AGRICULTURAL FINANCE ISSUES AND THE FARM BILL

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The decisions embodied in any farm legislation this year will affect financial institutions and their customers in a variety of ways. These range from the conduct of direct government lending programs targeted at farmers and rural areas to the effects of government policy on incomes, collateral values, and risks associated with agricultural or rural economic activity. Of course, "farm bill" is a misnomer. The last "farm bill" was officially titled the Food, Agriculture, Conservation, and Trade Act of 1990, or FACT. As the title indicates, this legislation affects much more than farm subsidies. Other policy areas touched on in the typical farm bill include resource conservation, trade policy, domestic and foreign food assistance, rural development, agricultural research, disaster assistance, and agricultural credit policy.

This will be the first farm bill in 40 years written under a Republican-controlled Congress. Members of the House agriculture committee are relatively inexperienced in writing farm bills. Only 10 of the committee's 49 members were involved in writing the 1990 farm bill, and only 4 of the veteran members are Republicans. In contrast, 14 of the 17 members of the Senate agriculture committee are 1990 farm bill veterans. In the full House, the percentage of members from rural and farm districts is smaller than just a few years ago. And both political parties have promised to reduce government spending, employment, and regulation.

Although farm bills have been used to reauthorize existing programs or introduce new policies for an extended period (generally 5 years), the changing political climate indicates that this may not always be the case. Proposals to remove the large food and nutrition programs from the farm bill reauthorization would have lasting repercussions on the coalition building necessary to pass each 5-year plan.

The Farm Bill as a Vehicle for Financial Legislation

In the grand scheme of things, farm bills have not been a major vehicle for explicit financial legislation. In the past, some in Congress have opposed including financial legislation in the farm bill. Despite these objections, explicit credit issues have been addressed in both a credit title and a rural development title in the last two farm bills. Table 1 indicates that of the 25 titles in the 1990 Food, Agriculture, Conservation and Trade Act, the last farm bill, only the two titles mentioned dealt explicitly with financial issues. Most of the other titles, however, have implicit, and sometimes major, financial impacts.

Explicit financial issues are those involving financial institutions, their regulators, or Federal programs including Farmers Home Administration (now part of the Consolidated Farm

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Service Agency), the Rural Development Administration (now part of the Rural Utilities Service), the Farm Credit System, commercial banks, the Federal Agricultural Mortgage Corporation (Farmer Mac), futures markets, and capital markets. Provisions addressing explicit financial issues to the extent they appear in the farm bill are incorporated in a credit or rural development title.

Implicit financial issues can be imbedded in any title of the farm bill. Such issues include provisions affecting cash flows, income risks, and asset values. To varying degrees, each of these is affected by provisions that affect potential land uses or change subsidies, crop insurance, other disaster relief, trade policies, environmental policies, and "takings" policies. Of course, such provisions are ubiquitous in the farm bill, and their impact on farm finances is recognized by all concerned.

Financial issues explicitly addressed in the last farm bill included changes in the operations of the former Farmers Home Administration, allowing Farm Credit System lenders to extend credit to farmers who process or market agricultural products, and authorization for Farmer Mac to sell securities backed by pools of FmHA/CFSA-guaranteed loans. Changes in CFSA procedures included more emphasis on guaranteed lending, imposition of a $300,000 per borrower lifetime cap on writedowns and writeoffs, and reducing to 1 year the period during which CFSA-acquired property could be sold only to CFSA-eligible borrowers.

These issues, while not unimportant to the people they directly affect, have a limited impact relative to the roughly $150 billion agricultural loan market. In contrast, table 2 shows other financial legislation passed since 1985. This legislation includes such far-reaching provisions as the phasing in of interstate banking, the reregulation and reform of commercial banks and thrifts, rescue and reform of the Farm Credit System and its regulator, and special bankruptcy treatment for family farmers.

Farm Bill Possibilities

It is too early in the farm bill process to have a clear idea about the outcome. However, public statements by members of Congress, interest groups, and the administration indicate some possibilities. Several factors increase the likelihood that fundamental changes in farm policy will occur this year. The political environment in Washington plays an important role.

Any substantial changes in regulation, program expenditures, or explicit financial provisions of farm legislation could have significant and varying impacts on farm lenders depending on the location and commodity mix associated with their loan portfolios. Suggestions for controlling farm spending include removing entitlement status from farm commodity programs, reforming quota-based commodity programs (tobacco, dairy, peanuts, and sugar, as well as fruits and vegetables grown under marketing orders), replacing traditional price support programs with some form of revenue insurance, moving away from commodity-specific acreage bases, targeting farm program payments to farmers with limited income, tightening the cap on total farm program payments per individual, downsizing the conservation reserve program, and curtailing domestic and foreign food assistance.

Of course, not all changes under discussion will have uniform, substantial, or necessarily negative impacts on farm income, asset values, or risks. In addition, some of the benefits farmers may lose through proposed changes in commodity programs may be offset by changes in the tax code or other legislation. Such legislation could include property rights protection, wetlands protection, endangered species protection, and pesticide restrictions. Tax changes under discussion include allowing full deductibility of health insurance premiums for the self-employed, reducing capital gains taxes, allowing tax-deferred savings to be used to offset income lost because of natural disasters, and reducing estate taxes.

Farm lenders also have changes they would like to see included in the farm bill. The FCS will be seeking new powers to serve nonfarm businesses, rural homeowners in communities up to 20,000, and to support rural infrastructure and community development. Such changes would represent a major expansion of the FCS's mission and Federal charter. Several changes will be considered related to the Farm Credit System Insurance Corporation (FCSIC), including whether to separate its board from that of the Farm Credit Administration. The two entities currently report to boards with the same membership but different chairpersons, but separate boards are to be established in 1996. The FCS opposes establishing a separate full-time board for the FCSIC. Other FCSIC issues that may be addressed are related to a forthcoming GAO report that was mandated in the Farm Credit System Safety and Soundness Act of 1992. That Act required GAO to consider four issues: risk-based premiums,FCSIC access to association capital, supplemental premiums, and further consolidation of FCS districts.

Commercial bankers have indicated a heightened interest in developing further access to funds through government-sponsored enterprises such as the Farm Credit System, Farmer Mac, and the Federal Home Loan Banks, but oppose any expansion of FCS retail lending authority. Other initiatives championed by commercial bankers would authorize Farmer Mac to make a secondary market in economic development loans and allow banks to establish corporations to market equity or quasi-equity interests to capitalize business start-ups or expansions.

Farmer Mac, the secondary market for agricultural and rural housing mortgages and certain USDA guaranteed loans, continues to struggle as an ongoing entity and may seek legislation soon to improve its charter. Past farm bill legislation has been used as a vehicle to change Farmer Mac's charter. In particular, Farmer Mac might request changes in two areas not found in the structures of the other successful government-sponsored secondary markets.

First, it may seek to reduce or eliminate the 10-percent subordinated participation requirement. Congress imposed this requirement to reduce the chances that lenders would sell bad loans into Farmer Mac guaranteed pools causing excessive losses. Such sales have not proved to be a problem for other secondary markets. Nonetheless, the requirement greatly reduces the incentive to participate in Farmer Mac because regulators have ruled that as much capital must be held for the subordinated participation as for the entire loan. The second possible change would give Farmer Mac the ability to directly purchase and pool loans. Farmer Mac must now rely on third parties that it certifies as poolers to purchase loans and form pools. Often these poolers find it advantageous to hold pools rather than sell them through Farmer Mac. Doing so, of course, eliminates a source of revenue for Farmer Mac.

The decline in the number of new entrants into farming over the past decade has drawn considerable Congressional attention. The 1995 farm bill debate will likely examine credit subsidies as a way to assist beginning farmers. Changes to CFSA programs and the FCS's charter are two possibilities that Congress might consider for improving beginning farmer access to credit. FCS's broad charter does not specifically require it to target its lending resources to this class of borrowers, but 1980 legislation does require it to operate programs to assist young, beginning, and small farmers.

CFSA's mission is more specific and legislation in 1992 created special USDA credit programs to assist beginning farmers. Improvements or additions to these programs and further targeting of lending resources to beginning farmers appear likely in any farm credit title. If total CFSA lending authority continues to shrink, the targeting of lending resources will garner even greater attention. The budgetary costs of credit programs could force a rethinking of the objectives and operation of all CFSA farm credit programs. This is especially true of direct lending programs where credit subsidy costs are greatest.

Table 1--Explicit financial provisions and implicit financial impacts in the Food, Agriculture, Conservation and Trade Act of 1990

Title	Explicit financial provisions	Implicit financial impacts
I-Dairy		X
II-Wool and Mohair		X
III--Wheat		X
IV--Feed Grains		X
V--Cotton		X
VI--Rice		X
VII--Oilseeds		X
VIII--Peanuts		X
IX--Sugar		X
X--Honey		X
XI--General Commodity Provisions		X
XII--State and Private Forestry		X
XIII--Fruits, Vegetables and Marketing		X
XIV--Conservation		X
XV--Ag. Trade		X
XVI--Research		?
XVII--Food Stamp and Related Provisions		X
XVIII--Credit	X	
XIX--Ag. Promotion		X
XX--Grain Quality		X
XXI--Organic Certification		X
XXII--Crop Insurance and Disaster Assistance		X
XXIII--Rural Development	X	
XXIV--Global Climate Change		
XXV--Other Related Provisions		X

Table 2--Other legislation significantly affecting agricultural and rural finance since 1985

1985	Farm Credit Amendments
1986	Farmer Bankruptcy Act (Chapter 12)
	Farm Credit Amendments
1987	Farm Credit Act of 1987
1989	Financial Institution Reform, Regulation, and Enforcement Act (FIRREA)
1990	Omnibus Budget Reconciliation Act
1991	FDIC Improvement Act (FDICIA)
1992	FCS Safety and Soundness Act
	Beginning Farmer legislation
1993	Chapter 12 provisions extended
	Omnibus Budget Reconciliation Act
1994	Community Development Financial Institutions Act
	Interstate Banking and Efficiency Act
	North American Free Trade Agreement
	Crop Insurance Reform
	The Department of Agriculture Reorganization Act
	General Agreement on Tariffs and Trade