Federal Legislation: Agricultural Credit Issues and Institutions

B. L. Ahrendsen

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INTRODUCTION

Farm bills historically have not been a major source of direct legislation affecting agricultural credit availability and finance. The most recent farm bill was the Food, Agriculture, Conservation and Trade Act of 1990. Two titles of the 1990 Act had a direct effect on agricultural and rural credit: Title XVIII on credit and Title XXIII on rural development. Most of the other titles of the 1990 Act have an indirect effect on the finances of agricultural producers. For example, Title XXII on crop insurance and disaster assistance has an indirect effect on agricultural credit. Although the legislation in the 1990 Act was not unimportant to the people concerned with agricultural and rural credit issues, other legislation related to credit issues passed since 1985 has been more far-reaching and is highlighted in Table 1. This legislation includes phasing in interstate banking, reregulation and reform of commercial banks and thrifts, reform of the Farm Credit System and its regulator the Farm Credit Administration, special bankruptcy treatment for family farmers, and special loan programs for beginning farmers.

Perhaps even more influential in its effect on the rural economy is macroeconomic policy originated at the national and international levels. Macroeconomic policy can simply swamp the effects of farm bills and other legislation targeted at agriculture (Schuh, 1991). Examples of macroeconomic forces that

Table 1. Legislation significantly affecting agricultural and rural finance since 1985.

Year	Item
1985	Farm Credit Amendments
1986	Farmer Bankruptcy Act (Chapter 12) Farm Credit Amendments
1987	Farm Credit Act of 1987
1989	Financial Institution Reform, Regulation, and Enforcement Act (FIRREA)
1990	Omnibus Budget Reconciliation Act
1991	FDIC Improvement Act (FDICIA)
1992	FCS Safety and Soundness Act Beginning Farmer legislation
1993	Chapter 12 provisions extended to 1998 Omnibus Budget Reconciliation Act
1994	Community Development Financial Institutions Act Interstate Banking and Efficiency Act North American Free Trade Agreement (NAFTA) Crop Insurance Reform The Department of Agriculture Reorganization Act General Agreement on Tariffs and Trade (GATT)

Source: USDA, ERS, Agricultural Income and Finance/AIS-56/Feb. 1995.

overwhelmed agricultural legislation are high interest rates, a strong U.S. dollar and weak demand for grain and oil seed crops in the early 1980s. Agriculture is particularly sensitive to macroeconomic forces because of agriculture's large capital requirements and degree of asset fixity. The sensi-tivity will intensify as the United States and other economies become increasingly open because of trade and other international agreements.

The issues surrounding agricultural credit and the financial institutions serving rural America are highlighted in this study. It is essential to highlight the important agricultural finance issues and discuss the financial institutions serving rural America to have a better understanding of the agricultural credit environment and the potential impact of future credit legislation. The first two sections highlight some of the important agricultural finance issues of the 1980s and 1990s. The third section discusses the different agricultural lenders and how previous legislation has affected them.

AGRICULTURAL FINANCE ISSUES OF THE 1980s

It is important to consider what happened to interest rates in general and farm mortgage rates in particular during the 1980s. The real farm mortgage rates of the 1970s, that is farm mortgage rates adjusted for inflation, were relatively low and, in fact, were negative for several years (Figure 1). These

rates were followed by the high nominal mortgage rates and the high real mortgage rates of the early 1980s. The low mortgage rates encouraged agricultural investment in the 1970s, which increased farmland prices and other farm asset prices. The high mortgage rates in the 1980s supported a strong U.S. dollar, which in turn tended to reduce the export demand for farm commodities. High interest rates also contributed to the downward pressure on farmland values, which deteriorated the collateral position of agricultural lenders and the credit position of farmers.

The demand and supply of grain and oil seed crops was an issue of the 1980s. The United States experienced a sharp reduction in the rate of growth in domestic and foreign demand for food and feed grains and oil seed crops. At the same time, the supply of these crops was continuing to increase. Excess production capacity was an issue. Too much land, machinery, and labor were available relative to the domestic and foreign demand for grain and oil seed crops. The acreage reduction program (ARP) and the conservation reserve program (CRP) are government programs that were partially designed to address this issue by taking farmland out of production.

Farmers experienced insufficient cash flow and high debt-to-asset ratios in the early and mid-1980s, which contributed to high financial leverage. Financial leverage is often measured by the debt-to-asset ratio and is an indicator of financial risk. Two forces caused the debt-to-asset ratio to increase: increases in debt and decreases in asset values. First, debt levels increased because farmers had used debt capital to finance their investments and because farmers used debt capital to cover the cash shortfalls they were experiencing in the early 1980s. Second, farmland values, which currently comprise approximately 75% of the value of total farm assets, as well as other farm asset values plunged in the early and mid-1980s. The net result was an increase in the debt-to-asset ratio and, therefore, the level of financial risk of farmers (Figure 2). The changes in debt-to-asset ratios were severe in states that were highly dependent on agriculture. For example, Iowa nearly doubled its debt-to-asset ratio from 1980 to 1985, and Arkansas experienced an increase to a lesser extent but still more than the increase the United States experienced over the same period (U.S. Department of Agriculture, various years).

The decreases in asset values caused large capital losses in the 1980s that eroded all farmers' equity positions and pushed many highly leveraged operations into insolvency. Farm assets for the United States had increased throughout the 1960s and accelerated in the 1970s before peaking in 1980 at $983 billion (Figure 3). Assets are divided into those financed with equity and those financed with debt. Farm equity followed an upward trend with farm assets and also peaked in 1980. However, farm equity, like farm assets fell from 1980 through 1986. Since 1986, farm assets and equity have resumed their upward trend but at a rate more comparable to the 1960s rate than the 1970s rate.

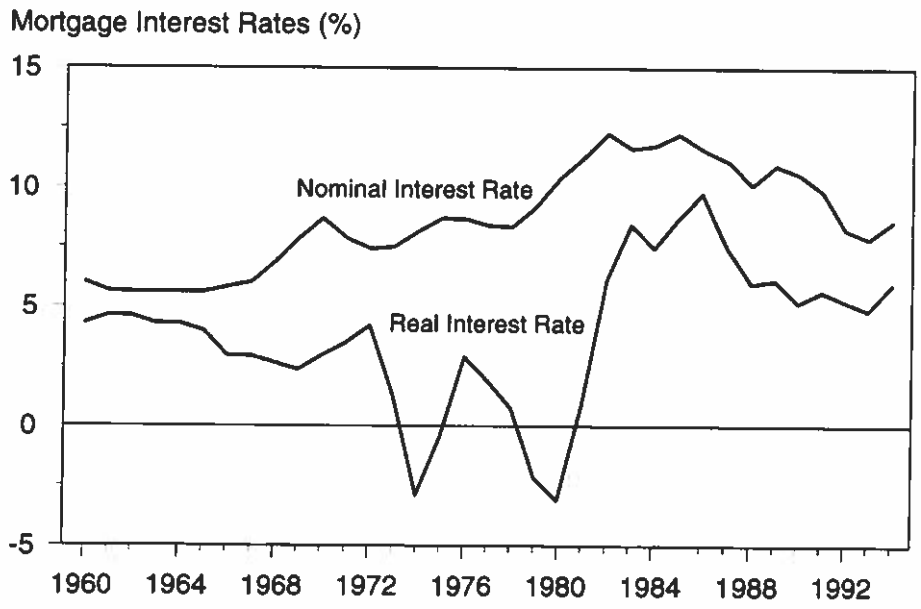

Figure 1. Nominal and inflation adjusted farm mortgage interest rates.

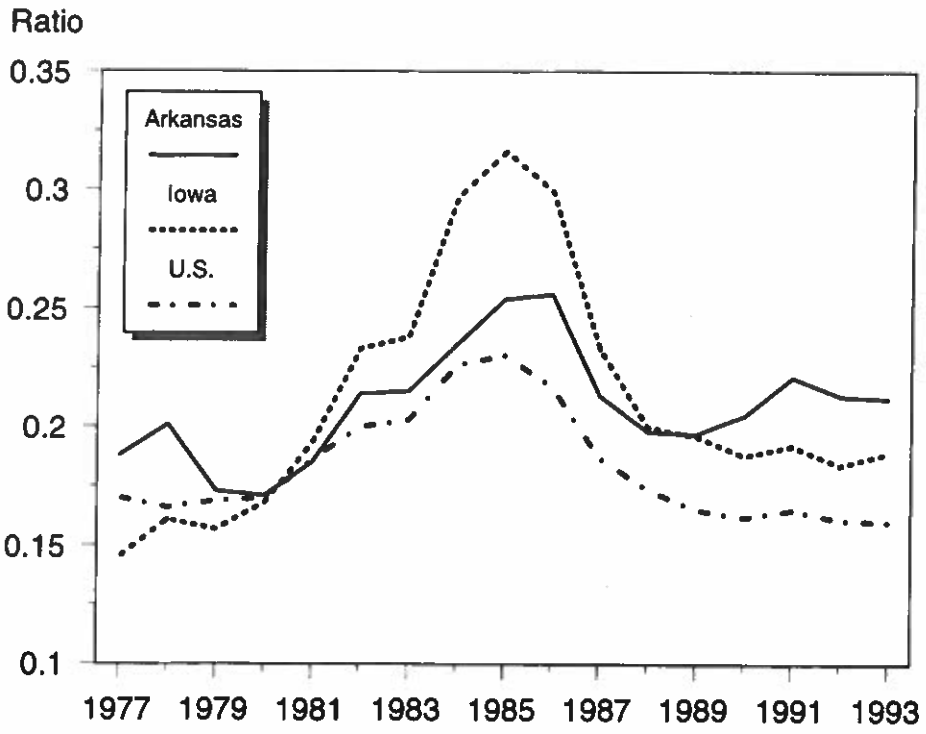

Figure 2. Debt to asset ratio: United States, Arkansas and Iowa.

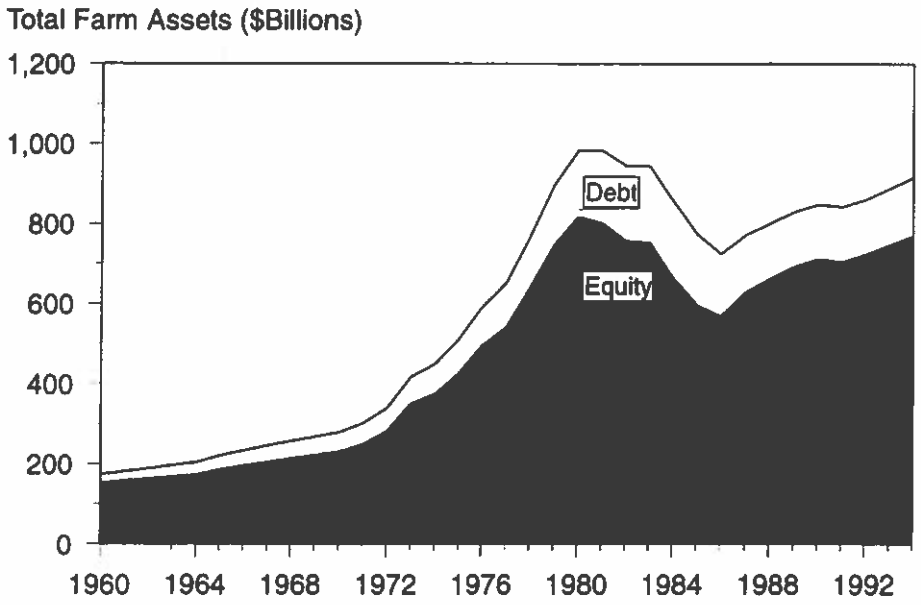

Figure 3. U.S. farm assets.

The picture is much different, however, when U.S. farm assets and equity are adjusted for inflation (Figure 4). Farm assets and equity when adjusted for inflation peaked in 1979 and started a decline that would last through 1992

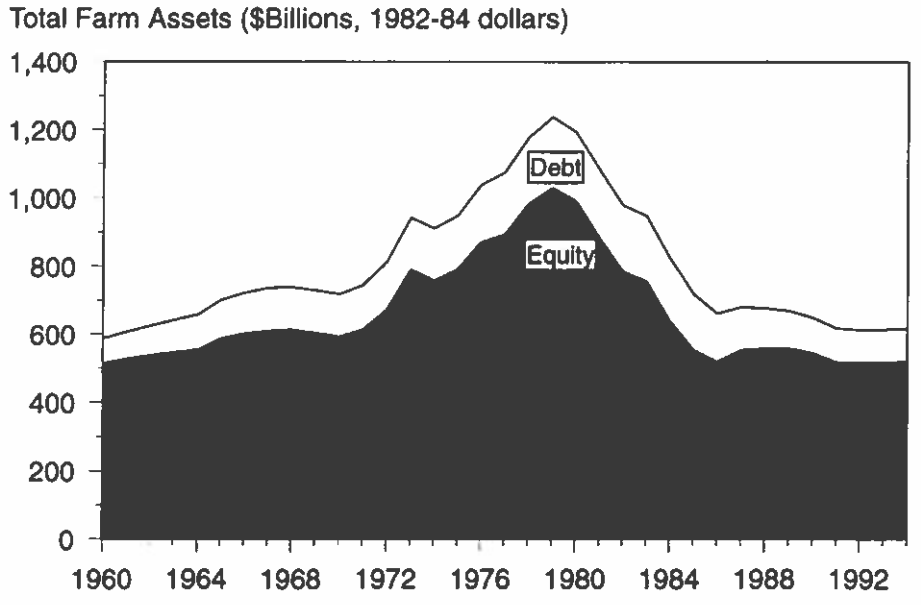

Figure 4. U.S. farm assets adjusted for inflation.

except for a one-year increase in 1987. Farm assets in 1995 are projected to be about the same as they were in 1962 when adjusted for inflation, and 1995 farm business equity is projected to be more than 2% less than 1962 farm business equity when adjusted for inflation (U.S. Department of Agriculture, 1995). Only over the past two years have U.S. farm assets and equity experienced slight increases in real terms. However, the forecast for 1995 is a reduction in real equity for the United States.

Debt concentration is another issue. Approximately 20% of farmers owed 50% of the farm debt outstanding in the 1980s. These were the farmers that experienced the most financial stress, and some were forced to leave farming. Although many farmers had low debt levels, most farmers experienced decreases in equity levels.

Large changes in farm debt and market share occurred among agricultural lenders during the 1980s. The farm debt owed to the five major U.S. farm lender categories—commercial banks, Farm Credit System (FCS), vendors and others, Farm Service Agency (FSA), which was formerly the Farmers Home Administration (FmHA), and life insurance companies—dramatically declined from a 1984 peak of $194 billion to $148 billion in 1994, a 24% decline (Figure 5, U.S. Department of Agriculture, 1995). However, when farm debt is adjusted for inflation the decline is even more dramatic—a 46% decline over the same period (Figure 6). The bulk of the decline in nominal farm debt levels is from declines in farm debt held by the FCS, FSA, and vendors and others while commercial banks experienced a net increase in farm loans. As a result, the market share of individual lender categories varied throughout the 1980s.

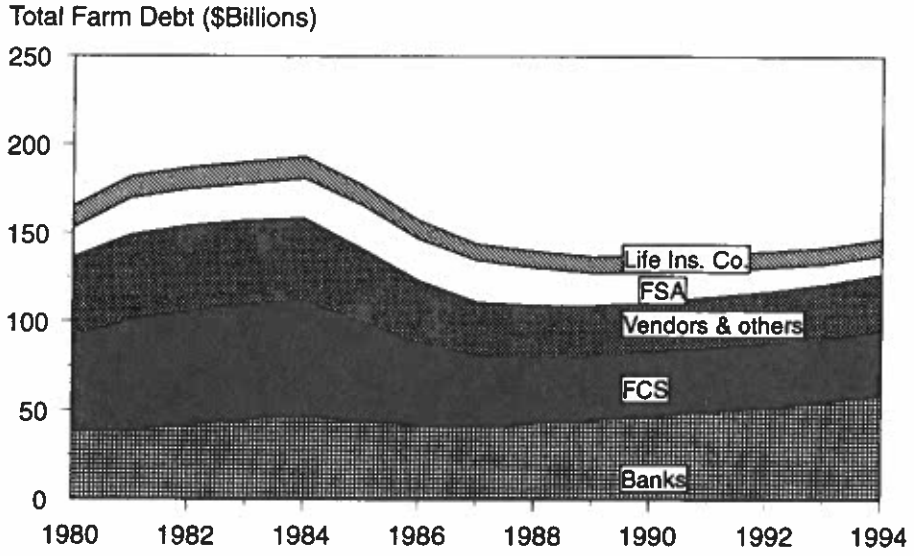

Figure 5. U.S. farm debt.

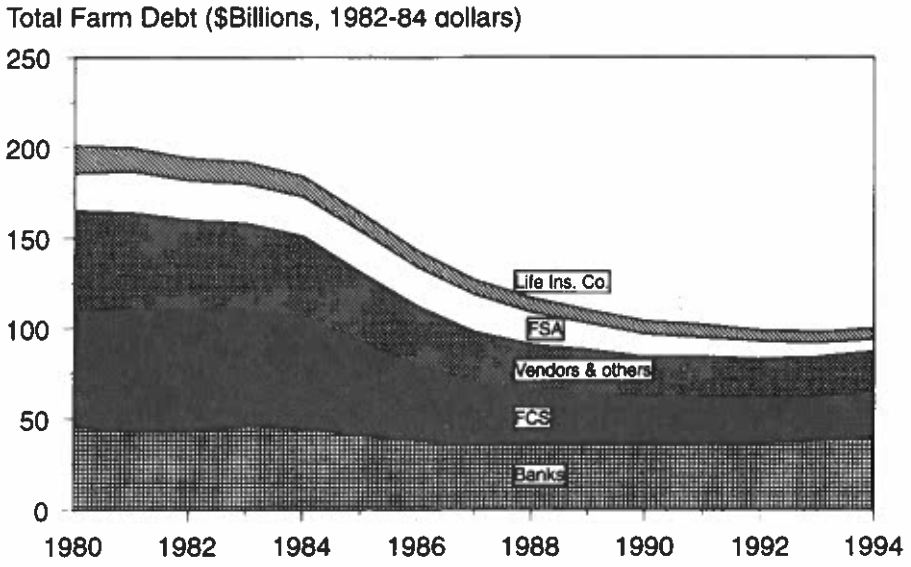

Figure 6. U.S. farm debt adjusted for inflation

For example, commercial banks, currently the largest agricultural lender, increased market share from a low of 21% in 1981 to a high of 40% in 1994 while the FCS lost market share from its peak of 34% in 1982 to 25% in 1994 (Figure 7). The FSA market share increased from 11% in 1980 to 16% in 1987 before retreating to 8% in 1994. Vendors and others decreased their market share continuously during the 1980s from 28% to 20% before experiencing modest gains since 1990, and life insurance companies' market share remained stable at approximately 7% (Ahrendsen et al., 1994).

The final issue of the 1980s was policy options. What were the policy options? Foreclosure moratoria, farm bankruptcy provisions, and credit subsidies such as low-interest loans and interest and principal write-downs; programs designed to increase farm incomes and stabilize farm asset values; assistance to and reorganization of agricultural lenders who were experiencing financial difficulties. All of these policies were enacted during the 1980s.

AGRICULTURAL FINANCE ISSUES OF THE 1990s

After the financial crisis of the 1980s, most farmers and agricultural lenders were left with cautious mentalities. Farmers and agricultural lenders were apprehensive to undertake new investments, although some became more innovative in their use of credit for investment purposes. For instance, some nontraditional lenders, such as input supply firms, developed mechanisms to provide a quick turnaround of loan decisions.

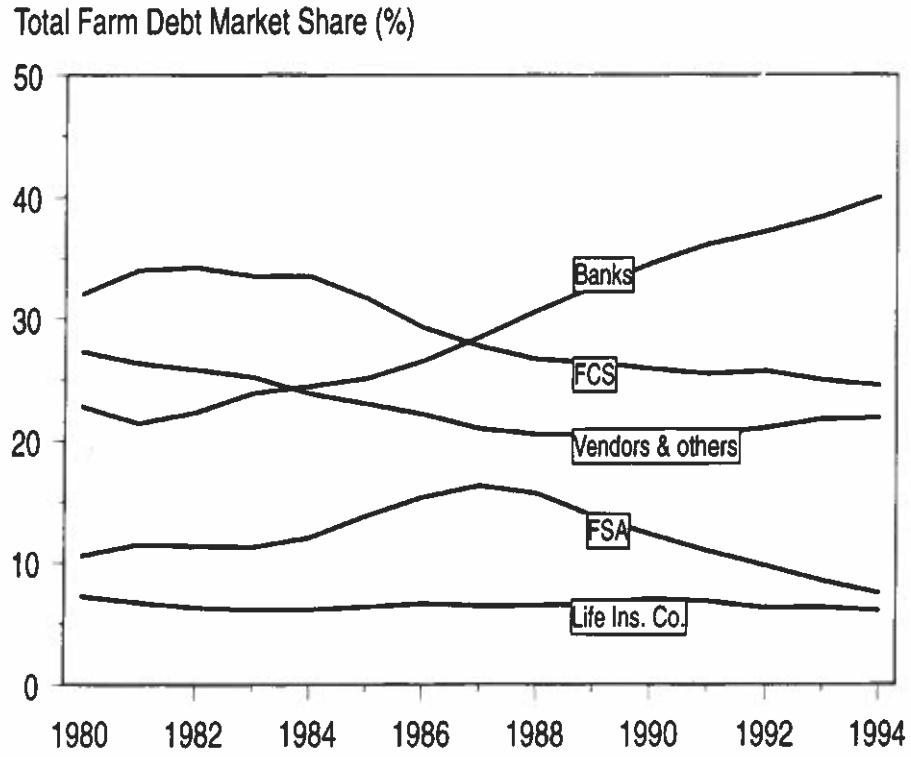

Figure 7. U.S. farm debt market share.

Relatively low interest rates is an issue of the 1990s. The 1993 farm mortgage rates were the lowest in 20 years, and real farm mortgage rates also were relatively low (Figure 1). Although farm mortgage rates in the 1990s are relatively low when compared to the 1980s, they are still higher than the farm mortgage rates of the 1960s.

Tight cash flow is another issue of the 1990s. Farmers continue to have high input costs, low prices and low price supports when adjusted for inflation, and increased flex acres, which, when taken together, has the net result of squeezing price margins and pressuring farms to either expand or seek off-farm employment to earn enough income to cover family living expenses.

A small proportion of farmers owing a large share of agricultural debt continues to take place in the 1990s as it did in the 1980s. The farmers of the 1990s are likely to be large, commercial farmers that have expanded their business and are able to limit their risk through the use of low-risk marketing plans, production contracts or other methods.

The debt-to-asset ratio, which is a measure of financial risk, has been relatively stable during the 1990s (Figure 2). However, a drastic decrease in farm income could have the same result as it did in the 1980s when debt levels

increased because of cash flow difficulties and asset values, particularly farmland values, declined because of decreases in income levels. As before, those declines in asset values would deteriorate the collateral position of agricultural lenders and the credit position of farmers.

As was seen earlier, there may be some small capital gains as a result of increases in farm asset values, but the capital gains may not be real gains after inflation adjustments are made (Figures 3 and 4). A related issue is an aging farmer population. The average age of farmers continues to follow an upward trend; however, the average age of people owning farmland has been increasing at a faster rate. Some of the people owning farmland are older farm operators, but many other owners are retired farmers. These issues have implications for legislation concerning beginning farmers and capital gains taxes as well as estate taxes and exemptions.

The farm structure of agriculture is experiencing increases in small farms, which often are dependent on off-farm income, and increases in mega-sized farms and a decrease in traditional, medium-sized farms. The farm structure also is experiencing an increase in the commercialization and industrialization of production agriculture. Evidence of this is the dramatic increase in the vertical coordination of agricultural production, particularly in the livestock industry. Vertical coordination is the alignment of direction and control across segments of a production/marketing system (King, 1992). Vertical coordination can be achieved through vertical integration—the direct acquisition and control of segments otherwise linked by open market transactions—or through formal contracts between otherwise independent firms.

Bank structure is also undergoing change. Banks have experienced efficiency pressures and regulatory changes that have promoted and allowed bank mergers and interstate banking. The banking industry and its market have changed. Banks may decide to loan to particular market niches such as commercial, traditional, and/or small farm loan markets.

The next issue is that the farm lending market is not experiencing growth, and some would characterize the market as having excess capacity. Commercial banks, the FCS, vendors and, in many instances, life insurance companies are considering ways to increase their share of a relatively static farm lending market. The public lender of the United States, the FSA, continues to decrease actual lending to farmers and offers 90% loan guarantees instead.

Another issue is that nontraditional lenders, such as input supply firms, have become active. Nontraditional lenders are subject to less regulation than traditional lenders such as commercial banks or the FCS. Traditional lenders argue for less regulation so that there is a level playing field for all agricultural lenders.

Equitable regulation of agricultural lenders is one of many regulatory issues. Farmers and lending institutions have become increasingly concerned

with the regulatory environment and environmental liability lawsuits, which might result in foreclosing on land in violation of environmental standards.

The United States is experiencing slow growth in domestic and foreign demand for many of its agricultural products. In theory, an increase in trade will assist a particular sector of a country's economy that has a comparative advantage, such as the farm sector of the United States. The General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA) should assist the U.S. farm sector. However, as world economies become more open, policies targeted at U.S. agriculture will become less effective, and macroeconomic policies will play a larger role.

The Federal Agricultural Mortgage Corporation, which often is referred to as Farmer Mac, is the secondary market for farm real estate loans and the portion of loans guaranteed by FSA. The purpose of Farmer Mac, which was authorized in 1987, is to give commercial banks and other lenders direct access to financial markets similar to that of Fannie Mae and Freddie Mac. Farmer Mac is under pressure to change and will be discussed in greater detail in the next section.

A difficult issue of the 1990s is that rural America continues to experience a deterioration of its infrastructure and an aging of its communities.

AGRICULTURAL LENDER CATEGORIES AND OTHER CREDIT ENTITIES

Agricultural lenders and other credit entities are important sources of credit to agricultural producers. Understanding the financial institutions serving rural America is crucial to a better understanding of the agricultural credit environment and the potential impact of future credit legislation on the source of credit to agricultural producers.

Commercial Banks

Commercial banks are the leading source of credit for U.S. farmers. Banks hold nearly two-fifths of the industry's total debt, the largest share among the five principal agricultural lender categories. About a third (3,689 as of June 30, 1994) of the nation's commercial banks are agricultural banks specializing, to some degree, in farm lending.[1] Most agricultural banks retain much larger agricultural shares in their loan portfolios and, therefore, remain sensitive to

[1] The Board of Governors of the Federal Reserve System classifies banks as agricultural if their ratios of farm loans to total loans exceed the unweighted average of the ratio at all banks on a given date (17.42% on June 30, 1994). The Federal Deposit Insurance Corporation criterion is a constant 25% ratio.

conditions in the agricultural sector of the economy (Ahrendsen et al., 1995).

Eighty-seven percent of agricultural banks are found in rural areas outside standard metropolitan statistical areas. Most agricultural banks are relatively small institutions: more than a third (1,351) have less than $25 million in total assets, and nearly all (99.5%) have less than $300 million in total assets. Despite their small size, however, agricultural banks hold over half of all bank-held farm debt.

Agricultural Bank Highlights. Agricultural banks in 1994 were profitable with a rate of return on assets equal to 1.2%. The benchmark for commercial bank profitability is considered to be 1.0%, and agricultural banks have exceeded this benchmark every year since 1988. Another measure of bank profitability is the rate of return on equity capital, which was equal to 12.4% in 1994.

Agricultural banks are well capitalized with a capital-to-asset ratio of 11.1% in 1994. These banks are more likely to withstand financial difficulties because of their strong capital position. However, agricultural banks generally have higher capital-to-asset ratios than other commercial banks because their lending is concentrated in one industry—agriculture—over a limited geographical area, and, therefore, agricultural banks are subject to more risk if agriculture experiences difficulty.

Bank liquidity is measured by the loan-to-deposit ratio, which was 62% in 1994. Although the loan-to-deposit ratio has been increasing in recent years, which generally indicates less bank liquidity and the availability of fewer loan funds, banks currently have more loan funding sources available to them than in previous decades because of access to secondary markets, bank holding company and correspondent banking relationships, interstate and branch banking, and Federal Reserve Bank seasonal borrowing privileges. The seasonal borrowing privilege makes additional funds available to banks during those periods when demand for short-term agricultural loans (operating loans) are large.

As was mentioned earlier, commercial banks are concerned with their regulatory environment. A concern of smaller commercial banks is how regulation or, in fact, deregulation, may promote the formation of larger banks. For instance, mandated reporting requirements in general promote larger lending institutions because there are economies of size in report preparation. Also, interstate and branch banking deregulation promotes large-sized banks because deregulation creates economies of size and geographical diversification opportunities, although the economies of size effect is generally found for only the smallest banks. In addition, relaxation of the Glass-Steagall Act of 1933, which limits bank activity in the insurance and securities industries, will allow banks to compete better with other financial institutions in providing financially related services. However, within the banking industry, relaxing the Act will promote the formation of larger banks because there are economies of size in providing financial services.

Although these regulatory and deregulatory actions have the effect of promoting the formation of large banks, recent legislation has simplified compliance of the Community Reinvestment Act of 1977 (CRA). Simplifying CRA compliance will assist all commercial banks, but especially banks under $250 million of assets because their regulatory reporting requirement is simplified to a greater extent than that of larger banks. The CRA was passed to encourage commercial banks and other depository institutions to help meet the credit needs of their communities (Spong, 1994). Again, another regulatory issue for commercial banks is that they want equitable regulation of various types of lenders to level the playing field.

Farm Credit System

After commercial banks, the FCS is the nation's second largest agricultural lender. The FCS holds about a fourth of the nation's farm debt and is commercial banks' chief competitor in farm lending. The FCS is a government-sponsored enterprise (GSE) and is owned by FCS borrowers, who hold an equity stake as cooperative members. Unlike commercial banks, which fund loan portfolios with deposits, the FCS obtains loanable funds from national money markets in which the FCS's GSE status gives its securities a pricing advantage.

History. The FCS has a long history that started with the Federal Farm Loan Act of 1916, which established 12 Federal Land Banks (FLBs) designed to make long-term real estate loans through Federal Land Bank Associations (FLBAs). A list of FCS institutions and abbreviations is in Table 2. The next major legislation concerning the FCS was the Agricultural Credits Act of 1923, which provided for 12 Federal Intermediate Credit Banks (FICBs) in the same locations as the 12 FLBs to discount (lend money) short- and intermediate-term notes executed with commercial banks and other lenders. However, this system of lending to rural areas did not have the intended effect, so the Farm Credit Act of 1933 established local Production Credit Associations (PCAs) with which the FICBs could discount notes. The PCAs then would make loans directly to farmers with funds from the FICBs. The 1933 Act also established 12 Banks for Cooperatives (BCs) to serve the financial needs of agricultural cooperatives and a Central Bank for Cooperatives to handle loans exceeding the capacity of the individual district bank.

A major source of legislation for the FCS was the Farm Credit Act of 1971, which increased and broadened the lending authority of the FCS. The Act increased the maximum loan-to-value percentage allowed by the FCS to 85% of current market value from 65% of normal agricultural value. It authorized loans on moderate single-family housing in rural areas and cities with populations of less than 2500. The Act allowed FCS to finance non-farmers providing farm services, such as custom work. The Act granted FCS the authority to provide financial services directly related to the farm, for example, business record

Table 2. Farm Credit System and related institutions.

Assistance Board:	The Farm Credit System Assistance Board.
Associations:	Cooperative lending associations including ACAs, FLCAs, FLBAs and PCAs
ACA:	Agricultural Credit Association
ACB:	Agricultural Credit Bank
Banks:	All Farm Credit System banks including FCBs, FICBs, FLBs, BCs and ACBs.
BC:	Bank for Cooperatives including Central Bank for Cooperatives and, after 1988, CoBank.
CoBank:	The National Bank for Cooperatives, established in 1989 following the merger of 10 of the 12 district Banks for Cooperatives with the Central Bank for Cooperatives. CoBank merged with the Springfield Bank for Cooperatives and Springfield Farm Credit Bank in 1995 to form CoBank, Agricultural Credit Bank.
FCA:	The Farm Credit Administration is an independent Federal agency that regulates the Farm Credit System.
FCB:	Farm Credit Bank—district bank created from the merger of the FLB and FICB in each district except Jackson.
FCS:	Farm Credit System
FICB:	Federal Intermediate Credit Bank
FLB:	Federal Land Bank
FLBA:	Federal Land Bank Association
FLCA:	Federal Land Credit Association
FAC:	Farm Credit Financial Assistance Corporation
Funding Corporation:	Federal Farm Credit Banks Funding Corporation
Insurance Corporation:	Farm Credit System Insurance Corporation
Insurance Fund:	Farm Credit Insurance Fund maintained by the Insurance Corporation
PCA:	Production Credit Association

services. It authorized FCS to make loans with variable interest rates, and it authorized credit lines. The Act broadened loss sharing among Farm Credit institutions. Finally, the Act authorized joint loans with Farmers Home Administration (FmHA) and correspondent relations with commercial banks.

The Farm Credit Amendments Act of 1985 gave the FCS's regulator, the Farm Credit Administration, considerable new authority to enforce corrective action in FCS banks and associations found to have deficiencies, including the power to issue cease-and-desist orders to prevent or stop unsafe or unsound practices or violations of federal laws or regulations; the power to levy civil money penalties against violators of regulations; and the power to remove or suspend officers and directors of FCS institutions for cause. Thus, the Act gave

the Farm Credit Administration regulatory powers comparable to those held by the Federal Deposit Insurance Corporation, the Federal Reserve System, the Comptroller of the Currency, and state banking authorities to supervise and regulate commercial banks (Lee et al., 1988).

The Agricultural Credit Act of 1987 required some mergers and requested other voluntary mergers among FCS institutions to increase efficiency. Although there had already been many voluntary mergers by associations, the 1987 Act required a merger of the FLBs and FICBs in each district to form Farm Credit Banks (FCBs). The Act also required the FCS to develop a proposal to consolidate the FCBs in the 12 districts into no fewer than six FCBs. From the first FCB merger in 1992 to the most recent merger on April 1, 1995, the number of FCBs has declined to seven (Figure 8).[2]

The 1987 Act also allowed for two new types of associations. The Act provided for FLBAs to form Federal Land Credit Associations (FLCAs), which would have direct long-term lending authority. Also, PCAs and FLBAs were given the opportunity to merge into consolidated Agricultural Credit Associations (ACAs), which would have direct short-, intermediate- and long-term lending authority.

The 1987 Act required the 12 district Banks for Cooperatives (BCs) to decide by stockholder vote whether to merge with the Central Bank for Cooperatives or remain separate (Barry et al., 1995). Ten BCs voted to consolidate to form a new National Bank for Cooperatives (CoBank). The BCs in the districts of St. Paul, Minnesota, and Springfield, Massachusetts, voted to remain separate. However, Springfield FCB, Springfield BC and CoBank have since merged to form CoBank, Agricultural Credit Bank.

Besides offering new organizational alternatives, the 1987 Act contained provisions affecting the capitalization of the banks and associations, making available federal financial assistance and creating several new features that included an insurance fund, borrower rights and loan restructuring.

The Farm Credit Banks and Associations Safety and Soundness Act of 1992 allowed BCs to finance rural water and sewer projects and FCS to underwrite municipal bonds for rural communities.

The lending authority of the FCS is restricted by its charter. The FCBs and affiliated associations are restricted to providing credit to farmers, ranchers and some businesses that furnish on-farm services to agricultural producers.

[2] Several associations have voted to receive funding and operational support from a FCB other than the FCB they have been affiliated with historically. Associations affiliated with Texas, FCB, include three PCAs in New Mexico, two FLBAs in Alabama, two FLBAs in Mississippi, and two FLBAs and one PCA in Louisiana. Associations affiliated with Western, FCB, include one PCA in Idaho. Associations affiliated with AgFirst, FCB, include one ACA in Ohio, two ACAs in Kentucky, one ACA in Tennessee, and one PCA serving Alabama, Mississippi, and most of Louisiana.

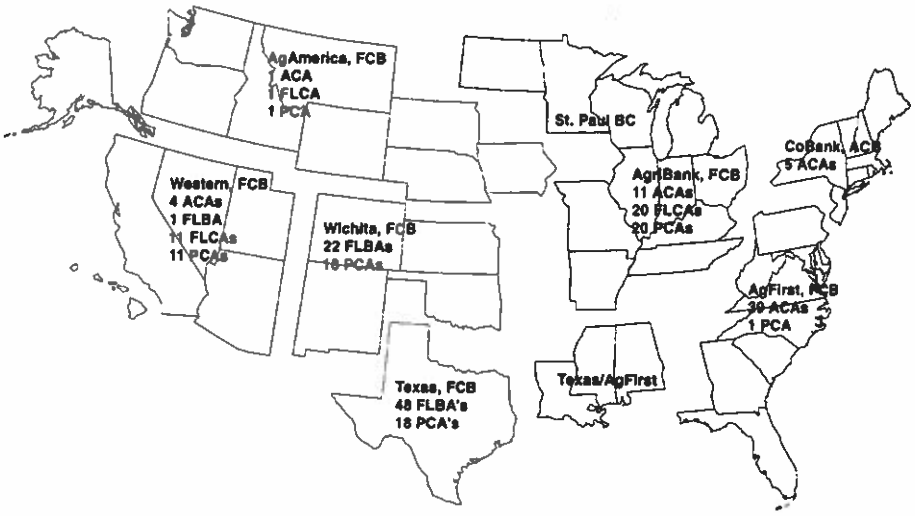

Figure 8. Farm credit system banks and associations: April 1, 1995.

Cooperatives engaged in the processing, handling, or marketing of farm or aquatic products, or in the acquisition of supplies or services for producers of such products, are eligible to borrow from the BCs, provided they meet minimum specified criteria. Many people in agriculture are seeking to expand the charter of the FCS. However, banking associations and others strongly oppose any charter expansion for the FCS.

The Federal Farm Credit Banks Funding Corporation is responsible for raising funds for the FCBs by selling three types of securities in the national financial markets: Federal Farm Credit Banks Consolidated System-wide Bonds, Medium-Term Notes and Discount Notes. The securities are purchased by private and public investors.

Vendors and Others

As a group, vendors, individuals, and others are the third largest source of credit for U.S. farmers, holding slightly more than a fifth of all farm debt. This group of lenders is widely diverse and includes retired farmers who provide credit to buyers of their farms and input supply firms that provide point-of-sale financing for their customers. Many vendors now consider their credit departments to be profit centers instead of extensions of marketing departments. Thus, vendors have become extremely competitive in the agricultural credit market.

Farm Service Agency

The next largest lender to U.S. agriculture, holding about a tenth of all farm debt, is the Farm Service Agency (FSA), an agency of the U.S. Department of Agriculture. The FSA makes direct, government-funded loans and guarantees

loans originated by private lenders to farmers who are unable to obtain credit elsewhere.

The FSA and a number of much smaller, state-supported lending programs share a social objective of assisting beginning, small, and other high-risk farmers and socially disadvantaged farmers, a mission that precludes most regulation for safety and efficiency. Significant losses in the FSA loan portfolio are an expected cost of the agency's mission. Competition with other lenders is blunted by the requirement that a loan applicant to the FSA must first be rejected by a private lender to be eligible for the agency's loan programs. In the 1980s, the agency shifted most of its activity from direct lending to loan guarantees to limit its losses and to take advantage of private lenders' greater efficiency in administering loans. For example, in 1982 only 1% of loan obligations were guaranteed compared to 68% in 1994.

The FSA is subject, however, to stringent rules enforcing the rights of the agency's borrowers. An extensive appeals process, including timely notification of appeal rights and decisions, is available to loan applicants and borrowers. Moreover, agency regulations provide for restructuring delinquent loans and write-downs or write-offs of loan principal to qualified borrowers.

History. The first name of the FSA was the Resettlement Administration in 1935, followed by the Farm Security Administration in 1937, and then the Farmers Home Administration (FmHA) in 1946. On October 13, 1994, the Consolidated Farm Service Agency was created. Farm credit programs were administered by Rural Economic and Community Development Services until October 1, 1995, when the programs were turned over to the newly named FSA. The FmHA ceased to operate with the signing of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 (P.L. 103-354).

Source of Loan Funds. The FSA grants two types of loans: direct and guaranteed. Direct (insured) loan funds are from congressional appropriations. The amount of direct loan funds obligated has fallen precipitously from $4,753 million in 1985 to $634 million in 1991, an 87% decline. The direct loan funds obligated for 1995 were $678 million. Guaranteed loan funds also are appropriated by Congress, but the source of funds are from private lending institutions, which are guaranteed up to a maximum of 90% by FSA.

Farm Loan Programs. The FSA has several different farm loan programs. Farm ownership loans (FO), of which 7% of outstanding principal was delinquent in 1994 (U.S. Department of Agriculture, 1995), may be used by family-sized farms to purchase or improve farmland and farm homes or refinance debt in which real estate is used as security for the loan (Lee et al., 1988).

Operating loans (OL), of which 23% of outstanding principal was delinquent in 1994, may be used by family-sized farms for any farm operating expense necessary to the success of the enterprise, including the purchase of live-

stock, crop inputs and machinery. The loan funds also may be used for family living expenses and refinancing debt.

Emergency-disaster loans (EM), of which 56% of outstanding principal was delinquent in 1994, may be made to established farmers, ranchers and aquaculture operators who have suffered property damage from a disaster in areas declared eligible for assistance by the president of the United States or the FSA state directors. Other emergency loans are economic emergency loans (EE) of which 40% of outstanding principal was delinquent in 1994. These loans were last made in the early 1980s.

Soil and water loans (SW), of which 17% of outstanding principal was delinquent in 1994, may be made to farmers and non-operator owners of land to promote conservation, development, and better use of soil and water resources and also for energy conservation and pollution control measures.

Although delinquency percentages seem quite high, they were lower in 1994 than they were a few years ago. The percentage of FSA principal outstanding that was delinquent decreased from a high of 34% in 1989 to 28% in 1994 (U.S. Department of Agriculture, 1995). The percentage of FSA active cases that were delinquent decreased from a high of 37% in 1988 to 23% in 1994. One reason for the reduction in the delinquency percentages is passage of the Agricultural Credit Act of 1987. The 1987 Act established rules for the restructuring of the agency's borrower loans. The restructuring included writing down or writing off borrower loans if the restructuring provided a lower cost to the government than foreclosure or forced liquidation.

Other rural loan programs that were formerly administered by FmHA include rural housing loans (RH), rural rental loans, and community loans such as water and waste disposal loans. These programs are administered by Rural Economic and Community Development Services.

Life Insurance Companies

The final major agricultural lender category is life insurance companies (LICs), which hold 6% of all farm debt as of 1994, primarily as farm mortgages. In 1994, 19 LICs held farm mortgages, but only seven were making additional mortgage loans. Although LICs are an important lender to agriculture, farm mortgages are a tiny slice (0.5%) of the LICs' total assets. The LICs fund their loan portfolios with premiums and investments from policyholders, who ultimately bear the risk of portfolio losses.

Commodity Credit Corporation

Another credit entity serving agriculture is the Commodity Credit Corporation (CCC). The goals of the CCC, which is a government corporation in the U.S. Department of Agriculture, are stabilizing and supporting farm income and prices, assuring adequate supplies of agricultural commodities, and facili-

tating distribution of commodities. The CCC carries out the P.L. 480 program, export credit sales (export enhancement program), and loans to farmers on commodities in storage.

State Governments

Many state government loan programs have emerged. Reasons for having a state loan program include perceived deficiencies in federal programs, protecting the family farm, assisting a sector of a state's economy, encouraging new types of agricultural enterprises, and providing capital for technological innovations.

One mechanism that state governments use to make loans is the link-deposit mechanism. A state's treasurer makes deposits of state tax revenues in approved lending institutions by purchasing, for example, certificates of deposit of commercial banks or bonds issued by the FCS. The deposit is "linked" to a specific use. For example, the deposit must be used to finance a beginning farmer. If the state makes the deposit at below-market rates, it is expected that the lending institution pass the savings to the borrower in the form of reduced interest rates. Since the borrower is usually of relatively high risk, the loans often are made at what would be normal to slightly below market rates for a borrower with average risk. The lending institution assumes all default risk.

Federal Agricultural Mortgage Corporation

The Federal Agricultural Mortgage Corporation (Farmer Mac) was authorized by the U.S. Congress in the Agricultural Credit Act of 1987 to be the secondary market for farm real estate and rural housing mortgages. Farmer Mac was formed to increase the supply of funds to the agricultural sector. However, Farmer Mac has had difficulty achieving an efficient size since most agricultural lenders have had adequate funds available to them to service loan demand. Thus, initial stockholder equity has continued to decline as operating losses have mounted. Farmer Mac II was formed as a secondary market for FSA guaranteed portions of operating and farm ownership loans, and Farmer Mac II has expanded to include some business and industry loans. Although the volume in this market is relatively small, the volume has continually increased. Life insurance companies have been active in Farmer Mac, whereas commercial banks have been active in Farmer Mac II. Some regions of the United States are beginning to experience some tightening of lending capacity by commercial banks. Additional tightening of lending capacity would benefit Farmer Mac. Agricultural lenders have argued for changes to Farmer Mac so that they may more effectively use the secondary market. These changes include authorizing Farmer Mac to pool loans itself rather than having others do the pooling and eliminating a mandatory 10% loan subordination.

CONCLUDING COMMENTS

The environment of the 1990s has been shaped by major upheavals in agricultural and rural finance that occurred during the 1980s, when after years of rapid expansion agricultural producers and capital providers were forced to abruptly retrench. Government and private entities began to reassess their involvement with farm and rural finance, laws affecting the industry were altered, a patchwork of state-sponsored programs emerged, and structural changes in banking and the FCS resulted in new strength but also uncertainty. Structural changes also occurred in agricultural production to include increased contract production and large-scale farming. Adding to the uncertainty for agricultural and rural finance is the uncertainty of the 1995 farm bill and other future legislation as well as the impact of international agreements on opening world economies. As world economies become more open, policies targeted at U.S. agriculture will become less effective, and macroeconomic policies will play a large role. However, legislation can still be used to make adjustments to U.S. agriculture.

Legislative issues for commercial banks include reducing their regulatory burden to permit a level playing field for all agricultural lenders and allowing commercial banks to offer more financially related services such as investment banking services. Like commercial banks, the cooperative FCS institutions want their regulatory burden reduced. In addition, FCS institutions want their charter broadened. Several recent proposals would broaden the FCS's charter to include agribusiness, expanded rural housing, and rural development lending and additional financial services. Although these regulatory changes, if enacted, will not necessarily assist the FCS to greatly increase its market share, the changes may assist the FCS adapt to how the farm and rural market structures are evolving.

Another area of legislative interest is the FSA. The FSA is the product of the recent reorganization of the U.S. Department of Agriculture. Legislation may be needed to work out any transition difficulties of the new agency. Other legislative issues for the FSA include streamlining the guaranteed loan procedures to encourage the use of the guaranteed loan programs by lenders, having sufficient direct loan funds available to adequately meet the needs of FSA borrowers, and deciding if the social benefits of the agency's credit programs justify the costs.

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