still, the bank is "impaired" by negative $2 million.

The bank may then turn to the excess interest deferral provision of RAP. Here, we assume the bank's $65 million in interest expense is substantially more than it would have been had its total debt been priced on October 21, 1986. RAP permits deferral of that excess to the extent necessary to eliminate the $2 million impairment remaining after the RAP loan loss deferral has been applied. The third column of the example shows $2 million "RAP deferral" of interest expense.

For regulatory purposes, the result is zero surplus and borrower stock is worth 100 cents on the dollar. Having avoided regulatory insolvency, the bank continues to do business, and borrower-stock is retired at par.

RAP Avoids Regulatory Insolvency

	No RAP	Loss deferral	Loss & interest deferral
	Million dollars		
Beginning Surplus*	$3	$3	$3
Earnings for the year**			
Interest income	70	70	70
Interest expense	65	65	65
Less RAP deferral	-	-	(2)
Net interest expense	-	-	63
Net interest income	5	5	7
Provision for loan losses	20	20	20
Less RAP deferral		17	17
Net provision for losses		3	3
Net interest income after provision for loan losses	(15)	2	4
Other:			
Income	1	1	1
Expenses	8	8	8
Net other	(7)	(7)	(7)
Net income (Loss)	(22)	(5)	(3)
Ending surplus*	(19)	(2)	0

*Total net worth less par value of borrower stock.
**Assumed outstanding loans of $600,000,000.

The bank's loan losses and interest expenses are not reduced; rather, they are artificially reallocated over time and must be paid from future years' earnings if the banks are to avoid insolvency in those years. In this way, RAP permits the banks to mortgage their future. For some farm credit banks, RAP will only postpone their day of reckoning. For other banks, whose problems are less severe, it may be a life saver.

The 1986 Legislation sent a strong message to system stockholders concerning the safety of their stock investment: "It will be protected, even if Congress has to rewrite the law to get the job done." That message was made even louder and clearer by the legislation enacted late in 1987 which explicitly guarantees the ability of current stockholders to redeem their stock at par.

By authorizing RAP, the Congress took a timely and imaginative step to keep the doors of troubled farm credit banks open and to avert a crisis of borrower/stockholder confidence if banks were unable to retire stock fully at par. The effects of RAP, including its continuing costs, will be felt by the Farm Credit banks for years to come.

The Farm Credit System:

It Has A New Lease on Life, But...

By J. Bruce Bullock and Charles Dodson

The Farm Credit System has a new lease on life. The recent legislation provides interest-free use of $4 billion for five years. This financial assistance gives the System an opportunity to focus on positioning itself for the future rather than trying to survive from month to month with inadequate capital resources. The legislation does not guarantee the long-run viability of the Farm Credit System, however.

The System will have to partially service $4 billion of new debt during years 6-10 and fully service that debt after 10 years. These costs will substantially increase required margins for the System. In addition, the so-called borrower rights provisions of the legislation will tend to increase the cost of servicing the System's loan portfolio and will likely reduce the quality of that portfolio. It is not at all certain that the Farm Credit System will be able to repay the $4 billion in new debts it acquired through the legislation. It it cannot, the U.S. taxpayer will be left holding the bag for what will have become a lending institution similar to the Farmers Home Administration.

As expected, Congress attached several strings to the financial assistance provided to the Farm Credit System. The three major strings relate to (1) borrower rights, (2) the System's structure, and (3) a secondary market for farm mortgages.

Borrower Rights

The new legislation restricts how the System deals with borrowers who have non performing loans. These restrictions are similar to long standing restrictions on the Farmers Home Administration.

The borrower rights legislation is restricted to borrowers of the Farm Credit System and FmHA. Apparently other agricultural borrowers do not need their rights protected, or do not warrant such protection.

The net effects of the borrower rights being imposed on the Farm Credit System will:

- Increase the System's operating costs relative to other lenders,
- Reduce the quality of the System's loan portfolio as non performing loans remain in the portfolio for a longer time and other loans become non performing as borrowers seek loan write downs, and
- Attract lower credit quality borrowers concerned about borrower rights to the System's portfolio while quality business borrowers willing to forego generous borrower rights in return for lower interest rates will obtain credit from commercial lending sources.

In combination, these effects will mean a smaller income stream generated by the System's loan portfolio.

Mandatory Changes in System Structure

The legislation requires that the Banks for Cooperatives vote on whether to combine their banks into a single bank. Most observers agree this is a good idea and that the consolidation will likely occur. The new legislation also requires that the Fed-

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eral Land Bank and the Federal Intermediate Credit Bank in each district merge within six months. This is largely a formality, since the two banks are already under joint management in almost all districts. These banks have been prevented from formal merger by previous legislation. The new legislation also requires that bank stockholders vote within 18 months to consider district mergers to reduce the number of Farm Credit Banks to not fewer than six.

The potential cost savings generated by district mergers was grossly overstated during the debate on the legislation. A press release from one prominent member of the Senate Agricultural Committee proclaimed that the reorganization would generate $800 million savings in operating costs. That seems unlikely since the total non-interest operating costs for the Farm Credit System in 1986 were $883 million. This number compares with $7,679 million of total interest expense in 1986. Reduction of operating expenses by even 50 percent would have had little impact on the $2.7 billion loss reported by the Farm Credit System in 1986. Reorganization of the Farm Credit System will make little, if any, contribution to the System's ability to repay the $4 billion loan.

Secondary Market

The legislation establishes a Federal Agricultural Mortgage Corporation (FAMC) or "Farmer Mac" to operate a secondary market for farm real estate and rural housing loans. It remains to be seen whether Farmer Mac can become an economically viable institution. If it does, the competitive pressure on the Farm Credit System for high quality farm mortgage loans will increase. If Farmer Mac provides lower cost access to capital markets (for the highest quality agricultural real estate borrowers and their lenders) than the Farm Credit System, both the size and quality of the System's loan portfolio will be adversely affected. This development would add to the Farm Credit System portfolio problems imposed by the borrower rights provisions of the legislation.

Risks Remain

In total, the new legislation makes it possible for the Farm Credit System to survive. However, there is a substantial risk that the final outcome of the legislation will be a new, government owned, lending organization similar to the Farmers Home Administration. The heavy focus of the legislative debate and the resulting legislation reflect continued Congressional efforts to use credit as a mechanism to soften the impacts of changing economic reality in rural America. FmHA's track record demonstrates that credit is an expensive and ineffective method of improving the economic well being of rural families.

The legislation has, in effect, provided the Farm Credit System with the equivalent of a disaster loan similar to those given farmers a few years ago. The sustained high delinquency rates on these farmer loans indicates that disaster loans are a poor way of correcting the financial problems of businesses. We can only hope that the $4 billion disaster loan to the Farm Credit System will be more successful (from the lender's perspective) than was the disaster loan program to farmers. There is considerable room for doubt.

(Please see Page 34)

The legislation was a pragmatic solution to the problem faced by Congress. The current federal budget situation and the strains on the U.S. financial system provided Congress with limited operating room. From Congress' perspective, a five year interest free loan costing about $1.5 billion over five years is preferable to either a several billion dollar cash gift or liquidation of the System. The legislation buys time for the U.S. financial market to determine if there really is an economic justification for the Farm Credit System in the future.

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Small-Town Revitalization Resources

A Selected Annotated Bibliography

By Nancy Stark

Editor's Note:
One of the important objectives of CHOICES is to facilitate exchange of information. Therefore, we were pleased that Nancy Stark brought this bibliography to our attention, especially since it relates so closely to the articles in the fourth quarter 1987 issue of CHOICES that focused on rural development.

• *Community Economic Analysis*, a manual for analyzing a community's economy. Huestedde, Shaffer and Pulver, North Central Regional Center for Rural Development, Iowa State University, 216 East Hall, Ames, IA 50011. (515) 294-8322. Single copies are free.

• *Community Economic Development Strategies*, a booklet introducing community economic development. Glen C. Pulver, Agricultural Bulletin G3366, Room 245, University of Wisconsin-Extension, 30 North Murray Street, Madison, WI 53715. (608) 262-3346. $0.55.

• *Economic Development for Rural Revitalization*, a handbook discussing the problems facing rural America, offering strategies, describing Extension's role and offering many case studies and resources. North Central Regional Center for Rural Development, Iowa State University, 216 East Hall, Ames, IA 50011. (515) 294-8322. Single copies are free.

• *Economic Development Manual*, a book introducing economic development, with particular attention to business attraction techniques, by Kenneth C. Wagner. University Press of Mississippi, 3825 Ridgewood Road, Jackson, MS 39211. (601) 982-6205. $9.95.

• *Economic Development Strategy: Noxubee County, MS*, an economic development plan and how-to manual. John Harenza, Tennessee Valley Authority, 1J105 Old City Hall, Knoxville, TN 37902. (615) 632-6385. Free.

• *Harvesting Hometown Jobs*, a coordinated, do-it-yourself training package containing a 13-minute videotape (or film), a 37-page small-town development primer, a 51-page user's guide and a set of six extensive case studies of successful development strategies for small communities. National Association of Towns and Townships, 1522 K Street, NW., Suite 730, Washington, DC 20005. (202) 737-5200. Package with video: Two-week rental for members $10, for non-members $35.

• *Local Economic Development: A Strategic Approach*, a self-instruction training package, including a handbook, user's guide, sample survey instruments and data collection sheets, and guide to leading training sessions. International City Management Association, 1120\G Street, NW., Washington, DC 20005. (202) 626-4627. $60.00.

• *Main Street At Work*, a set of audiovisual materials on downtown revitalization, including four 20-minute videotapes and accompanying user's guides for facilitators. National Trust for Historic Preservation, National Main Street Center, 1785 Massachusetts Avenue, NW., Washington, DC 20036. (202) 673-4219. $80.00.

• *Organizing a Small-Town Development Corporation* (Circular 491), a booklet about organizing LDCs in New Mexico, which is generically useful. Robert O. Coppedge, Department of Agricultural Information, New Mexico State University, Box 3AI, Las Cruces, NM 88003. (505)\646-3228. Free.

• *Retention and Expansion Business Visits: A Guide for an Effective Economic Development Program*, a compilation of step-by-step instructions, low-cost suggestions and other "how-to" information. George Morse, John Rohrer, and Sam Crawford, Ohio State University Cooperative Extension Service, 2120 Fyffe Road, Columbus, OH 43210. (614) 292-7922. $5.00; indicate Bulletin 728.

• *Revitalizing Rural America*, a booklet describing the Cooperative Extension System's response to rural America's challenges. Robert Lovan, USDA Extension Service, Room 3909 South Building, Washington, DC 20250. (202) 382-8743. Single copies free.

• *Rural Economic Development Source Book*, an extensive listing of training and technical assistance materials. Margaret G. Thomas, Midwest Research Institute, 425 Volker Boulevard, Kansas City, MO 64110. (816) 753-7600. $15.00.

• *Rural Development Perspectives*, a triannual journal of the Economic Research Service, U.S. Department of Agriculture. Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402. (202) 786-1548. $10.00/year.

• *Rural Community and Economic Development Manual*, a guidebook for rural electric cooperatives and other local leaders. Harenza and Scharre, National Rural Electric Cooperative Association, 1800 Massachusetts Avenue, NW., Washington, DC 20036. (202) 857-9562. $40.00 for non-cooperatives.

• *Setting Community Economic Goals and Strategies for Economic Development*, a set of two community development flyers. David L. Darling, Jr., Kansas State University Cooperative Extension Service, Umberger Hall, Room 215, Manhattan, KS 66506. (913) 532-5840. Free.

• *Shaping the Local Economy*, a book in a practical management series, geared to city administrators of medium-sized communities. International City Management Association, 1120 G Street, NW., Washington, DC 20005. (202) 626-4600. $21.00.

Small Town Strategy, a series of eight useful booklets on small-town development. Western Rural Development Center, Oregon State University, Corvallis, OR 97331. (503) 754-3621. $4.00 for set.

• *Southern Neighborhoods Network* has several inexpensive publications on community rural economic development. PO Box 121133, Nashville, TN 37212. (615) 320-5757.

• *Tool Kit for Alternative Economic Development*, a packet of technical materials (including a videotape) and subscription service. Missouri Community Economic Development Projects, 628 Clark Hall, University of Missouri, Columbia, MO 65211. (314) 882-2937. $150.00/year for complete kit.

• *Tourism USA: Guidelines for Tourism Development*, an extensive practical handbook showing how to assess and develop the tourism potential of most any community. Tourism USA, United States Travel and Tourism Administration, U.S. Department of Commerce, Washington, DC 20230. (202) 377-0140. Single copies free. Additional copies, $3 each. C

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