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Strings attached to farm credit aid

A look at how the government engineered the losses of the Farm Credit System so it could come to its rescue and take control.

On Jan. 6, President Reagan signed into law one of the largest government bailouts. He approved the infusion of as much as $4 billion into the Farm Credit System, which has lost $5 billion in the last three years. Since the government does not give unconditionally, there are some "strings" attached to this aid.

By July 6, each Federal Land Bank and each Federal Intermediate Credit Bank within the 12 Farm Credit Districts will be merged into one lending institution called the Federal Land Credit Bank. (This does not require a vote of the stockholders.) Six months later, the Production Credit Associations and Federal Land Banks will ask their stockholders to vote on merging the local lending associations. This vote by the stockholders is only to satisfy the requirement in the by-laws. If the merger does not pass, financial aid will not be forthcoming. Therefore, in all probability, the mergers will pass.

By July 6, 1989, a special committee will submit a proposal to consolidate the 12 Farm Credit System districts into at least 6 financially sound districts. Within 18 months of that proposal, stockholders will vote on the consolidation.

Merging the banks and the local associations is academic at this point. It will be done to simplify bookkeeping, because the management and staffs have been merged for over three years. In fact, this arrangement was in a long-term plan put together in the late 1970s.

Stockholders should not oppose merging the 12 districts into 6, because these are now merely regional service centers. The real regulation and decision-making is coming through the Farm Credit Administration, the Farm Credit System Assistance Board, and the Farm Credit System Insurance Corporation.

The reorganization will lower expenses and marginally affect the lending rates. However, this will most likely be offset by the additions to a trust fund and a reserve fund to collateralize the government debt, and to pay the interest and principal on the debt, which will start coming due in five years. The new minimum capital adequacy standards, to begin a five-year phase on May 6, will also affect the lending rate, because all of these funding needs must come from earnings.

Stockholders who fear a loss of local control are worrying about the wrong problem. There has not been local control for years on the lending rates, capitalization, and lending practices. Tucked away in the legislation was a provision for grants to the states to establish farmer-creditor mediator programs, a few other borrower rights, and the stipulation that the Farm Credit System be required to participate. These will give the borrowers as much control as they currently have—which is very little.

The real problem is what is happening to the acquired property. There has been a tremendous amount of liquidation during the last three years. Who is going to end up controlling all this land? The current trend is toward making the farmer a hired hand on what used to be his own operation. This has been the demise of the family farm, with its incomparable productivities.

Let's take a look at how the government "engineered" the losses of the Farm Credit System so it could then come to its rescue and take control. With the farm economy sliding into a depression, there were going to be a certain amount of losses suffered by some of the associations, which needed financial assistance. These were mostly the short-term lenders and those involved with land speculators. The Omaha Farm Credit District was one of the first to be hit hard by the Production Credit Association losses.

Other districts, with enough capital to provide assistance, balked at sending the needed funds. Congress, in a farm bill passed in December 1985, said that if the system would use up all of its reserves (including those backing the class "B" stock that borrowers are required to buy), then there would be federal assistance.

This feat was accomplished very simply by changing the lending practices. Instead of lending amounts up to the maxiumum repayment capacity of the operation, short-term loans were required to be 100% collateralized. If part of a loan balance could not be covered by collateral, then it was classified as a loss. The big losses came when the Federal Land Banks started reappraising their land loans downward. If the loan balance was larger than the appraisal, the difference became a loss. As more liquidations occurred and appraisals went lower, the losses got bigger.

Now that all of the money has been used up in the system and the farm economy is in shambles, the government has stepped in with aid, and the lending practices are returning to their previous standards of repayment capacity. Short-term loans, of necessity, must be based on repayment capacity because fewer farmers now own their land. Who does, and who will, have control?

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