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What FCS is Doing, and Not Doing

by Bert Ely

The Farm Credit System (FCS) was created in 1916 to provide real estate credit to farmers that banks in many cases were barred from providing or were too small to provide. Whatever original justification there was for the FCS has long since disappeared. However, the FCS does have some statutory obligations that it is not meeting today while, at the same time, it is engaging in lending and other activities that clearly contravene any remaining rationale for a government-sponsored ag lender.

FCS is not sufficiently focused on serving young, beginning, and small farmers.

The Farm Credit Act provides that "each Federal land bank association and production credit association shall prepare a program for furnishing sound and constructive credit and related services to young, beginning and small farmers and ranchers." Department of Agriculture economists Steven Koenig and Charles Dodson report, however, that commercial banks are doing a much better job of meeting these credit needs than the FCS in using the Farm Service Agency's loan guarantee program. This program, as Koenig and Dodson note, "serves as a mechanism to increase service to young, beginning, and small farmers, who often have higher credit risk profiles than other applicants."

This insufficient service to less well-capitalized farmers reflects another Koenig-Dodson finding: "Farm operators borrowing from the FCS tend to be wealthier than those borrowing from banks." On average, FCS borrowers are older, own more land, operate larger farms, and have higher revenues, net income, and net worth.

Not surprisingly, then, according to a 1991-92 study, "millionaire operators owe 28 percent of total FCS operator debt, compared to 19 percent of total farm operator debt owed to banks." The FCS is becoming a rich man's club, hardly what Congress intended.

FCS Increasingly Abuses its Special Privileges

The first issue of *Farm Credit Watch* generated numerous calls, faxes, and e-mails reporting different ways in which FCS institutions are building loan volume, often in violation of the spirit of the FCS's mandate. Over the coming months, we will gather documentation of these abuses so as to build the case that the FCS has exceeded its stated purpose to a much greater extent than members of Congress realize. A few examples of what has been reported to me illustrate how I will categorize these abuses.

Below-Market Pricing. The greatest number of complaints I received involved below-market loan rates which Congress has explicitly prohibited. The most common examples are 7.75 percent, 5-year and 15-year fixed-rate loans offered by FCS in Iowa, Nebraska, South Dakota, and Wyoming. Based on current yields on Treasury debt, FCS debt's spread over Treasury debt, and FCS's average net interest margin requirement (2.95 percent actual margin in 1997), I estimate that these loans are priced at least 100 to 125 basis points below

what they should be priced at. According to one letter sent to me, Badgerland FCS in Wisconsin was offering a 7.5 percent rate on a 3-year loan and 7.6 percent on a 5-year loan. I am sure many other examples of aggressive below-market lending exist.

Off-Farm Lending. Several troubling cases of off-farm lending were reported to me. Most egregious was a young, somewhat marginal borrower obtaining FCS credit to buy in-town residential rental property. Clearly, a bank could have provided that credit. Although farm-related, a high seven-figure working capital loan to a large, multi-state farm equipment dealer seems far afield from what Congress intends.

Lending to Those Who Clearly Can Get Credit Elsewhere. One of the most amusing, but troubling cases brought to my attention was a full-page ad run by Pee Dee Farm Credit in Florence, South Carolina. It pictures two doctors in relaxing, rural settings (each with a hunting gun across his lap) and this borrowing pitch: "It's hunting, fishing, or just listening to the quiet. It's a form of aroma therapy, pain management and stress relief. It's a recreational property loan from Pee Dee Farm Credit. Isn't it time you had a special place?"

Another example is the offering of a \$10 million loan to a wealthy foreigner to purchase U.S. farmland. How such loans relate to the family

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farm escapes me — they are just other indications that FCS increasingly is a rich man's club.

Deposit-Taking. Most surprising to me are the reports of FCS deposit-taking. One case involved the offering of a 6 percent yield on a checking account linked to a line of credit that could go as high as \$100,000. There is no requirement, though, that the line be used, which means that it serves only as overdraft protection.

Another example is an "investment bond program" offered by AgriBank, FCB, directly to "members and employees of Farm Credit banks and associations." Sounds like a CD to me. I wonder if these depositors

know that their deposits are **not** insured by FDIC.

I encourage readers to send me more examples of outrageous FCS practices. It is vitally important that you include documentation of these practices, in the form of ads, solicitation letters, loan agreements, courthouse files, etc.

A Final Note

One banker told me that FCS is not paying sales taxes on equipment that it is leasing. If you think that FCS is not paying sales tax when it should, check the legality of that practice with your state tax department. Don't hesitate to blow the whistle on FCS tax evasion. jal