farmland is something approaching priceless to farmers, a treasured heirloom endowed with personal, emotional, and historical value. That may be true, but everything we've learned today tells us that there's more than just clinging to tradition happening in the farm economy. Because farmland wasn't being bought left, right, and center on credit during the 70s for its emotional value alone. The exuberance of the time and the way that many farmers used farmland show that these were economic calculations. Farmland may be heritage for some but going into the 70s, and out of the 80s, and on to today it is undeniably also a financial tool use to accumulate and consolidate wealth.

Brent Gloy: One of my colleagues that produced tell a story, his farm management class, that they had a farmer come in and speak in the 70s and he would come in, and write a number, a big number on the bulletin board, and look at his watch, and start talking. And what he was talking about was how good things were in farming and how land values were just going up a lot. And at the end of the class, he'd look, and he had figured out - on a farmland was going up 15% a year - how much his net worth at increased in the last hour that he was talking to the students and it was a big number. And I think that was this kind of hysteria when things seem that easy, they rarely end well. And so, there's just a lot of almost irrational exuberance, but I don't think at the time people thought of it that way. There were lots of reasons that made a lot of sense to people to think that farming was going to, I continue to get better.

David Widmar: When things are growing at a rapid rate and you have a lot of inflation in the economy. It leaves this FOMO - it's fear of missing out, right? And so, if you don't get in and you don't buy this tractor today, if you don't buy this piece of farmland today, if you don't get this

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asset secured today, you're not going to be able to get it next year at a reasonable price. It's going to be worth more later. It's going to be more expensive, more valuable. And I think part of that was a lot of that was inflationary - you get it now, and you can get it financed, and you can take some control of that. But inflation really impacts our decision-making process and I think that was part of the situation. If people were calculating how much their net worth was increasing per hour, right. It was this sort of, I better get, take advantage of the opportunity before it slips away. And that's not something we've experienced in recent history. What's really hard to think about is how the role of significant double-digit inflation goes into impacting how individuals buy things such as capital assets.

Brent Gloy: The only thing that I think is even seemingly comparable is when the housing boom took off. But it was one of those deals where I remember trying to buy a house when I was a new professor at Cornell and going and looking at a house and having the house just come on the market and have five people put in offers, many of them well over the asking price. It was just a different kind of mentality. And of course, that didn't end well, either. The other kind of thing many of us can remember was the internet, the tech stock bubble of the 2000s. When we had companies going public all the time with no earnings and that being a badge of honor and prices just seemed completely disconnected from reality.

David Widmar: And even more recently, right? Sometimes you see the same behavior more recently in the venture startup world - a lot of money going to companies that have big ideas, and big plans, and they're pre-revenue, right. They're still working out the big ideas. And so, in this idea of we're going to fund these for the years while it takes them [or] maybe the decade for them to scale up and get to the point where they're sustainable and they can go for that IPO.

Brent Gloy: Of course. Some of those will turn out to be spectacularly successful. And what those people are betting is that there's enough winners in there to justify the losers and they may, or they may not. And I think even today though, the stock market is a pretty, I don't want to say, bubbly, but it's, you even wonder how much sense some of this makes in this environment.

Sarah Mock: Today farmland continues to be used as a financial asset, not just by outside investors, but by farmers as well. Since the 1980s, the U.S. farm economy has shed another 200,000 farmers. And those who remain are overwhelmingly better capitalized, earning higher incomes, and in a more stable financial position - in part because of low interest rates today - than farmers were in the 1980s. In other words, their investment in farmland financial assets largely has paid off. And this is true, even despite a decline in incomes earlier this decade.

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David Widmar: So, we've been calling this a margin squeeze of 2014 through 2018, 2019 was a margin squeeze. Whereas there were negative or very little economic returns in the crop budgets and the livestock budgets and so we were in a low-income environment and producers were needing to add more debt and use some of the working capital from their balance sheet to meet all their obligations. And so, you take the income and still needed to make the family living. They still need to service their debt. And so that was similar to what we saw in the early 1980s, that squeeze on returns, that squeeze on the income statement and the challenges of meeting all the financial obligations that the operation and the family had. What's very different today is we can continue to add debt to the balance sheets over the last few years. Farmland values, while they've adjusted lower, are still, in good shape. The balance sheets have held up and that's been a really good improvement. And also, the lending environment, the environment in which we're servicing debt today, versus where we were in the 1980s is dramatically different. So, we had lower interest rates. We can, we're churning our debt out over considerably more months or years in some cases than we were in that timeframe. And so, again, there's some rhyming, there's some similarities, but also there's several differences.

Sarah Mock: In public discussions we hear about whether today's ag economy is similar to the 1980s. The stability of farmland prices is one of the key pieces of counter evidence often pointed to today, to argue that we are more stable than we were in the 1980s, because the fundamentals of the market are good. The misleading thing about this conclusion is one of the fundamentals of farmland values is interest rates, and though interest rates are low now, and have been falling since the 1980s, hitting record lows every year since 2010, interest rates are not a market-driven reality that offer insight on the underlying value of assets.
Interest rates, as we've learned are largely set by the Federal Reserve, so the reality is the fundamentals of the farmland market are only good while we continue to live in a perpetually low interest rate world. How likely is that? What kind of situation might occur, where the Fed might feel that raising interest rates would be in the best interest of the rest of the economy? These are questions worth asking, not least of which, because they're usually [when] we think about the cost of high interest rates. There are also benefits for investors and savers, which many people, and farm businesses even, are.
The bottom line is low interest rates. It's likely won't last forever and preparing for a time when things might look different is important. If 2020 has taught us one thing, it is that the most absolutely unexpected occurrences can and will eventually happen. Despite 40 years of declining interest rates eventually that's likely to change. What will cause that turn is hard to predict, but what it would mean for farmland prices and the farm economy is not. It would be devastating. It would likely lead to federal programs even bigger than the ones we've seen over the past three years. We know because of the model we have of how the USDA stepped in, in the 1980s to try and save a sector on the brink of total collapse. How did USDA do it? That's next time on Escaping 1980.

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David Widmar: Until then please rate, review and subscribe wherever you listen to podcasts. Thanks again for joining in. Brent and I would like to thank the people who've made this episode and the podcast series possible. First, the AEI Premium subscribers. Second, a huge thanks to the show's and series' producer, editor, and co-host Sarah Mock. And finally, the rest of the AIT. This team has been working remote since, before it was popular. A special thanks to Megan, Sarah H., Jeff, and Aerin. Thanks, and so long.

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