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What Should Be the Farm Credit Policy:
An Overview of the Problem and Options Available*

by

Dr. Mark A. Edelman**

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Abstract: Analysis of (1) the nature and scope of the current farm credit conditions, (2) the policy environment that led to current farm conditions, and (3) the probable consequences of the current policy options.

*Moderator's summary of Farm Credit Policy Workshop Proceedings held April 27, 1983. U.S. Senate Committee on Small Business, Subcommittee on the Family Farm. Washington, D.C.

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Credit Policy and the Family Farm
Workshop Participants

1. Senator Larry Pressler, Chairman
Family Farm Subcommittee, Senate Small Business Committee
2. Dr. Mark A. Edelman, Moderator
Agriculture and Public Policy Economist
South Dakota State University
3. Mr. Charles Shuman, Administrator
Farmers Home Administration
4. Mr. John Waits,
Assistant Director of Congressional Affairs
Farm Credit Administration
5. Mr. Eugene Severens
Center for Rural Affairs
6. Mr. Paul Sacia
Assistant Director Legislative Services
National Farmers Union
7. Mr. Lawrence Patnoe, Farmer
Raymond, South Dakota
8. Ms. Catherine Lerza
Rural Coalition
9. Dr. Emanuel Melichar, Senior Economist
Board of Governors, Federal Reserve System
10. Mr. Roger Blobaum
Blobaum and Associates

**What Should Be the Farm Credit Policy:
An Overview of the Problem and Choices Available**

by **Dr. Mark A. Edelman**
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Mr. Chairman, it has been my privilege to moderate this workshop on credit policy and the family farm and to contribute to the overall understanding of the policy choices available for solving the problems currently faced. Farm credit policy is of interest to all who are concerned about (1) the current farm economic conditions, (2) the continuing trends of increased farm size and declining farm numbers and, (3) the impacts of these trends on the potential for young people to enter farming, the ability of leveraged family farm operators to stay in business, and the viability of many rural institutions and communities.

The credit workshop was a success in that the testimony will assist members of the newly formed Senate Small Business Subcommittee on the Family Farm in establishing an initial agenda for action. The testimony presented by the participants in the workshop adequately reflects four fundamental concerns:

1. What is the nature and scope of the current farm credit problems?
2. What environment led to the current farm conditions?
3. How much federally subsidized credit should be given and who should receive it?
4. What is the appropriate action for those in financial trouble and what should be done to prevent further difficulty?

This summary is designed to highlight many of the facts and concepts presented and to outline the alternatives and consequences for each of the fundamental concerns raised during the workshop. I have added additional thoughts for clarification and completion of the concepts reviewed.

The Nature and Scope of the Farm Credit Problem

The nature and scope of the farm credit problems can best be understood by examining: (1) who the farm borrowers are and (2) who the farm lenders are.

Who are the farm borrowers? The concept of what is called a family farm has changed dramatically over the years. One family can farm many more acres or care for many more animals than 50 years ago as a result of technological advances and the public policy environment. The food system stereotype of many small pastoral family farms—that are independent, self-sufficient and diversified operations in an open marketing system—is no longer accurate as a description. The pastoral approach to family farming simply does not produce what most farm families consider to be acceptable income levels.

In 1982 there were 2.4 million farms using the census definition of \$1000 in annual agricultural sales. This is down from 6.8 million in 1935. Over the years, the pastoral family farm has been replaced by a number of large and moderate size commercial farms and many types of small farms. These modern farms are no longer self-sufficient but use highly technical management processes, are more specialized, and are more interdependent with other sectors of the national and international economy for farm inputs and food markets.

Today's farmers are a diverse breed. Dr. Melichar points out that not all have the same perceived problems or financial circumstances. Only one fifth are high debt operators and one quarter are moderate debt farmers. The remaining 58 percent are equity financed. So only a minority are financially at risk (see Table 1).

Table 1 Farm Financial Position by Sales Class, 1982

Annual Sales Class	Percent of all Farms	Percent of Agricultural Sales	Percent of Production Expenses	Percent with High Debt ^a	Percent with Low Debt ^b
\$200,000 & over	5	49	40	44	20
\$40,00-\$200,000	24	38	39	31	34
less than \$40,000	71	13	21	14	67
All Farms	100	100	100	18	58

^aEnd of Year 1982 farms with a debt/asset ratio greater than 40 percent.

^bEnd of year 1982 farms with a debt/asset ratio less than 10 percent.

Source: 1. Economic Indicators of the Farm Sector, USDA/ESIFS 1-1, Table 50, August 1982.
 2. Emanuel Melichar, "Farm Profits and Financial Distress" Workshop on Credit and Tax Policies for the Family Farm, Committee on Small Business, U.S. Senate, Apr. 27, 1983.

The financial conditions vary by sales class. The largest commercial farms with annual gross sales over \$200,000 per farm represent less than 5 percent of the farms, but account for half of total agricultural sales, 40 percent of input purchases, and nearly 40 percent of both farm debt and farm assets. Compared to other sales classes, this group has the highest percentage of farmers who are at risk financially (44%) and the lowest percentage of equity financed farmers who borrow very little.

The moderate size farms with annual sales between \$40,000 to \$200,000 represent one quarter of the farms and approximately 40 percent of the sales, production expenses, outstanding farm debt and farm assets. In this group, roughly one-third are high debt operators, one-third are equity financed farmers and the remaining third have moderate debt/asset ratios.

The small farms with annual sales less than \$40,000 represent 71 percent of all farms but account for only 13 percent of sales, and approximately 20 percent of production expenses, farm debt and farm assets. This group includes many different types. Income data indicate that most of these farmers rely on non-farm income as the major source of family income. Age data also indicates that this sales class has a higher proportion of retired farm and non farm operators. As a result, the small farm sales class has the highest proportion of equity financed farmers (67%) and the lowest proportion of high debt farmers (14%) compared to the other sales classes. However, because this sales class is the largest group of farmers, in actual numbers over half of the total high debt operators for all classes are small farmers. These are likely to be young, full and part-time farmers with low resources and low family income.

Who are the farm lenders? At the close of 1982, there was nearly \$218 billion in outstanding farm debt. This was up \$16 billion or 7.9 percent over the end of 1981. Half of the outstanding debt was in real estate loans and half in operating loans.

The Farm Credit System was the largest lender with nearly a third of the outstanding farm debt (see Table 2). Individual lenders and banks each represented slightly more than one-fifth of the credit. The Farmers Home Administration—which is the federal agency lender of last resort—accounted for 11 percent.

Table 2. U.S. Farm Debt, Outstanding End of Year 1982

Lending Institution	End of Year Debt		Change During Year	
	bil.dol	percent	bil.dol.	percent
Farm Credit System ^a	68.1	31.3	2.6	4.0
Individuals and Others	51.5	23.7	.9	1.9
All Operating Banks	44.8	20.6	3.4	8.3
Farmers Home Adm.	23.8	11.0	.6	2.8
Commodity Credit Corp.	16.6	7.6	8.6	107.3
Life Insurance Cos.	12.8	5.9	-.3	-2.3
Total	217.7	100.0	16.0	7.9

^aIncludes farm operating and real estate loans made by the Federal Land Banks, Production Credit Associations and participating Federal Intermediate Credit Banks. The Farm Credit System institutions are borrower-owned cooperative lending agencies that receive no federal appropriations for lending purposes.

Source: Agricultural Finance Data Book. Board of Governors, Federal Reserve System, Washington, DC, March 1983.

Commodity Credit Corporation (CCC) and life insurance companies each represented less than a tenth of the outstanding farm loans. However, the CCC loan volume more than doubled during 1982. In addition to CCC credit growth, bank credit also increased at a faster pace than the increase in total farm debt during 1982. The life insurance companies was the only lender group to reduce the actual dollars loaned in farm credit during the year.

What Economic Environment Led to Current Conditions?

After almost two full decades of chronic surpluses and excess production capacity, American agriculture in the 1970's experienced record farm incomes and real capital gains (see Tables 3 and 4). Unprecedented growth in demand for agricultural exports and cheap credit policies were factors that greatly contributed to the farm prosperity in the 1970's. Now at the onslaught of the 1980's, American agriculture has been experiencing its worst cash flow problems since the Great Depression (see Tables 3 and 4). Weak export demand coupled with large grain supplies and tighter monetary and credit policies have greatly contributed to the agricultural economic environment. Therefore, it is appropriate to analyze market conditions and monetary policies more fully to understand what led to current conditions and to determine the potential for future change.

Table 3. U.S. Per Farm Cash Flow and Balance Sheet Statistics, 1960-82^{a/}

Year	Gross Receipts Per Farm (\$000)	Annual Cash Production Costs Per Farm (\$000)	Net Farm Cash Flow to Operator and Interest ^{b/} (\$000)	Farm Interest Rate (%)	Total Debt Per Farm (\$000)	Total Assets Per Farm (\$000)	Average Debt/Asset Ratio (%)	Break Even Debt/Asset Ratio ^{c/} (%)
1960	9.4	6.4	3.0	5.6	5.7	43.6	13.0	120.2
61	10.1	6.9	3.2	5.7	6.2	45.7	13.6	123.6
62	10.9	7.5	3.4	5.7	7.0	49.5	14.2	119.9
63	11.6	8.1	3.5	5.8	8.0	53.3	15.1	112.5
64	11.6	8.3	3.3	5.8	9.1	57.2	15.9	99.1
65	13.2	9.1	4.1	5.9	10.0	61.2	16.4	114.0
66	14.8	10.2	4.6	5.9	11.4	68.0	16.8	114.2
67	15.2	10.9	4.3	6.1	12.8	74.1	17.2	95.1
68	16.0	11.6	4.5	6.1	14.2	80.3	17.7	91.5
69	17.9	12.6	5.3	6.2	15.5	86.6	17.9	97.8
1970	18.9	13.5	5.4	6.6	16.6	92.0	18.1	89.9
71	20.3	14.6	5.7	6.7	17.4	96.9	17.9	88.4
72	23.7	16.4	7.3	6.8	19.2	106.3	18.0	101.4
73	33.7	21.1	12.6	7.4	21.5	121.2	17.7	141.0
74	33.5	23.2	10.3	8.0	24.6	150.1	16.4	86.0
75	38.0	26.8	11.2	7.9	30.1	175.5	17.1	80.8
76	38.5	29.7	8.8	8.0	33.8	204.3	16.5	54.0
77	41.3	32.3	9.0	8.3	38.9	240.1	16.2	45.2
78	48.9	36.0	13.0	8.6	45.7	269.0	17.0	56.2
79	58.4	42.4	16.0	9.6	52.3	321.7	16.3	52.1
1980	57.4	45.6	11.8	10.3	60.7	372.6	16.3	30.9
81	63.3	48.3	15.0	11.6	67.0	403.7	16.6	32.0
82	-	-	-	-	74.5	403.6	18.5	-

^{a/} Numbers may not add due to rounding. USDA farm definition through 1974. Census of Agriculture definition--which is \$1,000 in sales or more--applies for 1975 and all following years.

^{b/} Includes Intermediate Product Expenses, Capital Consumption, Business Taxes, Wages to Hired Labor, and Net Rent to all Landlords.

^{c/} Includes Returns to Operators and Interest Payments.

^{d/} Interest Payments divided by Beginning of Year Liabilities.

^{e/} Represents Maximum Debt/Asset Ratio that the residual farm cash flow for the operator and interest would service at the average farm interest rate. Break Even Debt/Asset Ratio = (farm cash flow for operator and interest per farm ÷ farm interest rate) ÷ total asset per farm.

Source: Compiled from USDA, Economic Indicators of the Farm Sector, 1981.

Table 4. U.S. Returns to Equity Per Farm, 1960-81.^{a/}

Year	Residual Income to Equity (\$000)	Capital Gains on Farm Asset Values		Equity Value of Farm Assets (\$000)	Return As A Percent Of Equity		
		Nominal (\$000)	Real (\$000)		Residual Income (%)	Real Capital Gains (%)	Total Return (%)
1960	1.0	0.7	0.3	38.0	2.7	0.2	2.9
61	1.3	2.1	1.8	39.5	3.3	4.6	7.9
62	1.5	2.1	1.5	42.4	3.5	3.6	7.2
63	1.5	2.0	1.3	45.2	3.3	2.9	6.2
64	1.3	2.6	2.1	48.2	2.7	4.3	7.0
65	2.2	4.6	3.5	51.2	4.4	6.9	11.3
66	2.6	4.1	2.2	56.6	4.6	4.0	8.6
67	2.0	3.7	1.5	61.4	3.2	2.5	5.8
68	2.0	4.2	1.2	66.1	3.0	1.9	4.9
69	2.6	4.0	-0.2	71.1	3.7	-0.3	3.3
1970	2.6	3.6	-0.2	75.4	3.5	-0.2	3.3
71	2.7	7.4	4.6	79.5	3.4	5.8	9.3
72	4.5	13.1	9.7	87.1	5.2	11.1	16.3
73	10.0	26.0	15.5	99.8	10.1	15.6	25.6
74	7.0	9.7	-4.1	125.5	5.6	-3.3	2.3
75	7.1	25.7	15.1	145.4	4.9	10.4	15.3
76	4.5	33.0	23.3	170.5	2.6	13.6	16.3
77	4.1	26.3	12.2	201.2	2.0	6.0	8.1
78	7.2	49.8	27.0	223.3	3.2	12.1	15.3
79	9.1	47.1	9.3	269.4	3.4	3.5	6.8
1980	3.9	32.9	2.5	311.8	1.3	-.8	0.5
81	5.6	-3.8	-29.0	336.7	1.7	-8.6	-6.9

^{a/} Returns to equity in farm assets (excluding farm households) from U.S. farm production income and real capital gains, market value basis. USDA farm definition through 1974, Census of Agriculture definition which is \$1,000 in sales or more applies for 1975 and all following years.

Source: USDA, Economic Indicators of the Farm Sector, 1981.

What led to the rapid export expansion of the 1970's? First, the international monetary system shifted from fixed to flexible exchange rates. This immediately devalued the dollar by nearly 20 percent relative to other currencies which meant that our exports became 20 percent cheaper overnight for our international food customers. Second, expansionary monetary policies created easy credit and allowed developing countries to borrow to buy food imports. Third, we entered detente with the USSR. Fourth, we normalized relations with China. Above all, a world food shortage had been developing since the late 1960's. All events set the stage for rapid expansion in US exports of grain.

During the decade (1971-81), US producers increased wheat, corn, and soybean export volumes an average of 10 percent per year (11.25, 10.6, and 8.1 percent respectively). In response to this rapidly expanding export demand, producers expanded production of these crops by 5 percent per year (5.6, 3.8, and 5.6 percent respectively). Many producers and analysts expected these trends to continue into perpetuity. They haven't.

In the early 1980's and before the advent of the Payment in Kind (PIK) program, many people perceived the farm problem as low commodity prices. Low commodity prices result from (1) too much production, (2) too much in reserve, (3) weak domestic demand, and (4) weak foreign demand. While the PIK program has recently improved the cash flow situation of many farmers, it is a short term program requiring significant outlays. High debt operators are still likely to experience serious cash flow

problems, and there is still much uncertainty about the future commodity market prospects after PIK's duration.

In the early 1980's, annual production of wheat, corn and soybeans was more than 50 percent greater than 10 years earlier (73, 45, and 73 percent respectively). Cropland acreage had expanded 20 percent over the decade. Grain reserve carryover stocks were surpassing the records established in the early 1960's.

Domestic demand has been weak due to the recent recession. The length and strength of the long awaited recovery is a widely debated topic. Almost no one is predicting a strong recovery as long as we continue to fight inflation.

Export demand is weak due to world-wide recession, a stronger dollar in the international money markets, and a rise in foreign competition. Over the past two years, the US dollar has appreciated relative to other major currencies by more than 25 percent. That simply means that exports become more than 25 percent more expensive holding everything else constant. The dollar is likely to remain strong as we continue to fight inflation with some success.

Meanwhile, many food importing countries are in a cash flow bind due to world recession and tighter credit. Mexico's food imports, for example, are partially tied to credit availability. However, just like American households in a cash flow pinch, borrowing more does not necessarily improve the developing country's financial position but may tend to dig a deeper financial hole.

Protectionist trade barriers and export subsidies have received much attention as producers in exporting and importing nations fight for world market shares. While violations may in fact be substantiated, the prospects for rapid and complete acquiescence is not likely. Farmers are well organized in the European Community and Japan. US public pressure for "free trade" is often perceived as meddling in the internal affairs of our allies. So, export demand is likely to remain weak for as long as the world recession continues, particularly if East-West relations become colder. After recovery, the analysts predict that it is unrealistic to expect export growth rates to mirror the 1970's. Those rates cut in half would be optimistic.

Monetary and credit policies have perhaps more directly contributed to the current financial distress in agriculture. As a nation, we have been living beyond our means and fueling the fires of inflation since the mid-1960's. We began by financing the Vietnam War and the Great Society programs without raising enough tax revenues to pay the full bill. The Federal Reserve accommodated by expanding the money and credit supply.

During the 1970's inflation continued to spiral. The baby boom generation--born during the 1950's--was entering the labor market. The labor force expanded nearly 25 percent between 1970 and 1980. OPEC created a world oil shortage that drained spending from many domestic sectors to oil imports. This resulted in the classic choice between higher unemployment or higher inflation. We simply chose higher inflation.

Who were the gainers and losers under inflationary monetary policies? The gainers were borrowers who received lower real interest rates, paid back loans with inflated dollars, and watched the value of their leveraged assets appreciate.

The losers were savers who watched the buying power of their savings erode. Inflation was greater than many interest rates on savings accounts. Particularly hurt were those who had fixed value retirement and insurance savings plans. Under inflationary policies, the economic incentives for government, private business, and consumers are clearly to "buy now" with cheap credit and "pay later." That's what a growing number of people did as the inflationary credit expansion of the 1970's progressed.

Since 1979, however, the Federal Reserve in general has been fighting inflation with tighter monetary policies. As monetary expansion becomes a declining source of funds for credit, interest rates rise to attract more savings as a source of loanable funds for credit. However, higher interest rates also ration credit among borrowers. Those with flexibility borrow less while others are forced to refinance at higher interest rates and develop cash flow problems.

Under tight monetary policies, the gainers and losers are reversed. Now, the savers get ahead and the borrowers must pay a premium interest rate until inflation declines and is not expected to reoccur. Hardest hit are those sectors that depend on credit, which include high debt borrowers in agriculture and those who depend on credit sales in agribusiness, rural communities and international food markets. Under non-inflationary policies the economic incentives for private business and consumers are to "save now to buy later" or to "pay as you go."

It remains to be seen whether higher real interest rates and the crowding out impacts of government borrowing will be great enough to provide an incentive for Congress to lower deficits in the near future. Federal borrowing has increased from less than 20 percent of total funds raised in the US financial markets in 1979 to about 40 percent last year. Under tight monetary policy, and as Uncle Sam borrows more, the amount of funds available to business, consumers and foreign borrowers declines. The Congressional Budget Office projects the 1984-88 deficits to be in the \$200 to \$250 billion range. A \$250 billion deficit would account for nearly half of the funds presently raised in the U.S. financial markets. This in turn is likely to put upward pressure on interest rates that could stall the recovery unless the Federal Reserve accommodates with inflationary expansion once again.

How Much Subsidized Credit and Who Should Get It?

The issue of how much credit and who should receive it is related to several broader domestic economic policy issues which are explored below.

How can interest rates be lowered? Dr. Melichar pointed out that the high debt farmers will not likely experience significant financial relief unless interest rates decline. If the perceived farm credit problem is defined as high interest rates, then there are four fundamental options for solving the problem: (1) Allow interest rates to trail inflation down, (2) Shift to expansionary monetary policy, (3) Lower the federal deficit or (4) Raise the farm credit safety net.

The first option is to rely on relatively tight monetary policy to keep inflation down, with the expectation that interest rates will trail inflation down as the uncertainty over its reoccurrence declines. This option relies on credit market forces, management skills of the individual farmers, and does not provide for more credit subsidies when an economic emergency exists. The probable consequences are that interest rates are likely to remain higher in the short run and more high debt farmers would go out of business. In some cases these farm enterprises would be large enough or numerous enough to affect businesses in rural communities. However,

most high debt farmers would survive intact provided that they are able to make the transition from high debt to equity farming.

The second option is to shift from relatively tight monetary policy to expansionary policies. Short term interest rates would likely decline until inflation heated up. Long term rates would rise immediately. The probable consequence would be another round of inflation and another disinflationary day of recession down the road.

The third option is to alter government fiscal policy. Under relatively tight monetary policy, higher deficits place added upward pressure on interest rates. Therefore, lower deficits would allow the Federal Reserve and financial markets to lower interest rates. As long as spending cuts or tax hikes are targeted away from those in a cash flow bind, the net effect would be to improve the financial condition of high debt businesses and consumers who are sensitive to higher interest rates.

The fourth fundamental option is to expand the safety net of federal assistance in credit. The consequences of this option depend on the criteria adopted. A safety net is like a fishing net, in that something is saved and something falls through the cracks in the net. So the success depends on the perspective. This option is explored more fully in the following testimony.

How much federally subsidized credit should be given? The Farmers Home Administration (FmHA) is the federal lending agency of last resort. It provides grants, insured loans, loan guarantees and interest subsidies for qualifying businesses, communities, and farm operators who are unable to secure credit elsewhere. Farm loans have accounted for about one-third of total FmHA loan volume in recent years.

FmHA's market share of total farm debt has doubled in the past decade (see Table 5). While the FmHA share of farm real estate debt has remained relatively constant during this period, the FmHA share of the non-real estate farm loans has quadrupled.

Table 5. Farmers Home Administration Farm Debt Statistics, 1971-83.

Year	FmHA Non Real Estate Farm Debt (bil. dol.)	% of Total Non Real Estate Farm Debt (%)	FmHA Real Estate Farm Debt (bil. dol.)	% of Total Real Estate Farm Debt (%)	Total FmHA Farm Debt (bil. dol.)	% of Total Farm Debt (%)
1971	.8	3.3	2.4	8.0	3.2	5.9
72	.8	2.8	2.6	8.1	3.4	5.7
73	.8	2.6	2.8	8.1	3.6	5.6
74	.9	2.6	3.0	7.6	3.9	5.3
75	1.0	2.8	3.2	7.2	4.3	5.2
76	1.8	4.2	3.4	6.8	5.1	5.6
77	1.9	3.8	3.7	6.6	5.5	5.3
78	3.1	5.8	4.0	6.3	7.1	5.8
79	5.8	8.3	4.1	5.8	9.9	7.0
1980	9.0	11.2	7.1	8.3	16.1	9.7
81	11.8	13.6	7.7	8.1	19.5	10.7
82	14.5	15.0	8.7	8.3	23.2	11.5
83	15.0	14.3	8.7	7.9	23.7	11.0

Source: USDA, Agricultural Finance Outlook and Situation, Dec. 1982.

This trend raises the fundamental question of whether the level of subsidized credit should continue to be increased, should be lowered or should be kept about the same. Subsidized credit increases the income potential for those who receive it relative to those who don't qualify or do not apply. Eventually, if enough farmers receive subsidies in a given locality, part of the benefits would be capitalized into farmland values.

What is the FmHA criteria? To be a FmHA borrower, one must (1) be unable to obtain credit elsewhere, (2) be a U.S. citizen, (3) have sufficient training and experience, and (4) be or become a not-larger-than-family farm operator. After this initial criteria is met, FmHA loan approval is based on additional criteria that includes repayment ability, adequate security, soundness of the Farm and Home Plan, and suitability of the farm. (For a detailed description of FmHA procedures, the Center for Rural Affairs has published a very helpful handbook: FmHA Farm Loan Handbook.)

As the lender of last resort, FmHA's security requirements are more flexible than those offered by commercial lenders. As a general rule, farm ownership loans are secured by real estate and chattel mortgages. On farm operating loans, FmHA will have a first lien on production and will require chattel and/or real estate security. If security is inadequate, FmHA must consider repayment ability. On emergency loans, FmHA will accept real estate or chattel security. Again if security is inadequate due to disaster or economic emergency, FmHA considers repayment ability.

Repayment ability is calculated on the Farm and Home Plan. It is determined by comparing an expected cash balance available for debt payment and the schedule of planned principle and interest payments. The appraisal of the cash balance for debt payment is an estimate of receipts minus expenses and by nature is not entirely an objective process. This leaves some room for negotiation.

If the initial Farm and Home Plan indicates repayment inability, FmHA is required to consider alternative plans. In addition, low producing farms resulting from lack of development may receive substantially reduced limited resource interest rates when there is repayment inability using the regular FmHA rate of interest. Mr. Severens testified that by law, "at least 20 percent of FmHA's farm ownership and operating loan funds (are to) go to qualifying limited resource borrowers." Presently limited resource loan authority has gone unused due to lack of limited resource applicants. Mr. Severens suggested possible reasons. One included a lack of awareness and knowledge by borrowers in some states that the program existed.

Who should receive subsidized credit? The options include one or a combination of the following: (1) no one, (2) young farmers, (3) low resource farmers, (4) minority farmers, (5) family farmers, (6) those impacted by acute natural disasters, (7) those impacted by chronic adverse weather, (8) those impacted by economic emergencies, (9) those who are creditworthy, and (10) all who apply. Many of these options were highlighted during the workshop. Particularly, Mr. Severens, Dr. Melichar and Mr. Blobaum raised debate over the role of FmHA. Is the agency's role to provide "development assistance", "economic emergency assistance" or some combination?

Should those who are not born with a silver spoon receive credit assistance or should farming be left to those who were born with the ready-made opportunity to farm? Farm structure is influenced by technological advances and the policy environment. If the farm credit policy objective is to foster those who initially

lack resources to start farming, then subsidized credit should be targeted toward minority and young, low resource farmers.

Ms. Lerza indicated that special efforts are required to assure that black and minority farmers receive developmental assistance. Mr. Severens pointed out that loan limits are probably the most effective tool for targeting loans to small family farms and limited resource borrowers. Several people entered the discussion concerning the appropriateness of raising the loan limits in the farm credit bill currently under debate in Congress. Mr. Shuman pointed out that the average FmHA Operating Loan (OL) is about \$30,000 while the OL limit is \$100,000, and therefore only a few borrowers would likely be affected by raising the limits on FmHA loan programs (which have been in effect for some time).

If the farm credit policy objective is to provide economic emergency relief for the farmers who produce most of the food and for private lending institutions who hold most of the farm debt, then the subsidized credit should be targeted toward the high debt commercial farmers who hold the largest portion of private farm debt. However, a number of these farmers financially leveraged their business to expand during the 1970's and are now financially at risk under current economic conditions. Should these farmers be rewarded with subsidized credit since their expectations exceeded their farm profits and capital gains?

Mr. Shuman indicated that present policy is to provide credit to those who can develop a farm plan that is able to cash flow loan payments from annual projected cash balances. To a degree, current policy cuts across both structural and economic emergency objectives. However in the longer term, farm structure develops by default under this current approach.

What is the appropriate action for those in financial difficulty and what should be done to prevent further financial trouble?

Mr. Shuman indicated that the actual FmHA failure rate from voluntary liquidations, foreclosures and bankruptcies was 2.9 percent of 270,000 borrowers. Mr. Sacia commented that 28 percent of FmHA borrowers are delinquent. Mr. Shuman indicated that those requiring special assistance actions were up substantially during the first six months of this fiscal year compared to last.

Mr. Waits indicated that in 1982 the delinquent loans were 3.2 percent for the Federal Land Banks and 3.3 percent for the Production Credit Associations and about 4 percent for commercial bank farm loans. The Farm Credit System foreclosure auctions in 1982 were 385 (less than 1 tenth of one percent) for the Federal Land Banks and 870 (less than 3 tenths of one percent) for the PCA's. Mr. Waits also indicated that the 1982 rates were up over 1981. With these statistics in mind, many people have become concerned about appropriate remedies and prevention of further difficulty.

What are the appropriate remedies? FmHA remedies for those borrowers who are delinquent and/or in default include loan consolidation, rescheduling, deferral, voluntary liquidation and foreclosure.

Consolidation occurs when a new loan is approved while another loan exists. The terms of a consolidated loan are set according to repayment ability. Initial payments may be delayed and loans may be consolidated even if the borrower is delinquent on the current loan.

Rescheduling spreads out the principle and interest payments over a longer period to reduce the size of a borrower's individual payments. Rescheduling is used if a borrower is delinquent, does not need a new loan, but does have a cash flow problem with the size of current payments. Depending on the circumstances, however, rescheduling a loan may carry either a higher or lower interest rate.

Deferral allows postponement of principle and interest for up to three payments. It does not cancel interest or principle. To receive a deferral, a farmer must prove ability to make up the deferred payments and continue normal loan repayment after the deferral period is over.

"Voluntary" liquidation occurs when the FmHA county committee and supervisor ask the borrower to arrange to sell or transfer security property to cover FmHA debt. This occurs after default and when FmHA determines that "further servicing cannot be justified" and "additional servicing no longer helps accomplish the loan objectives".

If the farm borrower does not volunteer to liquidate, the county supervisor recommends foreclosure for the approval of the state director. Foreclosure occurs if a net recovery of debt can be made or if failing to foreclose would hurt the program in the area. Acceleration occurs under foreclosure and means that the entire loan must be paid back within a specified period. FmHA also has the authority to file civil suit against the borrower and/or file claims in bankruptcy court to recover money owed.

Several alternative remedy proposals were raised in the workshop. Moratoriums were discussed by Mr. Sacia, Mr. Blobaum and Mr. Shuman. A moratorium implies an alternative FmHA policy for loan deferrals and rescheduling of payments. Presumably this is designed to partially forgive: (1) interest on any deferred interest and principle, (2) interest on the principle, or (3) part of the principle. The resulting increase in FmHA appropriations required would depend upon the nature and extent of such moratoriums. Mr. Waits pointed out, that if a moratorium were to be expanded to the cooperatively owned farm credit system, higher interest rates would result for the remaining farm credit system borrowers, and this would also further reduce the number of farm credit systems lenders.

Mr. Blobaum suggested that under present policy, FmHA may have some incentive to move against delinquent borrowers in order to receive preference status when a petition of bankruptcy is ultimately filed. Current bankruptcy law allows the trustee certain avoidance powers, and under certain conditions FmHA is able to avoid these provisions if its agency representatives move during the limited preference period. Mr. Blobaum suggested lengthening the preference period to remove the incentive. This may, however, lengthen the bankruptcy process.

What should be done to prevent further financial trouble? The issue of financial counseling services for problem borrowers was raised several times during the workshop. The potential alternatives include (1) voluntary financial counseling provided by FmHA, (2) FmHA approval of the borrower's farm and financial decisions, and (3) non-FmHA financial counseling services.

Voluntary financial counseling could be expanded in FmHA offices. Mr. Patnoe indicated that more farm visits would be an approach. Mr. Severens indicated that default rates vary widely for FmHA county offices in the same area, implying that more training in financial counseling may lower defaults in some areas. Mr. Shuman indicated that additional counseling services requires more staff and training dollars, which he has asked for but not received.

FmHA approval of the borrower's farm and financial decisions is the second option. Mr. Patnoe indicated that, historically, FmHA counter-signed checks and implied that loan supervisors would have to have more experience in farm production and marketing for this approach to work.

Non-FmHA financial management assistance is available from the Cooperative Extension Service and private consultants. In addition, volunteer farmers with the "right experience" might be available to provide counseling to young farmers during tough times. Finally, the issue of adequate farmer input into FmHA decisions was raised during the workshop. Perhaps additional farmer input would be useful in determining the best solution to the financial counseling problem.

CONCLUDING COMMENT

In summary, the Farm Credit Policy workshop highlighted a cross section of perceptions, facts, and recommendations. The outcome was a better understanding of (1) the nature and scope of the farm credit situation, (2) the policy environment that led to current conditions, and (3) the current problems and choices available. As a result, the testimony should prove useful to the members of the Senate Committee on Small Business and others who are interested in farm credit policy as these issues are debated in the future.