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CRS Report for Congress

Agricultural Credit: Farm Bill Issues

Jim Monke
Analyst in Agricultural Policy
Resources, Science, and Industry Division

Summary

The federal government has a long history of providing credit assistance to farmers by issuing direct loans and guarantees, and creating rural lending institutions. These institutions include the Farm Service Agency (FSA) of the U.S. Department of Agriculture (USDA), which makes or guarantees loans to farmers who cannot qualify at other lenders, and the Farm Credit System (FCS), which is a network of borrower-owned lending institutions operating as a government-sponsored enterprise.

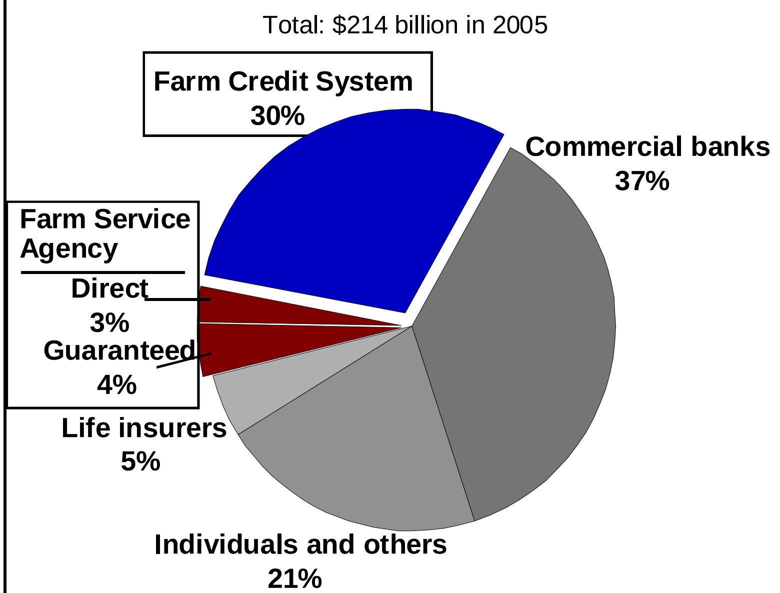
The 2007 farm bill and appropriations bills offer Congress opportunities to address agricultural credit. The House agriculture subcommittee markup of the farm bill includes several adjustments to the FSA loan program, and limited expansion of FCS lending authorities for renewable energy and rural housing. The FCS provisions are particularly controversial, between FCS desires for expansion in their *Horizons* project and opposition from commercial banks. Separately, appropriators will consider annual funding levels for FSA's farm loan programs. This report will be updated.

Background

The federal government has a long history of providing credit assistance to farmers. First, USDA's Farm Service Agency (FSA) issues direct loans and offers guarantees on loans made by commercial lenders to farmers who do not qualify for regular commercial credit. Therefore, FSA is called a lender of last resort. Second, the Farm Credit System (FCS) is a cooperatively owned commercial lender that is federally chartered to serve only agriculture-related borrowers. FCS makes loans to creditworthy farmers, and is *not* a lender of last resort. Statutory authority for both the FSA and FCS is permanent, but farm bills often make adjustments to eligibility criteria and the scope of operations.

Other sources of farm credit include commercial banks, life insurance companies, and individuals, merchants, and dealers. **Figure 1** shows that commercial banks lend most of the farm sector's total debt (37%), followed by the Farm Credit System (30%), individuals and others (21%), and life insurance companies (5%). The Farm Service Agency provides 3% of the debt through direct loans, and guarantees another 4% of the market (through loans of commercial banks and FCS). FCS has the largest share of real estate loans (38%); commercial banks lead for non-real estate loans (49%).

Figure 1. Market Shares of Farm Debt, by Lender



Source: CRS, using USDA-ERS and FSA data at [http://www.ers.usda.gov/Briefing/FarmIncome/Data/Bs_t6.htm]

The farm sector has about $214 billion in debt. Yet only about 66% of farmers have any debt (farm or nonfarm), and only 38% have farm debt. Most of the debt is owed by medium-sized family farms and large commercial farms. Creditworthy farmers generally have adequate access to loans. Credit conditions are generally good, and default rates have been declining. USDA data show stable or slightly declining debt-to-asset ratios, rising equity, and strength in farmers' ability to repay debts.

Nonetheless, some farmers continue to experience financial stress, and agriculture is prone to business cycles that may pose financial difficulties. Thus, many interests continue to see some need for federal intervention in agricultural credit markets.

Farm Lending Institutions

Commercial Banks, Life Insurers, and Individuals. Commercial banks, life insurance companies, and individuals and others provide 63% of total farm debt without federal support or mandate. Commercial banks provide most of the loans to farmers through both small community banks and large multi-bank institutions.[1] Life insurance companies historically also have looked to farm real estate mortgages for diversification. The "individuals and others" category consists of seller-financed loans from private individuals, and the growing segment of "captive financing" by agribusinesses.

Farm Credit System (FCS).[2] Congress established the Farm Credit System in 1916 to provide a dependable and affordable source of credit to rural areas at a time when commercial lenders avoided farm loans. FCS is not a government agency nor guaranteed

[1] Commercial bank issues are summarized by the American Bankers Association at [http://www.aba.com/Industry+Issues/issues_ag_menu.htm].

[2] Farm Credit System institutions are described at [http://www.fca.gov/FCS-Institutions.htm].

by the U.S. government, but is a network of borrower-owned lending institutions. It is not a lender of last resort; it is a for-profit lender with a statutory mandate to serve agriculture. Funds are raised through the sale of bonds on Wall Street. Five large banks allocate these funds to 96 credit associations that, in turn, make loans to eligible creditworthy borrowers.

Statute and oversight by the agriculture committees determine the scope of FCS activity as a government-sponsored enterprise (GSE), and provide benefits such as tax exemptions. Eligibility is limited to farmers and ranchers, farm input suppliers, rural home owners in towns with less than 2,500 population, and cooperatives. The system is regulated by the Farm Credit Administration (FCA). Permanent authority exists in the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 *et seq.*). Major amendments generally have been enacted as stand-alone bills, but Congress has used farm bills to make minor adjustments.

FCS does not receive an annual appropriation, but is privately funded. In recent years, appropriators placed a limit on the size of the FCA's budget, which is funded by assessments on FCS institutions. For more background about FCS, see CRS Report RS21278, *Farm Credit System*, by Jim Monke.

USDA's Farm Service Agency (FSA).[3] The USDA Farm Service Agency (FSA) is a lender of last resort because it makes direct loans to family-sized farms that are unable to obtain commercial credit. FSA also guarantees timely payment of principal and interest on qualified loans made by commercial lenders such as banks and the Farm Credit System. Permanent authority exists in the Consolidated Farm and Rural Development Act (CONACT, 7 U.S.C. 1921 *et seq.*). However, Congress uses omnibus farm bills to make changes to the terms, conditions, and eligibility requirements.

FSA makes farm ownership and operating loans to operators of family-sized farms who can demonstrate enough cash flow to make payments. Direct loans are limited to $200,000 per borrower. Guaranteed loans are limited to $899,000 per borrower (adjusted annually for inflation). Emergency loans are available for qualifying natural or other disasters. Some guaranteed loans have a subsidized (below-market) interest rate.

Since the 1980s, emphasis within the FSA loan program has shifted from making direct loans toward issuing more guarantees. This lessens farmers' reliance on direct federal lending, and leverages federal dollars since guarantees are cheaper to subsidize. In the late 1990s, 30% of loan authority was for direct loans; that ratio is now about 25%.

Certain portions of the FSA farm loan program are reserved for beginning farmers and ranchers (7 U.S.C. 1994 (b)(2)). For direct loans, 70% of the amount for farm ownership loans and 35% of direct operating loans are reserved for beginning farmers for the first 11 months of the fiscal year (until September 1). For guaranteed loans, 25% is reserved for such farmers for ownership loans and 40% for farm operating loans for the first six months of the fiscal year (until April 1). Funds are also targeted to "socially disadvantaged" farmers based on race, gender, and ethnicity (7 U.S.C. 2003).[4]

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[3] USDA Farm Service Agency loan programs are described at [http://www.fsa.usda.gov/dafl].

[4] For more background on FSA loan programs, see "Evaluating the Relative Cost Effectiveness

(continued...)

Farm Bill Issues

Farm Service Agency. Authority for the size of FSA's farm loan program is specified in the 2002 farm bill and expires at the end of FY2007. The 2007 farm bill is seen as a vehicle to set new loan authorization levels for FSA, although actual funding would continue to be set by annual appropriations acts. The 2002 farm bill authorized a maximum loan authority of $3.796 billion for direct and guaranteed loans for each of fiscal years 2003-2007 (7 U.S.C. 1994(b)(1)), and specified how this would be divided among different types of loans. Appropriators have funded between about 81% to 95% of the total authorization, with more than 100% for some loan types. The House Agriculture Subcommittee markup of the farm bill did not address new loan authorization levels.

The House Agriculture Subcommittee markup would increase to $300,000 the current $200,000 limit per farmer on direct farm ownership and operating loans. These limits were set in 1984 for direct farm ownership loans, and in 1986 for direct operating loans, and have not kept pace with inflation. (Limits for guaranteed loans were raised in 1998 and indexed for inflation.) The House subcommittee markup also would create a conservation loan guarantee program.

Another potential issue is the "term limits" set in statute for farmer eligibility. Term limits are intended to prevent chronically inefficient farms from continuing to receive federally subsidized credit, but the political and social prospects of eliminating support are sometimes unpleasant. Currently farmers are limited to receiving direct operating loan eligibility for seven years, and guaranteed operating loans for 15 years (7 U.S.C. 1949). A provision in the 2002 farm bill (Sec. 5102 of P.L. 107-171) suspended application of the 15-year limit through the end of 2006, and P.L. 109-467 extended the suspension provision until September 30, 2007. An increasing number of farmers are reaching their term limits. Thus, there will be pressures to again extend the eligibility allowance or revisit the purpose of the term limits requirement. The House subcommittee markup did not address any extension for the suspension of term limits.

Appropriations for FSA Farm Loans. Although the agriculture committee authorizes the multi-year "loan authority," the appropriations committee controls the annual discretionary appropriation to cover the actual cost of making loans (the "loan subsidy"). The loan subsidy varies with any interest rate subsidy and the projection of anticipated loan losses. The actual amount of lending that can be made (the appropriated loan authority) is several times larger than the appropriated loan subsidy.

For FY2007, the farm loan program is unchanged from FY2006 under the year-long continuing resolution (P.L. 110-5). A loan subsidy of $150 million supports $3.52 billion in loan authority, resulting in a "multiplier" of 23 ($23 dollars of loan authority for each $1 of loan subsidy). Guaranteed loans have higher multipliers than direct loans, and farm ownership loans have higher multipliers than operating loans. The highest multiplier is

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[4] (...continued)
of the Farm Service Agency's Farm Loan Programs," by Charles Dodson and Steven Koenig, at [http://www.fsa.usda.gov/Internet/FSA_File/farm_loan_study_august_06.pdf]

208 for guaranteed farm ownership loans. The lowest is eight for subsidized guaranteed operating loans. Expenses to administer the loan program are an additional $309 million.

For FY2008, the Administration requests $3.37 billion in loan authority (-4.3%) to be supported by $152 million of loan subsidy (+1.7%). Guaranteed loan levels would decline less than 1% overall, although subsidized operating loans would decrease 8%. The direct loan program would decline 12%, including an 18% decrease for direct ownership loans and 6% for direct operating loans. Despite the reduction in direct loan authority, subsidies for the direct loan programs would rise by over 10%. Administrative expenses would increase by 3.3%. As in recent years, nothing is requested for emergency loans due to carryover funds.

Farm Credit System. In recent years, FCS has expanded its lending, to a limited degree, beyond traditional farm loans and into more rural housing and non-farm businesses. In early 2006, FCS released a report titled *Horizons*, which highlights perceived needs for greater lending authority to serve a changing rural America.[5] Some see *Horizons* as a guide for legislative action to expand lending authorities, possibly in the 2007 farm bill.[6] The primary objectives in the *Horizons* project include (1) expanding lending authorities to include rural housing in towns with up to 50,000 population (currently 2,500), (2) expanding lending authorities by adding agribusinesses to the list of eligible borrowers (regardless of farmer ownership or throughput), and (3) replacing the numerical stock-holding requirements for borrowers with FCS discretion.

Commercial banks oppose any expansion of FCS lending authority, saying that commercial credit in rural areas is not constrained and that FCS's government-sponsored enterprise (GSE) status provides an unfair competitive advantage. Commercial banks assert that, with financial deregulation and integration, there is no credit shortage for agriculture. They say that the federal tax benefits for FCS are no longer necessary, or at least should not be extended to non-farm, non-agriculture loans. FCS counters this by asserting its statutory mandate to serve agriculture (and by extension, rural areas) through good times and bad, unlike commercial lenders without such a mandate.

Farm bill markup at the House agriculture subcommittee level would expand FCS lending authorities, albeit less than FCS desires in *Horizons*, and change borrower stock owning requirements. The markup's primary changes would (1) increase the population cutoff for rural housing loans from 2,500 population to 6,000 population, (2) add a general agribusiness category to the list of eligible borrowers, except that it would limit these new types of agribusiness loans to *renewable energy projects* only, and (3) replace the borrower stock-holding requirement, which is currently a numerical target (the lesser of $1,000 or 2% of the loan), with the discretion of the institution.

The policy decision of whether to expand FCS lending authority has become less about "farm" credit, and more about the ideological role of a retail GSE lender competing with private lenders. Committee jurisdiction even has been called into question by the

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[5] The *Horizons* report is available at [http://www.fchorizons.com].

[6] Bert Ely, "The Farm Credit System: Lending Anywhere but on the Farm," at [http://www.aba.com/NR/rdonlyres/E1577452-246C-11D5-AB7C-00508B95258D/45256/Horizons2006ELYFINAL.pdf].

House Financial Services committee. In letters to the Agriculture Committee, Representatives Frank and Bachus of the Financial Services Committee assert their committee's jurisdiction for nonfarm lending (Feb. 28, 2007) and their specific opposition to *Horizons* (May 22, 2007).

Regarding stock ownership, many observers believe that giving FCS discretion to set the borrower stock-holding requirement may reduce the cooperative nature of FCS, which has been one of its hallmarks since inception. But so long as the provision is interpreted for borrowers to purchase at least $1 of voting stock, they still would be entitled to one vote as a shareholder, regardless of the loan size or shares owned. Thus, this could affect the principle of cooperative ownership more than of cooperative control.

Beyond the farm bill, the scope of lending authority also could grow under an still-pending October 2006 proposed rule to expand eligibility for farm processing and marketing loans (71 FR 60678, October 16, 2006). The intent is to allow FCS to finance larger value-added farm processing firms that are being built with more outside capital and involvement than in the past. Opponents fear that the regulation could allow more non-agriculture financing.

Some also have questioned FCA's recent approval of a pilot program that allows "mission-related" investments in what sometimes are called "Rural America Bonds." Like banks, FCS institutions can make investments in additional to issuing loans, usually in negotiable instruments like Treasury bonds. However, the pilot program allows investments in certain private or public bonds (e.g., for rural community facilities). This effectively results in lending, sometimes for purposes that otherwise may not qualify for FCS loans. For FCS institutions, the investments are not subject to statutory restrictions on borrower eligibility.[7] FCA promotes the program "to allow greater flexibility" and "to better serve the changing needs of agriculture and rural areas." Commercial banks assert that the investments allow FCS to exceed its statutory lending scope.

Lending authorities and GSE preferences were highlighted again in 2004 when a private bank, Netherlands-based Rabobank, tried to purchase an FCS association. The board of directors of Omaha-based Farm Credit Services of America (FCSA) initially voted for the sale, indicating to some that FCS may no longer need government sponsorship. A general outcry led FCSA to withdraw from the deal.[8] At that time, commercial bankers said that FCS institutions should be allowed to leave if they want more lending authorities, while FCS asked Congress to eliminate the provision allowing institutions to leave the system (12 U.S.C. 2279d). It is not clear whether Congress, in 1987, intended the provision to be used by outside companies to purchase parts of FCS. The Farm Credit Administration has since amended the regulations for FCS institutions terminating their charter (71 FR 44409, August 4, 2006). The changes allow more time for FCA to review the request, more communication, and more shareholder involvement.

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[7] For background, see FCA, "Investments In Rural America," presentation to the Farm Credit Council Annual Meeting, Jan. 2006 [http://www.fccouncil.com/uploads/Laurie_Rae_FCA.ppt]; and FCA, Informational Memorandum on Investments in Rural America, June 25, 2004.

[8] For further background, see CRS Report RS21919, *Farm Credit Services of America Ends Attempt to Leave the Farm Credit System*, by Jim Monke.