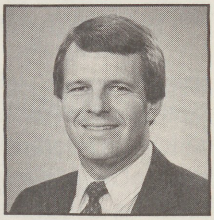
Up and Down the Hill

by Rusty L. Jesser



Rusty L. Jesser is a federal legislative representative for ABA's Government Relations Division, and works directly with the Ag Bankers Division. Prior to this post, he worked as a legislative assistant to Senator Steve Symms and Congressman Larry Craig. From 1978-1982, he served as a loan officer for the FmHA.

When the first session of the 101st Congress adjourns in either late November or December, many agricultural issues will probably remain for the second session: federal crop insurance, environmental issues, rural development, and the 1990 Farm Bill legislation.

When Congress analyzes the issues, particularly rural development and the 1990 Farm Bill legislation, it will be important for both the agricultural banking industry and policy makers to firmly establish a basic framework relative to the rural population and the makeup of the agricultural sector. The recent publication of the National Research Council, *Alternative Agriculture,* summarizes some of the key factors.

About 65 million people or 25% of the United States population live in rural areas, and another 5 million live on farms. (The U.S. Bureau of the Census and the USDA Economic Research Service define rural areas as open countryside and towns with under 2,500 residents that are not located in major metropolitan areas.)

"The total number of farms, which are defined as places with actual or potential sales of agricultural products of $1,000 or more, declined from 5.9 million in 1945 to slightly more than 2.2 million in 1985 (USDA, 1987c). It is noteworthy, however, that even in the farm recession of the mid-1980's, the decline in the number of farms between 1980 and 1986 (a loss of 220,000 farms, or 11% of all farms) was far less than that which occurred in the 1950s (1.6 million farms, or 28% of all farms) or the 1960s (960,000 farms or 24% of all farms) (USDA 1987c). Total harvested acres have remained relatively constant at approximately 340 million acres, indicating that average farm size has almost tripled. Although individuals and their families operate most farms, the growth in average farm size has been largely at the expense of the small farm with a full-time operator. Fifteen to *20 percent* of all farms produce more than *80 percent* of all output. Three quarters of all farm households generate off-farm income."[1]

1990 Farm Bill

Environmental issues, widely acknowledged by various political figures, will be major components of the agricultural policy of the 1990s and will be addressed in the next farm bill. From ABA's perspective, environmental proposals must be reasonable. Allowing the pendulum to swing too far could damage food production in this country and affect farm suppliers, producers, processors, and agricultural lenders.

Probably the next most significant component of the farm bill will be the modifications to the commodity programs which will be adjusted after the 1991 international negotiations on the General Agreement on Tariff and Trade (GATT) are completed. Another area to be seriously debated will be farm program flexibility. Farmers trying to maintain a crop base, are locked into planting the same crops year after year. This mandated crop planting program does not allow the United States to be competitive in domestic and international markets as changes occur in the supply and demand for various commodities.

Rural Development

Rural development legislation was passed by the Senate in August and was the subject of House hearings in June, July and August. The subject is now back on the agenda of Congressman Glenn English and Congressman Tom Coleman, Chairman and Ranking Member, respectively, of the Agricultural Conservation, Credit, and Rural Development Subcommittee. The Subcommittee plans to introduce legislation in late October with markup scheduled for November. ABA testified on June 20, 1989, stressing its intent to be heavily involved in rural development legislation. ABA has been in close consultation with Congressman English and House Agriculture staff on various components of the rural development bill.

Suggestions for Legislation

Although rural development initiatives cover a broad range, the banking industry offers these four areas for discussion and consideration in a rural development legislative package: (1) rural housing--both moderate and low income; (2) business financing to restructure debt, and to purchase, expand, and develop new rural businesses; (3) information, technical, and marketing assistance; and (4) infrastructure and community facilities (including water and sewer).

There are four USDA agencies that could facilitate rural development initiated at the local level and coordinated at the federal level. The Soil Conservation Service (SCS), Agricultural Stabilization and Conservation Service (ASCS), Farmers Home Administration (FmHA), and the Extension Service (ES) serve all rural communities. FmHA and ES are the most likely candidates for an expanded rural development role.

Rural Housing

Some commercial bankers have expressed interest in a guaranteed rural housing program modeled on the successes of the FmHA Farm Guarantee Program. Allowing the banks to originate and service housing loans would reduce the FmHA administrative cost and potential delinquency. Currently, the FmHA rural housing program can serve low and moderate income residents in communities under 20,000 in population. The Federal Agricultural Mortgage Corporation (FAMC) only can serve communities of under 2,500 in population. By expanding the size of communities served to 20,000, FAMC could be a mechanism to serve rural residents. Also, unlike FmHA which is bound by budgetary limits, FAMC has its own source of revenue from the private sector and does not depend upon budget allocations for its income.

Business Financing

One issue that has been raised is the availability of credit for new companies and small businesses in rural communities. The problem is not a lack of credit availability, but rather the fact that new businesses frequently do not meet the standards established by banks and regulators to protect depositors' funds.

If extending credit to these higher risk borrowers who do not now qualify for private commercial credit is considered worthwhile public policy, then guarantees through the Farmers Home Administration's Business and Industry (FmHA B&I) Loan Program can be of assistance. Guarantees allow banks to both extend credit and amortize the loan over a longer period of time for higher risk customers, while protecting depositors' funds. Such a public/private partnership has worked in the FmHA Farm Guaranteed Loan Program.

Congress appropriated $2.6 billion for FmHA operating loan guarantees for FY 1989. As of September 15, 1989, only $950 million has been obligated. Since there was more than $1 billion in guarantees appropriated but unobligated during the 1989 fiscal year, this unobligated guarantee amount could be directed to the B&I Program, which currently receives only $96.4 million. Recently, the B&I allocation has been fully expended within the first few months of each fiscal year.

Secondary Market For FmHA Guaranteed Loans

The Agricultural Credit Act of 1987 authorized a workable secondary market for the FmHA guarantee programs. The USDA has not implemented this directive despite the support and involvement by lenders. Insistence on the implementation of this secondary market would improve the effectiveness and desirability of these loan guarantee programs.

Education, Information and Technical Assistance

Many lenders would support a stronger effort by the Extension Service or other agencies in assisting new rural entrepreneurs gather the data necessary to apply for commercial loans. Because of the special fiduciary relationship between lenders and borrowers, commercial banks are extremely hesitant to advise local businessmen. In order to avoid lender liability, bankers must maintain the clear role of lender rather than that of advisor or active partner with the customer. However, the bank could limit that risk by acting as a third party conduit for a private/public clearing house established through the Extension Service or another agency.

Infrastructure and Community Facilities

Banks are particularly interested in providing long-term credit to communities for necessary infrastructure projects. However, due to banks' short-term funding source and the volatile nature of interest rates, banks' participation is limited in financing long term infrastructure needs. Enhancing the FmHA community facility direct loan program with a guarantee program could enable commercial banks to participate in financing community facilities.

Farmer Mac

In September, Michael Grove, President, First National Bank, White Sulphur Spring, Montana testified before the House Agriculture Subcommittee on Conservation, Credit, and Rural Development on the proposed underwriting standards for Farmer Mac. While believing the standards are generally reasonable and workable, several suggested changes were offered. Farmer Mac programs must be open to all stockholders with participation by many loan originators. This will help to ensure that the interests of small institution originators' and individuals with small farms are protected. ABA feels it is essential to develop means for the regulators to treat loans sold into this secondary market as assets sold and removable from the books of bank originators. There remain significant questions as well as to the regulatory treatment of secutiries created by bank poolers under the program. ABA plans to continue to try to resolve the issues related to the successful operation of Farmer Mac.

Farmers Home Administration

The Government Accounting Office (GAO) has issued an investigative report on the Farmers Home Administration, which focuses on the guaranteed loan program for farmers. GAO is critical of the banking sector and points out that the program losses in FY 1989 could exceed \$115 million. However, the guaranteed loan losses are minimal as compared to the nearly \$4 billion losses in direct loans through FmHA in FY 1989. None the less, the GAO report calls for new guaranteed loan requirements to minimize losses and improve collateral collections.

Thus, the banking industry finds itself in a dilemma--GAO criticizing the banking industry for losses in the guaranteed loan program and, at the same time, Congress wants banks to increase their use of the guaranteed loan programs. (See related article on Jonathan Kislik.)

Future Topics

In the next "Up and Down the Hill," I will discuss the Farm Credit System's predatory loan pricing and its request for expanded financial authority. An update on the status of the 1990 Farm Bill will be provided.

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[1] *Alternative Agriculture*, National Research Council, Washington, D.C., 1989, p. 56.