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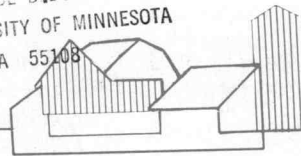
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FRB CHICAGO



AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO  
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Number 1673

### New legislation to shore up Farm Credit System

New legislation amending the Farm Credit Act of 1971 was signed into law on December 23, 1985. The legislation is expected to better equip the troubled Farm Credit System, which has been battered by mounting losses and nonperforming loans, to work through its current difficulties and avoid similar problems in the future. Toward that end, the legislation calls for a major restructuring within the Farm Credit System (FCS) and expands the regulatory authority of the Farm Credit Administration (FCA), the federal agency that oversees the lending network. The legislation also establishes a mechanism through which federal assistance may be extended to the 37 banks in the FCS.

The Farm Credit System, which was established to facilitate the flow of credit to the agricultural sector, is a borrower-owned network of lending institutions. Under the supervision of the Farm Credit Administration, the system provides real estate loans through Federal Land Banks, shorter term operating loans through Federal Intermediate Credit Banks, and loans to cooperatives through the Central Banks for Cooperatives. The system generates funds for lending by issuing bonds and discount notes through its Funding Corporation.

The financial condition of the Cooperative Farm Credit System deteriorated sharply during 1985. During the first nine months of the year, net loan charge-offs of the 37 banks in the system totaled \$318 million, more than two and a half times the total net charge-offs reported for the entire previous year. In anticipation of further large charge-offs, the 37 banks during the first three quarters of 1985 took a charge against earnings of \$675 million as a provision for (pending) loan losses, up from \$122 million in all of 1984. The increase in provision for loan losses was the major factor leading to a sharp decline in earnings for the 37 banks. Through the first three quarters of 1985 the system reported a net loss of \$426 million for the 37 banks, in marked contrast to a net profit of \$363 million during the first three quarters of 1984. Many analysts expect that further large provisions for future loan losses during the fourth quarter will push the net loss for the 37 banks combined to around \$2.5 billion for all of 1985.

Faced with that possibility and waning investor confidence, Farm Credit System officials requested financial assistance from the federal government. The legislation that was enacted establishes a procedure to receive the assistance, and also calls for a more streamlined organizational structure and enhanced regulatory powers of the Farm Credit Administration. A major organizational change involves the replacement of the Federal Farm Credit Board with a new FCA Board and Chairman. The Federal Farm Credit Board was composed of 13 members, one from each of the twelve farm credit districts, serving staggered six-year terms, and a repre-

sentative appointed by the Secretary of Agriculture. Formerly, this body, which served on a part-time advisory basis, appointed the governor to administer the affairs of the FCA. The new FCA Board will consist of three full-time members appointed by the President, with one serving as chairman to replace the post of governor. During the interim that the full-time board is being selected and confirmed by the Senate, the thirteen-member Federal Farm Credit Board will continue to serve in an advisory capacity, while the governor, who will continue to serve at the pleasure of the President, will exercise all powers previously granted to the board as well as the expanded authorities that have been granted to the new FCA Board and Chairman.

The expanded authorities of the FCA Board and Chairman enhance the regulatory powers of the organization. Many analysts have noted that in the past the FCA's limited authority and its tendency to involve itself in the management of the banking institutions in the system prevented it from being an effective arm's-length regulator. Provisions of the new legislation are intended to rectify that situation. Toward that end, a new duty of the FCA will be to perform examinations of system institutions on a regular basis. In addition, the FCA will require the publication of annual financial reports by each system institution, audited by an independent public accountant. The FCA Board will also have the authority to set minimum capital levels for system institutions.

To enforce its new powers and assure the sound operation of the system, the FCA Board will be empowered to issue cease-and-desist orders, a power the Farm Credit Administration did not previously enjoy. Temporary orders can be invoked for system institutions thought to be undertaking unsafe or unsound practices or in violation of other FCA regulations. These orders would become effective immediately and, unless suspended or limited by a court, remain in effect while proceedings on permanent orders were underway.

Additional new duties of the FCA are outlined in the legislation. It will appoint a conservator or receiver for any system institutions that become insolvent, or where solvency is threatened by unsound practices. In addition, a conservator or receiver may be appointed for an institution that violates a permanent cease-and-desist order issued by the FCA. The regulator will also be responsible for approving the issuance of system securities along with establishing standards for the rates paid on those securities and the rates charged system borrowers. Finally the FCA Board Chairman will have the authority to establish a reserve fund for troubled institutions. This "Central Reserve" fund can be created at the discretion of the Chairman after January 1, 1991, when the funding authority of the Farm Credit System Capital Corporation expires. If established, it would be funded by assessments of

0.1 percent on bonds issued by the system and could be used to provide temporary assistance to FCS institutions experiencing financial difficulties.

To enable the system collectively to address its current difficulties, the legislation provides the means for pooling the resources of the 37 member banks. The Farm Credit System Capital Corporation, established earlier this year to assist the Spokane and Omaha Federal Intermediate Credit Banks, has been formally designated to provide a central source of financial aid to individual FCS institutions. The Capital Corporation will be under the authority of a five-member Board of Directors. Three of the members are to be selected by the system banks, and two by the Chairman of the FCA Board.

The activities of the Capital Corporation will center on assistance for troubled system institutions. For institutions under severe stress, the corporation can act as a central source of aid, providing loans and capital injections or purchasing stock of individual system institutions experiencing difficulties. In addition, it can aid in the restructuring, refinancing and guaranteeing of loans, or can participate in nonperforming loans. These activities would all involve dealing with system difficulties at the local institution level. Alternatively, it could serve as a system-wide warehouse for bad loans or acquired properties. The Capital Corporation can make further attempts to restructure these problem loans itself or, if necessary, administer their liquidation.

To finance its activities, the Farm Credit System Capital Corporation can draw funds from a number of sources. One means of acquiring funds would be to require that system banks purchase stock in the corporation. Any required purchases of stock would be under guidelines established by the Farm Credit Administration, and must come from the surplus capital of the banks rather than member-borrowers' capital stock. Moreover, stock purchases by a system institution could not jeopardize its capital position or its ability to extend credit to borrowers on reasonable and competitive terms. In addition, the Capital Corporation can be funded through issuing system-wide securities and is authorized to borrow on its own responsibility from commercial banks. However, the Capital Corporation's authority to assume new liabilities is scheduled to expire at the end of 1990. That stipulation, given the Capital Corporation's role of participating in and acquiring loans to stabilize the systems financial position, is intended to prevent it from evolving into a permanent, primary lender to the agricultural sector.

The legislation also designates the Farm Credit System Capital Corporation to receive and administer any federal financial assistance that might be forthcoming. In the event of such assistance the five-member Board of Directors of the Capital Corporation will be expanded to seven. A sixth member would be appointed to the Board by the Secretary of Agriculture and those six would select another member from the general public. Furthermore, the legislation stipulates that

one of the three Directors elected by the system institutions is to come from an FCS institution and District that is a net contributor to the Capital Corporation, while another must come from an FCS institution and District that is a net recipient of Capital Corporation assistance.

Federal assistance, if provided, would be a line of credit from the Treasury. Although no limit on the amount of aid is specified by the legislation, it does require that a number of conditions be satisfied before the credit is extended. To receive assistance, the Farm Credit Administration would have to certify that the system's available capital surplus and reserves, excluding member-borrower capital, have been committed and that any further drain on system resources would hinder the ability of its institutions to serve their borrowers on reasonable terms. At that point, the FCA Board Chairman would notify the Secretary of the Treasury that assistance is needed. The request for assistance must then be approved by the House and Senate Appropriations Committees. If approved by the Congressional Committees, the Secretary of the Treasury then has the authority to extend credit to the system through its Capital Corporation. The amount and timing of the assistance, however, is still at the discretion of the Treasury Secretary, and is not required to match the original request or that approved by Congress.

The new legislation offers the opportunity to stabilize the condition of the Cooperative Farm Credit System. The greater authority afforded the FCA Board and Chairman will allow the system to consolidate its efforts to overcome its current difficulties and provide it with the tools to avoid their repetition. Moreover, the commitment of system resources and establishment of the means of providing public assistance is likely to maintain investor confidence in the system and assure its ability to effectively serve the credit demand of the agricultural sector. Reflecting this, interest rate spreads between Treasury and system securities have already narrowed appreciably.

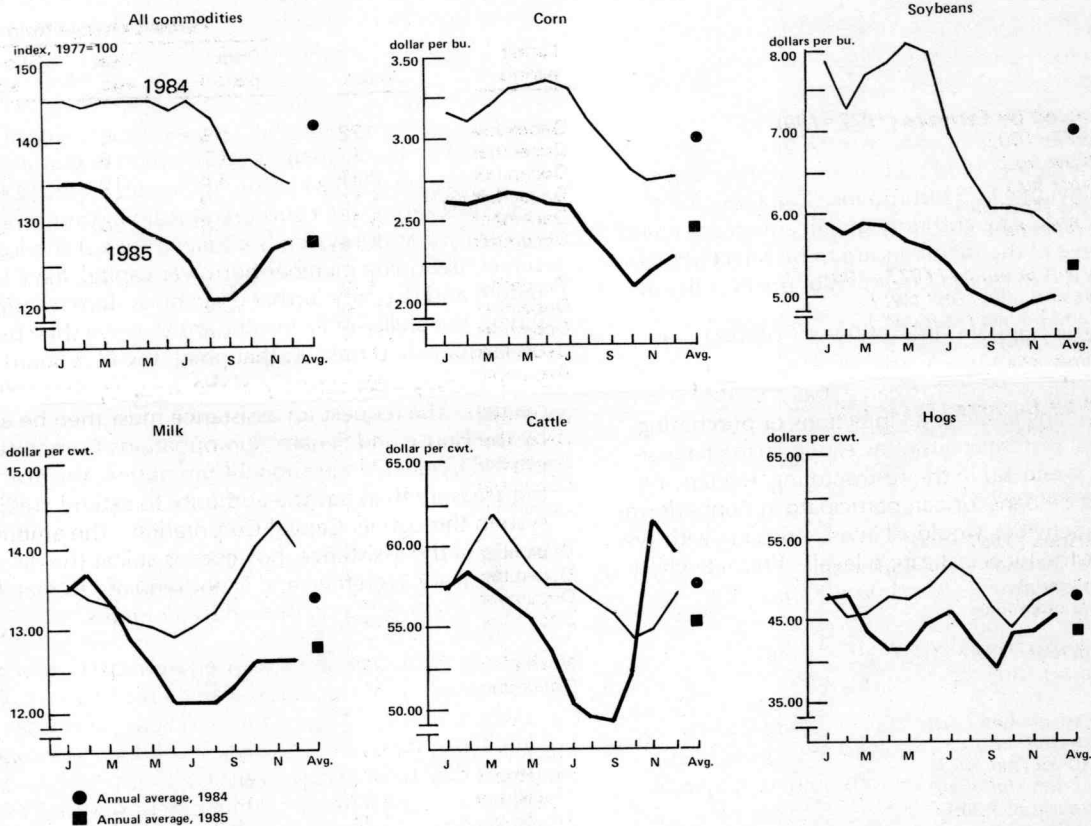
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## 1985 In Perspective

### Farm Commodity Prices



	Units	1980	1981	1982	1983	1984	1985*
<b>Production</b>							
Corn	bil. bu.	6.64	8.12	8.24	4.18	7.66	8.72
Soybeans	bil. bu.	1.80	2.00	2.19	1.64	1.86	2.13
Wheat	bil. bu.	2.38	2.79	2.77	2.42	2.60	2.42
Cattle slaughter	mil. head	33.8	35.0	35.8	36.6	37.6	36.0
Hog slaughter	mil. head	96.1	91.6	82.2	87.6	85.2	83.8
Milk	bil. lbs.	128.4	132.8	135.5	139.7	135.4	143.1
<b>Income of Farm Families, Per Farm</b>							
Net cash farm income							
Current dollars	thou. dol.	15.3	14.7	16.0	16.2	16.8	17.1
1972 dollars	thou. dol.	8.5	7.5	7.7	7.5	7.5	7.4
Total net farm income							
Current dollars	thou. dol.	8.3	12.2	10.2	6.3	14.8	11.8
1972 dollars	thou. dol.	4.6	6.3	5.0	3.0	6.6	5.2
Off-farm income							
Current dollars	thou. dol.	14.4	15.2	15.8	16.4	17.1	17.9
1972 dollars	thou. dol.	8.0	7.8	7.6	7.6	7.7	7.7
<b>Farm Sector Balance Sheet (year-end)</b>							
Assets							
Current dollars	bil. dol.	1,003	1,005	978	957	856	815
1972 dollars	bil. dol.	562	515	472	445	384	353
Liabilities							
Current dollars	bil. dol.	170	189	204	203	199	198
1972 dollars	bil. dol.	95	97	99	94	89	86
Equity							
Current dollars	bil. dol.	833	816	774	754	657	617
1972 dollars	bil. dol.	467	418	373	351	295	267

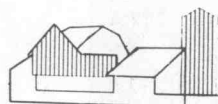
\*Preliminary production figures and mid-points of forecast ranges for income and balance sheet figures.



## Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
<b>Prices received by farmers (1977=100)</b>					
Crops (1977=100)	December	128	0.8	-5	-9
Corn (\$per bu.)	December	117	1.7	-6	-14
Oats (\$per bu.)	December	2.31	5.0	-10	-27
Soybeans (\$per bu.)	December	1.14	0	-34	-34
Wheat (\$per bu.)	December	5.01	1.8	-14	-35
	December	3.16	-2.2	-7	-9
<b>Livestock and products (1977=100)</b>					
Barrows and gilts (\$per cwt.)	December	139	0.7	-4	-4
Steers and heifers (\$per cwt.)	December	46.30	5.5	-7	2
Milk (\$per cwt.)	December	60.10	0	-5	-1
Eggs (¢per doz.)	December	12.60	0	-10	-8
	December	66.2	0	13	-21
<b>Prices paid by farmers (1977=100)</b>					
Production items	December	163	0	0	1
Feed	December	149	0	-2	-3
Feeder livestock	December	113	2.7	-7	-21
Fuels and energy	December	146	-2.7	-5	-6
	December	206	0.5	4	2
<b>Producer Prices (1967=100)</b>					
Agricultural machinery and equipment	December	297	0.2	2	4
Fertilizer materials	December	338	0	0	2
Agricultural chemicals	December	226	-0.7	-2	-1
	December	460	0	1	0
<b>Consumer prices (1967=100)</b>					
Food	November	327	0.3	4	8
	November	311	0.4	2	6
<b>Production or stocks</b>					
Corn stocks (mil. bu.)	October 1	1,379	N.A.	91	-56
Soybean stocks (mil. bu.)	September 1	318	N.A.	81	-8
Beef production (bil. lbs.)	November	1.81	-14.1	-6	-6
Pork production (bil. lbs.)	November	1.24	-8.9	-7	-16
Milk production (bil. lbs.)	November	11.6	-3.9	10	5

N.A. Not applicable



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