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The Congressional Response to a Crisis in Agricultural Credit: The 1985 Farm Credit Amendments

by

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INTRODUCTION

Congress has responded to the current crisis in agricultural credit by restructureing the Farm Credit System and refusing to supply it with additional capital. Certain features of the Congressional restructuring effort are "significant" because they represent a sharp break with traditional methods of revitalizing a depressed farm economy. The 1985 Farm Credit Amendments, however, do not represent a "significant" contribution by the federal government to problems in the delivery of farm credit.

BACKGROUND

In 1916, Congress created a Federal Land Bank in each of twelve districts in the United States. The Land Bank system was a response to economic depression in farm country and was modeled after the European rural credit system. The stated purpose of each of the land banks was to provide long-term credit to borrower-members. The original capitalization for the Federal Land Banks was $9 million in government-owned stock. This stock provided the base for loans for real estate purchases on terms affordable to farmers. The original capital was repaid to the Federal government in 1947, making the Banks wholly owned by the Federal Land Bank Associations, which are in turn wholly owned by their member-borrowers. These member-owned Federal Land Bank Associations are the link between member-borrowers and Federal Land Banks.

In 1923, Congress created the Federal Intermediate Credit Bank system. The federal government funneled money through each District’s Federal Intermediate Bank to commercial banks, where it was made available to farmers as short-term operating loans. The economic depression of the early twenties made it difficult, if not impossible, for farmers to secure short-term operating loans from commercial lenders. The creation of a nationwide system which

2. Brake, A Perspective on Federal Involvement in Agricultural Credit Programs, 19 S.D.L. REV. 567, 571 (1974). The constitutionality of the federal land bank system was upheld when challenged on the theory that only the states had the authority to create a land and joint stock bank. Smith v. Kansas City Title & Trust Co., 255 U.S. 180 (1921). Id. at 572.
3. Appendix, supra note 1, at 111.
4. Id. at 116.
5. Id. at 111.
6. Brake, supra note 2, at 571.
8. Brake, supra note 2, at 578.
9. Appendix, supra note 1, at 111.
10. Brake, supra note 2, at 572.
provided low-cost, short-term credit to farmers was plainly a response to continuing difficult economic times. The Federal Intermediate Credit Banks (FICBs) were capitalized by a $60 million loan from the Federal government which these banks, after their merger with Production Credit Associations, repaid in 1968. Policies of the FICBs are determined by their respective District Farm Credit Boards.

In 1933, worsening economic conditions made it evident to Congress that the FICBs were unable to provide adequate short-term capital to farmers. In response, Congress created the final components of the Farm Credit System—the Banks for Cooperatives and Production Credit Associations—in the Farm Credit Act of 1933. The Banks for Cooperatives were to make loans to farmers' marketing, purchasing and business-services cooperatives. The Banks for Cooperatives, through the Central Bank for Cooperatives, were provided with a total of $136 million in funds for start-up capital. The Banks for Cooperatives repaid the original capital and became farmer-owned by 1968.

The system of Production Credit Associations was also created with the passage of the Farm Credit Act of 1933. This system was chartered to make short- and intermediate-term production loans to farmers. The Association received a loan of $28.7 million dollars in Government capital which it repaid in 1968, after merger with the Federal Intermediate Credit Banks in 1956. Like the other components of the rural credit system, the Production Credit Associations' policies are determined by their member-owners.

The history of rural credit in the United States is marked by two distinguishing factors. First, each major legislative response to a series of farm credits crises was a national, "co-operative" response to a regional problem. Second, each addition to the system was accompanied by an infusion of Federal capital. The Farm Credit Act Amendments of 1985 represent a sharp philosophical break with past legislative initiatives which assured the nation a self-sustaining farm economy.

The Farm Credit Act Amendments of 1985

The 1985 farm bill brings five major changes to the Farm Credit system. First, the bill replaces the part time Federal Farm Credit Board with a three-
person Farm Credit Administration Board. Second, the FCA will no longer participate in the day-to-day management of the system; instead, it will approve rules and regulations for the system and provide for strict annual examinations of the financial condition of System institutions. Third, the FCA will have the authority to issue cease and desist orders to System institutions whose practices are determined to be unsafe or unsound. Fourth, and perhaps most significant, the legislation creates a Farm Credit System Capital Corporation which will have the authority to both raise funds within the system and to act as a central source of financial assistance to the Farm Credit System. Fifth, the bill grants to the Secretary of the Treasury the discretion to provide (or not to provide) financial assistance to the Farm Credit Administration on terms which the Secretary deems appropriate. The significance of this fifth factor lies in the rejection of a direct, mandated infusion of federal financial assistance to the Farm Credit Administration.

The structure of the system had been significantly changed by the replacement of the part-time Federal Farm Credit Board with a full-time three-person Farm Credit Administration Board. Before the bill, the Board consisted of thirteen members: one nominated from each member district and appointed by the President and one appointed by the Secretary of Agriculture as his representative. The new Board will consist of three members, appointed by the President with the advice and consent of the Senate. Congressional justification for this change in the management of the system is the perception that the “existing regulatory structure was not only frequently too beholden to System banks but was frequently unresponsive to Congress and out of tune with Administration policies.” Congress apparently felt that a Presidential-appointed board of three members would be more easily controlled, and thus more “responsive,” than a system-nominated board of thirteen.

This perception of the unresponsiveness of the existing regulatory structure led Congress to enact the second of the five major changes in Farm Credit legislation. No longer will the FCA participate in direct supervision or management of the System. Instead, the structure of the Farm Credit Administration will mirror the structure of other regulating agencies: examination of

30. Brake, supra note 2, at 577.
System banks will no longer be delegated, generally accepted accounting principles will govern the annual examinations of the financial conditions of the System, and the merger of weaker districts will be regulated by the FCA. The perceived inability of the Federal Farm Credit Board to "accurately determine [the] financial conditions of the System" led Congress "to great uncertainty in recent months in designing a legislative response to stress in the system" and provided the rationale for shifting the role of the FCA from hands-on participant to arms-length regulator.

The third significant Congressional response to its perception of the ineffectiveness of the FCA was to grant it a broad enforcement power to issue cease and desist orders to those member institutions whose lending practices are in violation of FCA regulations. Congressional perception is that the FCA "has generally relied on jawboning or negotiation to stop unsafe practices. If this did not work, the agency then resorted to its power to remove officers or directors, an action which was sometimes too extreme..." Under this legislation, cease-and-desist orders replace negotiation as a means by which to bring the lending practices of member institutions in line with a national model.

The fourth response of Congress to the depression in the farm credit system was to centralize the power to both raise funds and to distribute existing funds within the system. Congress created the Farm Credit System Capital Corporation in order to draw funds from existing System resources to shore up weaker Districts. The Capital Corporation, however, is prohibited from depleting the resources of stronger institutions to the extent that they are "unduly threatened."

The threat to agricultural lenders as a whole is enormous. At the end of 1985, farmers owed $194 billion, $61 billion of which is owed to the Federal Credit System. As of December 1985, the 12 land banks held $45 billion in farm real estate loans. Land prices, however, have collapsed in farm country, plummetting thirty-two percent from 1980 to 1985, leaving many loans
Another power granted to the Capital Corporation is to serve as a "warehouse" for bad loans and property upon which the System had foreclosed. The Capital Corporation could hold, restructure, guarantee, and administer loans, as well as refinance, reamortize, or otherwise adjust debts for borrowers or, if necessary, eventually liquidate loans or require a troubled unit to sell its nonperforming loans before receiving financial assistance. The potential size of a warehouse for bad farm loans might be estimated from the fact that 200,000 farms were unable to generate enough cash to make interest payments and meet living expenses in 1985.

The Capital Corporation will be controlled by a five-person board: four members are elected by banks owning voting stock in the Capital Corporation, one member is appointed by the FCA. Congress felt compelled to change the management of the System, describing recent attempts by the FCA to restructure in order to bail out weaker institutions in Spokane, Washington and Omaha, Nebraska as "inefficient." Congress also believed that, if the farm economy does not improve, similar attempts would be "too unwieldy to respond to potential problems."

The fifth shift in emphasis toward a systemic, national approach to the farm credit crisis is that the Secretary of the Treasury is empowered to "provide financial assistance on terms and conditions the Secretary deems appropriate after a certification of need from the Farm Credit Administration." In delegating to the Secretary of the Treasury this discretionary power, the legislation "reject[s] the idea of a direct, mandated infusion of Federal funds into the Farm Credit System." Congress has not yet been convinced that the System needs new capital in order to be salvaged, noting that "if the System uses its own resources effectively, outside assistance is not now needed and not likely to be needed . . . " Congress believes the Capital Corporation's power to distribute existing funds will be sufficient to provide a continuing source of capital to the nation's farmers.

ANALYSIS

Four of the five major changes in the 1985 Farm Credit Act dramatically restructure the current system of delivering farm credit. Against this backdrop of a restructured farm credit system looms the fact that Congress pro-

49. Todd, supra note 44, at 18.
51. Id. at 13, reprinted in 1985 U.S. CODE CONG. & AD. NEWS at 2599-2600.
52. Id.
53. Id. at 14-15, reprinted in 1985 U.S. CODE CONG. & AD. NEWS at 2601.
54. Id. at 14, reprinted in 1985 U.S. CODE CONG. & AD. NEWS at 2600.
55. Id. at 14, reprinted in 1985 U.S. CODE CONG. & AD. NEWS at 2601.
vided no new funds for what is by all accounts an ailing farm economy. These two themes, a new system and no new money, provide the framework within which to analyze the Farm Credit Act of 1985.

THE RESTRUCTURED FARM CREDIT SYSTEM

Four elements have significantly changed the structure of the Farm Credit System: the System is administered by a full-time board, the System is a regulator rather than a participant in the delivery of farm credit, cease and desist orders replace negotiation as a means for bringing member lending practices in line with balance sheet economics, and the Farm Credit System Capital Corporation assumes the role of a central bank in administering the delivery of credit to the nation’s farmers. Within the context of the bill, these changes appear significant. It remains open to question, however, whether the restructuring of the farm credit system will enable it to continue to operate.

The Combined Condensed Statement of Operations for the thirty-seven Farm Credit Banks shows that for the first three months of 1984, the System recorded net income of $126,431,000; at the end of nine months, the System showed a net income of $363,070,000. During the period in which the restructuring of the farm credit system was being considered by Congress, however, the System sustained severe losses. At the end of the first three months of 1985, the combined Farm Credit Banks lost $522,479,000; at the end of nine months, $426,255,000. (The System as a whole has lost almost half a billion dollars during the first nine months of 1985).

The restructure of the Farm Credit System is predicated upon the idea that a free flow of capital between district banks will result in solvency for the System as a whole. Recent history indicates, however, that the restructure of the System along the lines proposed by Congress would have had little impact on net system losses. For example, were the System to have been restructured for the first nine months of 1985, the free flow of funds between districts would have not prevented a net system loss of nearly one-half billion dollars. Restructuring would only have spread this loss among the entire system, rather than allowing two individual system banks to suffer the entire loss.

Failure to Provide Additional Capital

The three major legislative responses to past crises in farm credit were similar in that each allocated either start-up or additional capital for the farm credit system. In 1916, the federal government provided $9 million to capital-

56. See supra note 25 and accompanying text.
57. See supra notes 33-38 and accompanying text.
58. See supra notes 39-40 and accompanying text.
59. See supra notes 41-52 and accompanying text.
60. Appendix, supra note 1, at 122.
61. Id.
ize the Federal Land Banks. In 1923, the Federal Intermediate Credit Banks were capitalized by a $60 million loan from the federal government. In 1933, a total of $136 million was provided for the Banks for Cooperatives and $28.7 million for the Production Credit Associations. The 1985 Farm Credit Amendments reject a mandated infusion of capital into the system, relying instead upon the perceived ability of the System to survive difficult economic times. It is impossible to determine whether this shift in federal policy is an aberration which later Congresses will correct or whether this refusal to provide capital to the farm credit system is symptomatic of a broader move away from federal participation in the delivery of farm credit. If this legislation is indicative of the federal government’s unwillingness to act as a participant in the farm economy, it is a sharp break with historical precedent.

The past repayment record of the major components of the Farm Credit System does not support Congressional refusal to provide additional capital to the System. The 1916 loan was paid back in 1947; the loans extended in 1923 and 1933 were repaid in 1968. Of course, Congress has “saved” the amount which it might have contributed as capital to the System. The potential long-term damage caused by a refusal to supply new capital, however, may easily exceed this short term gain.

CONCLUSION

The Congressional response to a crisis in farm credit is similar to that of the steward who, as the ship started to list, began rearranging the chairs on the deck of the Titanic. Congressional attempts to shift the furniture about the deck of a listing farm credit system may not damage the farm economy, but seem to do little to help. Salvage operations in the past have always been tied to an infusion of new capital into the farm credit system. Congress, however, feels that the System has enough capital but that it is just in the wrong places. The current rescue effort is therefore noteworthy not for what it does, but for what it fails to do.

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62. See supra note 4 and accompanying text.
63. See supra note 12 and accompanying text.
64. See supra notes 17, 20 and accompanying text.
65. See supra note 6 and accompanying text.
66. See supra notes 12, 18 and accompanying text.