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What Should Be The Farm Credit Policy?

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Given the current state of the agricultural economy, many farmers and other rural people are concerned about the continuing farm financial distress and the impact of these conditions on rural communities. As a result, many people are interested in (1) studying the nature and scope of the current situation and (2) defining the proper role of the Federal Government in dealing with the present problems. This newsletter explores the farm credit conditions and the public policy choices available.

Who are the farm borrowers? Today's farmers are a diverse breed and 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 58/5 are equity financed. So only a minority are financially at risk (see Table 1).

Table 1 Farm Financial Position by Sales Class, 1982

<table>
<thead>
<tr>
<th>Annual Sales Class</th>
<th>Percent of all Farms</th>
<th>Percent of Agricultural Sales</th>
<th>Percent of Production Expenses</th>
<th>Percent with High Debt</th>
<th>Percent with Low Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200,000 &amp; over</td>
<td>5</td>
<td>49</td>
<td>40</td>
<td>44</td>
<td>20</td>
</tr>
<tr>
<td>$40,000-$200,000</td>
<td>24</td>
<td>38</td>
<td>39</td>
<td>31</td>
<td>34</td>
</tr>
<tr>
<td>less than $40,000</td>
<td>71</td>
<td>13</td>
<td>21</td>
<td>14</td>
<td>57</td>
</tr>
<tr>
<td>All Farms</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

The moderate size farms with annual sales of $40,000 to $200,000 represent one quarter of the farms and approximately 40% 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% of all farms but account for only 13% of sales, and approximately 20% 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 indicate 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 is up $16 billion or 7.9% over the end of 1981 and is double the amount of farm debt in 1976. Half of the outstanding debt was in real estate loans and half

However, the financial conditions vary by sales class. The largest commercial farms with annual gross sales over $200,000 per farm represent less than 5% of the farms, but account for half of total agricultural sales, 40% of input purchases, and nearly 40% 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.
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%.

<table>
<thead>
<tr>
<th>Lending Institution</th>
<th>End of Year Debt</th>
<th>Change During Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm Credit System</td>
<td>$11.676 billion</td>
<td>9%</td>
</tr>
<tr>
<td>Individuals and Others</td>
<td>23.8</td>
<td>7%</td>
</tr>
<tr>
<td>All Operating Banks</td>
<td>4.0</td>
<td>1%</td>
</tr>
<tr>
<td>Farmers Home Adm.</td>
<td>3.9</td>
<td>1%</td>
</tr>
<tr>
<td>Commodity Credit Corp.</td>
<td>7.7</td>
<td>3%</td>
</tr>
<tr>
<td>Life Insurance Cos.</td>
<td>5.7</td>
<td>-3%</td>
</tr>
<tr>
<td>Total</td>
<td>7.7</td>
<td>1%</td>
</tr>
</tbody>
</table>

What are 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 these initial criteria are 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.

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 principal 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.

Farms which are low-producing because of a "lack of development" and who fail to meet the regular FmHA interest repayment ability criteria are eligible for substantially reduced limited-resource loan interest rates. By law, at least 20% of FmHA's farm ownership operating loan funds are to go to qualifying limited-resource borrowers. Presently limited-resource loan 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. This trend raises the fundamental question of whether the level of subsidized credit should be changed.
authority has gone unused due to lack of limited resource applicants. One reason may be a lack of awareness and knowledge by borrowers in some states that the program exists.

Who should receive subsidized credit? There are many options, including 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. The debate has centered on whether the government's role is 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.

Loan limits are probably the most effective tool for targeting loans to small family farms and limited resource borrowers. However, the average FmHA Operating Loan (OL) is about $30,000 while the OL limit is $100,000. Therefore, only a few borrowers would likely be affected by raising the limits on FmHA loan programs, even though these limits 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 businesses 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?

Present FmHA policy is to provide credit to those who can develop a farm plan that is able to meet cash flow loan payments from annual projected cash balances. To a degree, current policy cuts across both structural and economic emergency objectives.

What is the appropriate action for those in financial difficulty? Last year, the actual FmHA failure rate from voluntary liquidations, foreclosures and bankruptcies was 2.9% of 270,000 borrowers. However, about 28% of FmHA borrowers were delinquent on payments. Those requiring special assistance actions were up substantially during the first six months of this fiscal year compared to last.

In 1982, the delinquency rates for other financial institutions were 3.2% for the Federal Land Banks, 3.3% for the Production Credit Associations and about 4% for commercial bank farm loans. The Farm Credit System foreclosure auctions in 1982 were 385 (less than one tenth of one percent) for the Federal Land Banks and 870 (less than three tenths of one percent) for the PCA's. All 1982 rates were up over 1981.

Many people have become concerned about appropriate remedies for those in financial difficulty. Present FmHA remedies for those borrowers who are delinquent and/or in default include (1) consolidation of new and old loans, (2) rescheduling payments out over a longer amortization period, (3) deferral of interest and principal payments to be made up later with interest, (4) voluntary liquidation of some assets and foreclosure. The use of a particular tool depends upon the severity of the circumstances and the estimated repayment ability of the borrower.

Recently, other remedies have been proposed. A "moratorium" implies an alternative FmHA policy for loan deferrals and rescheduling of payments, presumably designed to partially forgive: (1) interest on any deferred...
interest and principal, (2) interest on the principal, or (3) part of the principal. The resulting increase in FmHFA appropriations required would depend upon the nature and extent of such moratoriums. If a moratorium were to be expanded to the cooperatively owned farm credit system, higher interest rates would be spread over the remaining farm credit system borrowers who do not qualify for such a moratorium. In both cases we create an incentive to become delinquent in order to receive the preferential treatment under a moratorium.

CONCLUDING COMMENT

It is not likely that high debt farmers will experience significant financial relief unless interest rates decline further. 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 using relatively tight monetary policy, (2) Shift to expansionary monetary policy which will rekindle inflationary pressures, (3) Lower the federal deficit and government borrowing to facilitate lower interest rates or (4) Raise the subsidized farm credit safety net.

In the final analysis, the Farm Credit Policy will be hammered out through the political process. Much will depend upon the developing farm economic conditions, monetary and fiscal policy decisions and the politics of farm and food policy. The objective of this newsletter is solely to provide food for economic thought, so that decisions are based on a broader understanding of the problem and the choices available.