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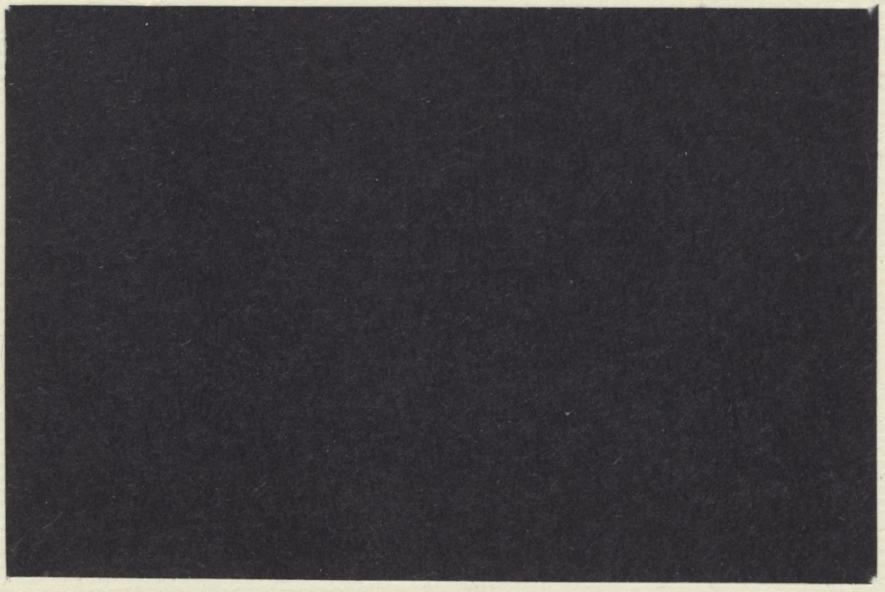

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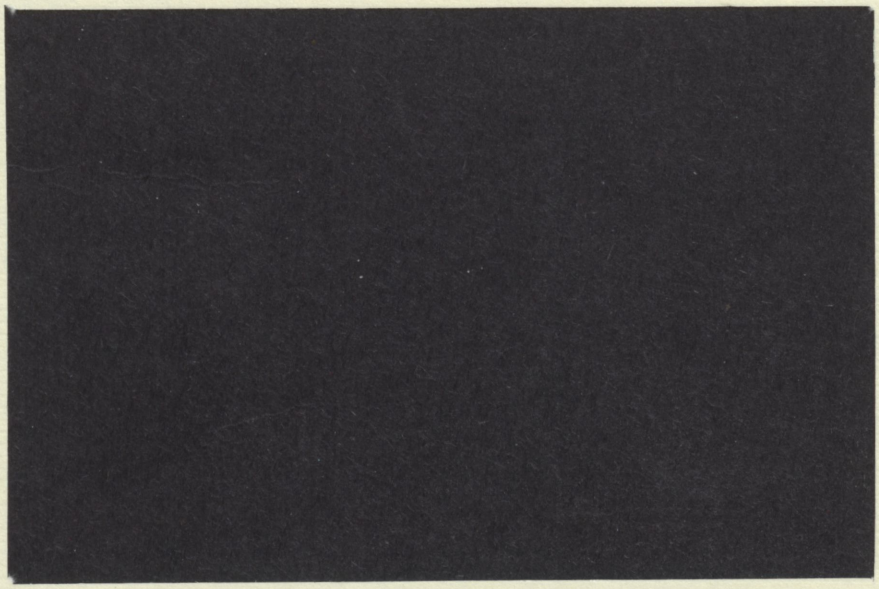

FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY

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SUMMARY

FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY

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The nature and magnitude of the farm financial situation is different than is generally recognized. The increased frequency of loan delinquencies and bankruptcies are not caused by high interest rates and the strong value of the dollar. The current financial problems were created by the annual increases in farm debt throughout the 1970s by the amount of increases in asset values rather than at a rate dictated by growth in repayment capacity. Moreover, this debt was borrowed at double digit interest rates while rates of return on agricultural assets were less than 5 percent. The result is $50 billion of farm debt (about 20 percent of total) that cannot be repaid from the combined farm and non farm income of the families that owe the debt.

There are several policy implications of the excess agricultural debt situation.

- The magnitude of the farm finance problem makes traditional price support programs ineffective for dealing with the problem. Commodity prices would have to be increased by more than 50 percent to help most of the financially stressed farms.

- The magnitude of farm debt swamps the impact of "high" interest rates for most farms experiencing financial stress. Reducing interest rates by 50 percent (100 percent in some cases) would not eliminate the cash shortfall of farms with excess debt.

- Government loan guarantees do not increase repayment capacity of farms with financial stress. Thus, loan guarantee programs do not effectively deal with the financial problem.

- More debt, even at subsidized interest rates, is not the solution to an excess debt problem. An expanded government loan program is the worst possible policy that could be pursued.

The magnitude of the farm debt problem requires large scale and immediate action. There is no way of avoiding the wealth transfers and losses associated with the creation of excess debt and the asset devaluations that have occurred. The challenge facing policy makers is to determine how these losses are to be distributed among borrowers, lenders, and the government.

FARM CREDIT SITUATION: IMPLICATIONS FOR AGRICULTURAL POLICY*

J. Bruce Bullock**

It is widely recognized that there is a considerable amount of financial stress in the agricultural sector. A USDA report released last week provides us with a comprehensive look at the extent and distribution of financial difficulties in U.S. agriculture.[1] The report indicates that about 18 percent of the farms in the U.S. owe 56 percent of all farm debt. These 386,000 farms are considered to be highly leveraged and have less than 60 percent equity in their farm businesses. The USDA estimates that by January 1986, about six percent of U.S. family size commercial farms will be technically insolvent (i.e., have negative net worth). They also estimate that if current economic conditions extend into the future, an additional 2.8 percent of family farms will become insolvent each year.

Simply stated, the farm financial problem is that there is more farm debt than can be repaid from farm and non farm income of those who owe the debt. High interest rates and the strong value of the dollar

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[1]USDA, "The Current Financial Conditions of Farmers and Farm Lenders," Economic Research Service, Agricultural Information Bulletin No. 490, March 1985.

tend to compound the pressures created by the excess debt situation. However, high interest rates and weak export demand are not the cause of the financial problems in agriculture.

The symptoms of an excess debt situation are increasing inability of borrowers to make interest and principal payments on schedule and a subsequent increase in loan foreclosures and bankruptcies. The observed rise in loan delinquencies has occurred simultaneously with record levels of real interest rates and substantial increases in the value of the U.S. dollar. Thus, government economic policies designed to bring inflation under control have been blamed for much of the financial problems in agriculture. Unfortunately, most of the policy proposals for dealing with the farm finance situation have focused on treating the negative cash flow and loan delinquency symptoms of the excess agricultural debt problem rather than with correcting the problem itself.

Viewing high interest rates and the strong value of the dollar as causes of the current farm finance situation has prevented most observers from looking beyond these factors in their search for the cause of the farm finance problem. Examination of the USDA data clearly reveals that a substantial portion (perhaps as much as 24 percent) of the existing farm debt cannot be repaid even at zero interest rates or if farm product prices were increased by 50 percent. Consequently, the difficult question facing policy makers is how the inevitable wealth losses are to be distributed among farmers, lenders, and the government.

Four questions regarding the current farm finance situation are of interest from a public policy perspective:

1. How did we get into the current situation?

2. What is the cause (not the symptoms) of the current financial stress in U.S. agriculture?

3. What are the policy options available for dealing with the problem?

4. What are the likely impacts of these policy options?

How did we get here?

The agricultural sector financed its trip to the current situation on borrowed capital. Unfortunately, repayment capacity from farm earnings never existed for a large part of the agricultural debt expansion over the past 10 years. Table 1 shows that the rate of return on farm assets was less than 5 percent throughout the 1970s when much of the increases in farm debt occurred. Moreover, the return has been less than three percent since 1980. Clearly, asset values were increasing more rapidly than farm income over this period. The current financial problems were created because debt expanded annually by the amount of increases in asset values rather than at the rate dictated by growth in repayment capacity. Moreover, this debt was borrowed at double digit interest rates while rates of return on agricultural assets were less than 5 percent.

Borrowing money against inflated asset values with inadequate earning capacity for debt repayment makes sense only if inflation continues forever, or if the assets are sold at their inflated value (and the debt repaid) prior to termination of inflation. Obviously, neither of these developments occurred. Inflation was brought under control and caused the inevitable decline in land values. Land values established in 1981 made sense only if inflation continued at levels anticipated in 1981.

TABLE 1

KEY INDICATORS OF CHANGES IN ECONOMIC HEALTH OF U.S. AGRICULTURAL SECTOR

	Net Farm Income Bill $	Value of Farm Assets Bill $	Farm Debt Bill $	Incomes as % of Asset Value	Debt Asset Ratio	Farm Debt ÷ Net Farm Income
1940-49	11.8	90.3	9.45	13.1	.11	.80
1950-59	12.8	171.5	17.3	7.5	.10	1.35
1960-69	12.4	247.4	36.7	5.0	.15	2.96
1970-79	23.6	521.9	83.7	4.5	.16	3.55
1980	21.2	1005.5	159	2.1	.15	7.50
1981	31.0	1089.8	175	2.8	.16	5.65
1982	22.3	1083.5	202	2.1	.19	9.05
1983	16.1	1045.2	216	1.5	.21	13.42
1984[1]	31	1031.1	215	3.0	.21	6.94
1985[2]	22	NA	217			9.87

[1] preliminary

[2] forecast

The decline in land values has had the obvious impact of consuming farmers' equity and hence their lenders' margin of collateral. Consequently, the debt/asset ratios of farm borrowers have increased and the quality (as measured by collateral margin) of the lenders' agricultural loan portfolio has declined.

However, the decline in land values has had no impact on the debt repayment capacity of the agricultural sector. Declining land values have simply removed the artificial impression of financial well being that both farmers and their lenders had been operating under for the past 10 years. Without the umbrella of inflation driven increases in land values to collateralize expanded debt to cover cash flow shortages, the agricultural sector is faced with rising delinquency rates on farm loans and increasing numbers of loan foreclosures and bankruptcies.

What is the Cause of the Current Financial Stress?

The data in Table 1 indicate that excess debt is the cause of the current financial stress in agriculture. Excess debt refers to debt that cannot be repaid from income generated by the asset purchased with borrowed capital. However, not everyone is convinced that excess debt is the problem. Some argue that high interest rates are the culprit.

The data in Tables 2 and 3 clearly demonstrate that the magnitude of farm debt swamps the impact of "high" interest rates for most farms experiencing financial stress. Note that reducing interest rates 50 percent (100 percent in some cases) would not eliminate the cash shortfall of farms with excess debt. It is also clear from the data in

TABLE 2

AVERAGE DEBT SERVICE OBLIGATIONS AND CASH SURPLUS (SHORTFALL) FOR FARMS WITH DEBTS EXCEEDING 70 PERCENT OF ASSET VALUES 1983

Sales Class $1,000	Principal Payment	Interest Payment	Cash Surplus (Short Fall)
> 500	$59,671	$119,674	(56,456)
250-499.9	26,348	61,691	(5,510)
100-249.9	15,905	29,679	(21,592)
50-99.9	10,347	17,509	(21,606)
25-49.9	7,294	12,610	(24,689)
10-24.9	3,736	12,839	(28,064)
< 10	2,650	4,835	(11,369)

Source: USDA, "The Current Financial Condition of Farmers and Farm Lenders," Economic Research Service, Agri. Info. Bulletin, No. 490, March 1985, Appendix Table 1.

TABLE 3

AVERAGE DEBT SERVICE OBLIGATIONS AND CASH SURPLUS (SHORTFALL) FOR FARMS WITH DEBTS RANGING FROM 40 TO 70 PERCENT OF ASSET VALUES, 1983

Sales Class $1,000	Principal Payments	Interest Payments	Cash Surplus (Short Fall)
> 500	$52,600	$108,533	$6,978
259-499.9	21,074	48,201	7,222
100-249.9	14,323	32,996	(4,840)
50-99.9	9,892	23,223	(22,443)
25-49.9	5,071	11,864	(21,056)
10-24.9	3,736	7,690	(22,405)
< 10	2,585	5,419	(14,604)

Source: USDA Agri. Info. Bulletin No. 490, March 1985, Appendix Table 1.

Tables 2 and 3 that proposals to provide up to $3,000 or $4,000 in interest rate relief funds for farmers with debt problems are at best token efforts. Cash payments averaging at least $20,000 per farmer are required to eliminate the cash short falls of the farmers under financial stress. Moreover, these payments would have to be made annually for several years into the future since no improvement in farm cash receipts is anticipated.

Policy Options and Their Potential Effectiveness

Higher Price Supports:

Raising price support levels is the old standby solution for dealing with farm finance issues. Many farmers and other observers seem to think that higher farm commodity prices will cure any problem facing agriculture. However, the data in Table 4 show that these observers are kidding themselves about the capacity of higher support prices to solve the current financial problems in agriculture. The data show the cash surplus (shortfall) of farms in each size/debt category as a percent of gross farm sales. Farm prices would have to be increased from 15 to 560 percent to correct the financial problems for most of the 386,000 farms with the most severe financial stress.

Price increases of this magnitude generated by price support programs are neither practical nor possible. The current financial problems of U.S. agriculture are too large to be solved by price and income support programs.

TABLE 4

AVERAGE CASH SURPLUS (SHORTFALL) AS A PERCENT OF CASH SALES BY SALES CLASS AND DEBT/ASSET RATIO 1983

Sales Class $1,000	Debt Asset Ratio		
	Over .7	From .4 to .7	Less than .4
> 500	(5.2)	.7	14.1
250-499.9	(1.8)	2.2	13.9
100-149.9	(14.7)	(3.3)	10.3
50-99.9	(32.5)	(31.8)	(2.0)
25-49.9	(72.9)	(61.1)	(23.7)
10-24.9	(211.3)	(150.2)	(44.2)
< 10	(567.9)	(499.8)	(144.0)

Source: USDA Agricultural Information Bulletin No. 490.

Provide Government Loan Guarantees:

Policy makers should keep one thing in mind as they consider this policy option. Government loan guarantees do not increase the repayment capacity of farmers with financial problems. A loan guarantee program will successfully deal with the financial stress problem only if the program requires that the excess debt situation of the borrower be corrected as a pre condition for obtaining the loan guarantee. Failure to impose such requirements will simply mean that the unavoidable wealth losses required to correct the excess debt problem will be transferred from borrowers and lenders to the government (assuming the government does not confiscate the assets of the defaulting borrower). This is certainly a viable policy option. However, it should be recognized as a loss transfer mechanism.

Proponents of the loan guarantee program point to the government bail out of Chrysler Corporation as an example of how this approach has been successful elsewhere in the economy. However, the Chrysler loan guarantee program simply provided the company with an opportunity to get its internal organization and operation into shape for operating in the new economic environment in which it found itself. Is the agricultural sector willing to make similar changes?

Add Liquidity to the Land Market:

One proposal is to create an agency to purchase land. The actions of the agency would provide strength and liquidity to the land market. The agency would then lease the land back to the farmer so that the farming operation could be continued. Presumably the land purchase agency would expect to receive a competitive rate of return on funds

invested in land purchases. Thus, if land is purchased at a price equal to the debt of the selling farmer the lease payments would be about the same as the interest payments the farmer is currently making on the debt he transferred with the land. The net effect is that the borrower transfers title to his land to the agency in return for making no principal payments.

The average principal payments of farmers under financial stress are shown in Tables 2 and 3. The land purchase/lease back agency would completely solve the cash short fall problems only for farms over $250,000 gross sales with less than 30 percent equity and for farms with over $100,000 sales and equity between 30 and 60 percent. This accounts for about 21 percent of the highly leveraged farms. The remaining farms would still have several thousand dollars in annual cash short falls.

The land purchase proposal does deal directly with the problem of excess debt. It removes the burden of principal paymentsfrom the farmer, but does not remove interest payment obligations.

Debt Removal:

Solution to the excess debt problem requires that the debt and associated principal and interest payments be removed from the agricultural balance sheet and cash flow. Public policy will determine how this wealth loss is distributed among borrowers, lenders, and the government.

How much excess debt is there? The USDA estimates of cash shortfall provide the basis for determining the amount and distribution of excess debt in the agricultural sector assuming that farm production,

commodity prices, and off farm earnings of farm families remain at 1983 levels.

The USDA cash flow analysis assumed that principal payments are 1/20 of the existing debt. Thus, if we use 10 percent interest rates, annual principal and interest payments are $150 per $1000 of debt. This estimate of debt servicing cost is used to calculate the amount of debt that must be removed in order to reduce the cash shortfall to zero.

The first two columns of Table 5 show the average debt per farm in each category. The second two columns show the amount of debt that would have to be removed in order to reduce the average farmer's cash shortfall to zero. The last two columns show the percent of debts that would have to be removed.

Table 6 shows the total amount of debt owed by farms in the financially stressed category. Table 7 shows the total amount of excess debt for each group of farms. There is approximately $50 billion of agricultural debt that cannot be paid from current income (both farm and non farm sources) of farmers owing that debt. This is 23.5 percent of the total debt owed by the agricultural sector.

Three fourths of the excess debt is held by farms producing less than $100,000 in annual gross sales. Forty-five percent of the debt is owed by farms with less than $50,000 annual sales.

The USDA cash shortfall data clearly reveal the inappropriateness of including farms with less than $50,000 annual sales in our calculations of farm numbers used in formulating agricultural policies. Note in Table 5 that more than 100 percent of the debt owed by these farms would have to be written off to generate a zero cash balance for these

TABLE 5

AVERAGE DEBT AND AMOUNT OF DEBT WRITE OFF REQUIRED TO REDUCE CASH SHORT FALL TO ZERO

Sales Class	Average Debt		Debt Forgiveness Required		Percent of Debt That Must Be Forgiven	
	DA < .7	.4 < D/A <.7	D/A ≧ .7	.4 < D/A < .7	D/A ≧ .7	.4 < D/A < .7
	$1000		$1000		Percent	
> 500	1,195	1,074	376	------	31	-----
250-499.9	586	461	37	------	6	-----
100-249.9	303	315	144	32	48	10
50-99.9	185	220	144	150	78	68
25-49.9	132	112	165	140	125	125
10-24.9	110	76	187	149	170	196
≦ 10	49	53	76	97	155	183

TABLE 6

AMOUNT OF DEBT OWED BY FARMS WITH DEBT ASSET RATIOS IN EXCESS OF .4

Sales Class ($1000)	Amount of Debt (Bill. $)			Percent of Total Farm Debt		
	D/A > .7	.4 < D/A < .7	Total	D/A > .7	.4 < D/A < .7	Total
> 500	10.4	10.2	20.6	4.9	4.8	9.7
250-499.9	8.9	10.8	19.7	4.2	5.1	9.3
100-249.9	12.5	22.4	34.9	5.9	10.6	16.5
50-99.9	8.3	13.1	21.4	3.9	6.2	10.1
< 50	10.2	12.3	22.5	4.8	5.8	10.6
All Farms	50.3	68.8	119.5	23.7	32.5	56.2

TABLE 7

AMOUNT OF DEBT WRITE OFF REQUIRED TO REMOVE CASH SHORTFALLS

Sales Class $1,000	Amount of Write Off Required ($ Bill.)			Percent of Total Write Off	Write Off as A Percent of Total Farm Debt		
	D/A > .7	.4 < D/A < .7	Total		D/A > .7	.4 < D/A < .7	Total
> 500	3.2	---	3.2	6	1.5	---	1.5
250-499.9	0.5	---	0.5	1	.2	---	0.5
100-249.9	6.0	2.2	8.2	17	2.8	1.0	3.9
50-99.9	6.5	8.9	15.4	31	3.1	4.2	7.3
< 50	10.2	12.3	22.5	45	4.8	5.8	10.6
All Farms	26.4	23.4	49.8	100	12.5	11.0	23.5

TABLE 8

AVERAGE GROSS FARM INCOME MINUS OPERATING EXPENSES (EXCLUDING INTEREST) BY FARM SIZE FOR FARMS WITH DEBTS IN EXCESS OF 70% OF ASSET VALUES

Sales Class $1000	Gross Sales	Operating Expenses	Net Contribution of Farm Operation to Cash Flow
	---Dollar Per Farm---		
> 500	1,141,608	1,026,386	115,224
250-499.9	337,463	248,336	89,127
100-249.9	155,350	122,680	32,670
30-99.9	72,653	56,718	15,935
25-49.9	36,769	33,603	3,166
10-24.9	16,481	23,621	(7,140)
< 10	9,432	12,880	(3,448)

Source: USDA Agricultural Information Bulletin 490, Appendix Table 1.

farms. These farms have cash flow problems unrelated to their debt structure.

Tables 8 and 9 show that the average farm producing less than $25,000 of gross agricultural sales generates about a $6,000 drain on cash flow even before debt payments are considered. Providing debt to these "farming" operations is hardly good business. Table 10 illustrates that if public policy is to maintain these families in rural areas with a standard of living comparable to commercial farmers, we would be better off to shut down their farming operation. The amount of compensation required in addition to 100% debt write off arises because the off farm income of these families is less than the amount of living expenses used in the USDA calculations.

Expand Government Loan Programs:

More credit, even at subsidized interest rates, is not the solution to an excess debt problem. An expanded government loan program is the worst possible policy that could be pursued. Providing additional debt to these farmers is analagous to putting more water in the swimming pool in an attempt to save a person observed to be drowining in water over their head.

A strong case can be made that liberal government lending policies promulgated by Congress through FmHA has already compounded rather than eased the farm credit problem. Government lending programs have provided 20 percent of the growth in non real estate farm debt over the past 12 years. Table 11 shows that FmHA operating loans increased 70 percent in 1976. This was followed by annual increases of more than 50 percent over the 1978-80 period. FmHA provided 34 percent of the

TABLE 9

AVERAGE GROSS FARM INCOME MINUS OPERATING EXPENSES (EXCLUDING INTEREST) BY FARM SIZE FOR FARMS WITH DEBTS RANGING FROM 40 TO 70 PERCENT OF ASSET VALUES

Sales Class $1000	Gross Sales	Operating Expenses	Net Contribution of Farm Operation to Cash Flow
	----------Dollars Per Farm----------		
> 500	1,056,994	896,548	160,446
250-499.9	340,040	257,215	82,825
100-249.9	157,949	106,784	51,165
50-99.9	76,157	55,800	20,357
25-49.9	38,236	34,406	3,830
10-24.9	16,494	23,128	(6,630)
< 10	4,176	10,330	(6,154)

Source: USDA Agricultural Information Bulletin 490, Appendix Table 1.

TABLE 10

ANNUAL CASH PAYMENTS IN ADDITION TO 100% DEBT WRITE OFF REQUIRED FOR ZERO CASH SHORTFALL

	If Farming Operation Is Continued		If Farming Operation Is Terminated		Off Farm Income Minus Median Non Farm Family Income 1983*
Class	D/A ≥ .7	.4 < D/A < .7	D/A ≥ .7	.4 < D/A < .7	
25-49.9	$ 4,950	$ 4,200	$8,116	$8,030	$-7,951
10-24.9	11,500	10,944	4,360	4,313	-4,349
≤ 10	4,042	6,598	594	444	- 436

*The USDA calculations of cash surplus (shortfall) estimated family living expenses as the 1983 median family income for non metropolitan counties ($20,938).

TABLE 11

ANNUAL INCREASE IN NON REAL ESTATE DEBT OUTSTANDING
FROM PREVIOUS JANUARY 1, 1973-1984

Year	Banks	PCA	FHA	Individual and Others*	Total Excluding CCC
	Percent				
1973	14	9	1	9	11
1974	20	18	12	14	18
1975	6	21	19	10	11
1976	12	13	70	13	11
1977	15	13	6	17	15
1978	10	10	67	23	15
1979	10	11	84	17	16
1980	10	21	55	16	18
1981	2	9	31	6	8
1982	4	7	23	6	8
1983	10	(4)	2	4	4
1984[3]	8	(7)	(1)	(6)	1

[3]Preliminary

*Includes SBA

Source: USDA, Economic Indicators of the Farm Sector

increase in farm non real estate debt during the 1979-82 period Tables 12 and 13). FmHA market share of non real estate farm debt increased from 3 percent in 1973 to 15 percent in 1983 (Table 14).

A good portion of this debt was for disaster loans. Disaster loans simply add to the disaster of farms that already have more debt than can be repaid. Borrowed funds can profitably be used only on investments that yield a return higher than the interest rate at which the funds were borrowed. Payment of last year's production expenses from funds borrowed in lieu of a failed crop produce no return on investment. There is a genuine need for farm programs to provide mechanisms for disaster relief. However, this disaster relief must take the form of indemnity payments from insurance to avoid doing more harm than good in providing farmers with money to deal with the disaster.

Do Nothing:

One policy option is to simply let the chips fall where they may. This will mean that the wealth losses will be shared between borrwers and lenders. Unless lenders and borrowers move quickly to cut their losses and get debt into line with repayment capacity, the magnitude of the problem, and the cost of adjustment will continue to grow.

A do nothing government program will result in either a substantial transfer of asset ownership from borrowers to lenders to remove the debt and/or a substantial increase in the amount of land sales. Land prices have already fallen 10 to 28 percent in the midwest. Forcing the complete adjustment to occur through land sales will generate additional declines in land values. Further declines in land values may occur regardless of the policy selected. However, a do nothing policy is

TABLE 12

SOURCES OF INCREASES IN FARM NON REAL ESTATE DEBT 1973-1984

Period	Amount of Increased Debt Provided				
	Banks	PCA	FHA	Individual	Total
	1000 dollars				
1973-1976	5,523	3,945	873	2,491	12,832
1976-1979	7,667	3,993	3,527	5,629	20,816
1979-1982	4,583	5,892	7,632	4,393	22,500
1982-1984	5,812	(2,188)	170	162	2,956
1973-1984	23,585	11,642	12,202	12,675	60,104

Source: USDA Economic Indicator of Farm Sector

TABLE 13

PERCENT OF TOTAL INCREASE IN NON REAL ESTATE DEBT ACCOUNTED FOR BY LENDER

Period	Percent of total Provided				
	Banks	PCA	FHA	Individuals	Total
1973-76	43	31	7	19	100
1976-79	37	19	17	27	100
1979-82	20	26	34	20	100
1982-84	150	(58)	4	4	100
1973-1984	39	19	20	21	100

Source: USDA Economic Indicators of Farm Sector

TABLE 14

LENDER MARKET SHARES FOR FARM NON REAL ESTATE DEBT
SELECTED YEARS

Year	Banks	PCA	FHA	Individual and Other
	Percent			
1973	51	24	3	22
1978	46	25	5	23
1983	40	22	15	22

Source: USDA Economic Indicators of Farm Sector

likely to cause an over reaction in land prices in the short run.

A do nothing policy is workable. The market will adjust. The results will include a substantial increase in the number of loan foreclosures and farm bankruptcies. It will also result in a substantial increase in the number of agricultural bank failures. Both agriculture and the lending industry can survive a do nothing policy. However, a do nothing policy will result in major structural changes in both industries. Moreover, the impacts of these structural changes will spill over into mainstreet of rural communities across the U.S. Policy makers will have to decide if these changes are an acceptable price to pay for the solution to the farm finance problem.

Conclusions

There is clearly a serious financial problem in U.S. agriculture. The problem is about $50 billion of farm debt that cannot be repaid from the combined farm and non farm income of the families that owe the debt.[2] This accounts for about 23 percent of the total debt held by the agricultural sector.

The magnitude of the excess farm debt problem requires large scale and immediate corrections. There are no satisfactory partial solutions. Failure to correct the problem will completely consumer the equity of farmers holding the excess debt. Furthermore, failure to correct the problem will also seriously impact the economic viability of financial institutions currently providing credit to agricultural producers.

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[2]The estimates of excess debt derived from the USDA data are probably upper bound estimates. However, if the USDA data and/or these calculations are over estimated by 50 percent, there is a substantial excess problem to be dealt with.

There is no way of avoiding the wealth transfers and losses that have occurred from creation of the excess debt and the asset devaluations that have occurred. Failure to recognize the losses and to terminate the growing debt service obligations associated with the excess debt simply compounds the problem.

The challenge facing policy makers is to determine how those losses are to be distributed among borrowers, lenders, and the government.

The government holds about $25 billion of the excess debt in the form of FmHA loans. Since FmHA is by law the lender of last resort, a very high proportion of its portfolio is almost certainly in the "impossible to repay" category. Thus, one step of the adjustment process might be to terminate FmHA lending operations and forgive all outstanding FmHA farm loans. This would eliminate about one-half of the excess debt.

High interest rates are not the cause of the problem. Thus, efforts to subsidize interest rates to farm borrowers is not an appropriate policy response. Moreover, the problem is so large that interest rate subsidies provide only insignificant, partial relief to the symptoms of the excess debt problem.

The magnitude of the excess debt problem also renders price support policies ineffective as a solution. The farm finance problem must be dealt with separately from price and income policies. Moreover, the finance problem should be dealt with before price and income policies of the 1985 farm bill are developed.

One thing is clear. A policy decision should be made quickly. If the decision is to do nothing, then lenders and borrowers must immediately initiate the adjustment to minimize losses. Similarly, if

there is to be relief in the form of a government program, it should be implemented as soon as possible to terminate the losses and the disruption caused by the current situation.