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What Governs Farm Land Prices?

Research studies by the USDA and the state agricultural experiment stations have helped to pinpoint the forces that have been operating in the land market, both as to their existence and the nature of their effects.

by Melvin G. Blase

Farm land values generally have been rising throughout the past 20 years. The rise continued during the 1950's - even though net farm incomes were dropping in most of the 50's.

What are the factors and forces that have been influencing farm land prices? The same factors probably will continue to influence farm land prices in the future. Research studies by the USDA and the state agricultural experiment stations have helped to pin down the forces that have been operating in the land market, and the nature of their actual effects.

There have been factors with positive and ones with negative influences on farm land prices. Let's look at them classified in terms of the "plus" or "minus" influences that they've had on land values during the past 10-20 years. There's some danger in this classification, however, in attempting to apply it to the future.

"Plus" Factors...

Let's look first at some of the general factors that have been at work to increase farm land values:

- Inflation psychology and expected future increases in capital value. These are different but related. Inflation is the upward movement of the general price level without a similar increase in our national productivity. During periods of inflation investors tend to prefer stocks, farm land, and other securities whose prices go up with inflation. The idea that land is a good hedge against expected continued general inflation has given some over-all stability to the market.

- National economic growth...
and development and population growth. Even though farm production has outstripped the demands created by these forces, it appears that both have acted to provide bases for higher land prices.

+ Land "hunger." This is perhaps an oversimplified term to describe several forces or ideas at work. In the absence of further frontiers, there's the idea that, at least someday, we'll be faced with a land shortage. This, plus the tangible aspects of land as an investment and the idea of the inherent goodness of land, has resulted in this loosely described "land hunger" and desire for ownership among farm people.

These are all general and underlying forces that, in one way or another, have worked either to increase or at least to provide an underlying firmness for land prices in the past 20 years. While it's difficult to estimate the extent of the influence of any of these factors, the direction of their influence is more certain. Some of these involve psychology as well as fact. A change in psychology could turn the direction of their influence the other way.

Now let's turn to some of the more specific forces that have had an influence on increasing farm land prices during the past 20 years:

+ Demand for farm enlargement is by far the chief specific force currently in the upward pressure on land prices and is related to or has a bearing on the following factors. More and more farm sales involve farms or tracts of land to be added to existing farms. The force here is mainly economic as individual farm operators attempt to achieve a more efficient "mix" of resources — spreading their management, labor, machinery, etc. over more acres.

+ Entry into agriculture. This is related to the first factor. As average farm size increases, there are fewer opportunities for prospective farm operators. Those seeking entry tend to bid up the price of land along with the efforts of established operators to enlarge their existing farms.

+ Nonfarm investors. Purchases of farm land by nonfarm investors has traditionally been regarded as an important factor in the land market. But the relative importance of this phase of demand is questionable on the basis of the evidence available. Its influence undoubtedly has been positive to some degree, but it's doubtful if a reduction in this demand would have much influence in forcing land prices downward.

+ Financial position of older operators. This seems to be related to the forces of farm income mentioned later. Apparently many older operators — as the result of good incomes in the late 40's and early 50's — are in a favorable position to compete in the land market for farm enlargement. Another way of looking at it: Many of those who recognize the need for farm enlargement are in a favorable position to do something about it and aren't, on the other hand, forced to sell because of weak financial position.

+ Land for nonfarm uses. The demand for farm land to be converted to nonfarm uses is of only slight importance in total. But it has been an important force in localized areas, particularly in areas of concentrated urban and industrial expansion.

+ New technology and resources in agriculture have tended to reinforce the rise in land prices in two ways. (1) They have made it possible for one family to profitably handle more acres, thus contributing to the demand for farm enlargement. (2) Because of accounting difficulties, the return from new technology and capital resources is often "credited" to land as such. Land, of course, must be credited for its capacity to absorb added inputs productively. But the added technology and resources have made the productivity possible. Fertilizer, improved machinery, improved crop varieties, etc., for example, have helped to make formerly unproductive soils suitable for many profitable farming operations.

+ Changes in methods of land transfer have had some positive influence on the increase in land prices. Low-equity financing, such as purchases with land contracts, as an example, has made it possible for some buyers to enter the market and add to the effective demand who couldn't have done so in the absence of low-equity arrangements.

+ Fewer farms for sale. This factor more or less follows as the result of increasing average farm size. The demand for farm enlargement continues as farms, meanwhile, become fewer.

"Plus" and "Minus" . . .

+ and — Farm income could be expected to have a major influence on farm land prices. But, at least during the past 20 years, it has been subordinated to or "drowned out" by other factors. Favorable farm income (when present) during this period seems to have added emphasis to the upward pressure on land prices. But the land price rise continued also in years of unfavorable farm income. While erratic in effect in the short run, the influence of farm income may be "lagged" and may be much more pronounced and important in the long run — given extended periods of either favorable or unfavorable farm income.

+ and — Weather. The influence of good and bad weather has been something like that of favorable and unfavorable farm income — erratic. But the influence of weather on land prices during the period appears to have been both more immediate and more localized. Like farm income, an extended period of unfavorable weather could have a much more pronounced effect in the area(s) concerned.

"Minus" Factors . . .

Now let's consider some of the specific forces that have tended to decrease or retard the rise in farm land prices during the past 20 years:

— Higher interest rates. There seems to be little question that higher interest rates had some
downward influence on land prices. The forces of this influence and of the following "minus" factors simply have been much more than offset by the "plus" factors during the past 2 decades.

— "Tight money" has had about the same kind of influence as higher interest rates in keeping some buyers off the market.

— Uncertainty about government programs, despite the positive force of government programs generally, shows up in some research results as one of the factors tending to retard the increase in land prices in recent years. The extent of its influence on land prices isn't known, but this uncertainty has been with us in the past and is likely to continue in the future.

Can We Predict?

No — especially when it comes to specific tracts of land. Here, with the general land market as a base, buyer and seller "make their own deal." Taken all together, however, the weight and number of the "plus" factors indicate no immediate or serious break in farm land prices.

But remember that the "plus" factors outlined are classified by the over-all influence they've had in the past 20 years, and some could become "minus" factors with a major change in psychology. The best bet is to consider each of the factors on its own merit and in relation to the others. As to possible changes in mass psychology, your guess is as good as ours. This article merely outlines some of the factors that research has tied down as having some influence — positive, negative or erratic — on land prices during the past 20 years.

Regardless of the causes of the increase in land prices, there is one other observation to make: The rise in land prices, now coupled with decreasing farm incomes, is tending to make it increasingly difficult to pay for land from farm income. This, in turn, tends to increase the pressure to use the land in the most efficient resource combination possible.

TO OVERCOME the surplus problem, it's likely that most of the adjustment will have to be in land—at least in the short run and, perhaps, even in the long run. One way or another, enough land will have to come out of crop production to curtail our rapidly increasing surplus stocks.

The other main alternative would be to expand demand rapidly enough to use all that agriculture can produce as well as to absorb surplus stocks. But it appears that little short of a miracle could cause demand to expand this much. Improving demand — while it has some merit as a much longer-run solution — just isn't likely to handle our problem within the next 10 years or more.

Many types of production control programs have been suggested: production quotas, an expanded soil bank or conservation reserve with land in all regions taken out of production, land retirement on a regional basis, land use easements, marketing quotas and many others.

All of these proposals need careful consideration to find out which would be best for holding output in line with demand over the next few years. We need to know several things about each of them—their cost; their acceptability; the burdens placed on communities; their fairness to producers who participate in them; the extent to which, as short-run policies, they contribute to the long-run problem, etc.

Considerable research is underway at Iowa State on the various types of production and supply adjustment problems. Such studies are difficult and time consuming to provide sufficient detail for all of the different areas of the country. Progress in research methods, however, permits analyses for the country as a whole. This article reports on the results of our analysis of one of the al-