CHAPTER TWO

> Farmers have very few options available for financing long-term investments in capital assets. They must currently make long-term commitments based on short-term information about volatile markets. Few instruments exist through which they can share the risk of such decisions with other investors (Bill Duke, President, Western Canadian Wheat Growers Association, Issue 10:8, 4-3-87).

FARM FINANCE

A. Defining the Problem

Canadian agriculture experienced a period of relative prosperity throughout the 1970s. Farm incomes increased sharply early in the decade and remained high by historical standards, fueled by strong commodity prices and expanding world markets. The industry was characterized by heavy capital investment, rapidly rising land values and increasing reliance on debt financing, which resulted from favourable income prospects and low real interest rates.

As the decade came to a close, few farmers, creditors, or farm finance advisors expected that by late 1981, interest rates would reach unprecedented high levels, that commodity prices would subsequently fall as production outpaced demand on a world scale, and that farm asset values would begin to decline. The combined effects of restricted cash flow, record high interest rates, and eroding equity generated widespread financial stress in the industry, particularly for highly leveraged producers.

Significant increases in debt refinancing activities, accounts in arrears and financial failures since 1980 provide strong evidence of the deteriorating financing situation throughout the industry. Successive years of drought in 1984 and 1985 and deterioration in international commodity market conditions have had an especially devastating impact on income and thus financing conditions Canada-wide, particularly in western Canada.

Quantifying the true depth and extent of farm financing problems among farm businesses must be done with caution: no one financial indicator is sufficient to describe the extent or nature of farm financial problems or a farmer's ability to meet his or her debt servicing requirements. Both Agriculture Canada and the Farm Credit Corporation have estimated the number of farms in financial difficulty by focusing on debt servicing capacity and performance. These two sets of estimates are useful indicators of farm financing difficulty because they both focus on debt servicing.

The Farm Credit Corporation's estimates are based on a survey of farmer financial statements; Agriculture Canada's estimates are based on a survey of creditors' views on the severity of clients' debt servicing problems. Agriculture Canada's estimates are about 10 months older than the FCC's.