

Farm Credit Problems: The Policy Choices

By Mark Drabenstott and Marvin Duncan

American agriculture is under its greatest financial stress since the Great Depression. Heavily leveraged farmers are having great trouble servicing their debts. Capital losses in the sector promise to be large as farm asset values decline. And farm financial problems are resulting in substantial loan losses to agricultural lenders. The roots of the problems are to be found in events of the 1970s—rapidly growing export markets and escalating price inflation—and farmers' aggressive use of debt in response to those events. The problems also are rooted in the growing need to compete for capital and product sales in an international marketplace. These adjustments are proving traumatic for farmers and their lenders. To

ease the sector's necessary adjustment, several proposals for public assistance have surfaced.

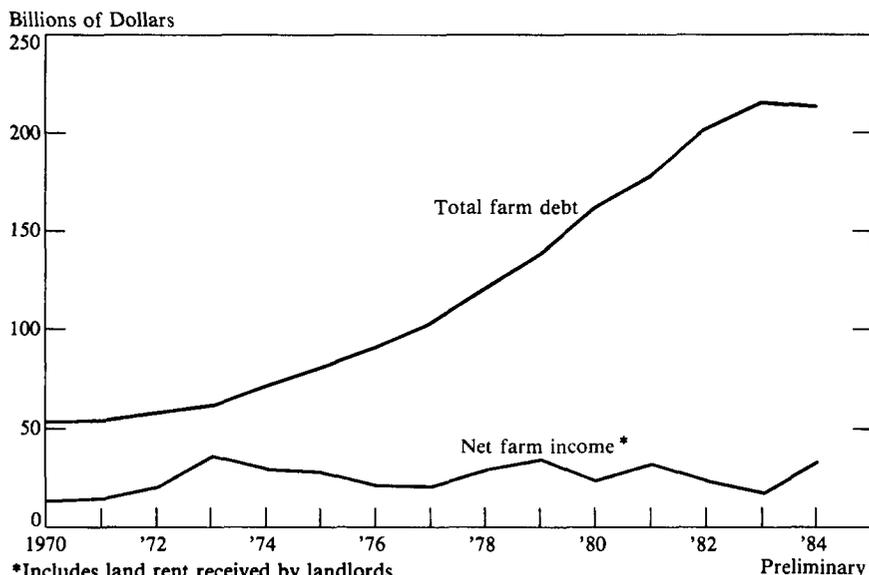
Although financial stress may persist for a noticeable subset of American farmers, the need to compete in a global market will constrain the public policy response. This paper outlines the origins and dimensions of the farm sector's financial stress. The likely duration of financial stress is then discussed and a number of public sector initiatives to ease the stress are identified and evaluated.

Dimensions of financial stress

Leverage separates farmers doing reasonably well from those having serious troubles. Misled by rising income expectations and price signals distorted by rising inflation, farmers used debt aggressively in the 1970s to finance expansions and to paper over short-term debt service problems. Farm debt at the beginning of the 1970s was about three times annual farm income (Chart 1). By 1983 and 1984, farm sector debt was about eight times annual farm income.

Mark Drabenstott is a senior economist and Marvin Duncan is a vice president and economist in the Economic Research Department at the Federal Reserve Bank of Kansas City. This article is based on a paper, "Farm Financial Conditions: A Difficult Transition," authored by Duncan and Drabenstott and originally presented to the Agribanking Roundtable of the Agricultural Banking Institute on January 7, 1985. The paper also was submitted as testimony before the House Budget Committee's field hearing in Atchison, Kansas on February 15, 1985.

CHART 1
Farm income and farm debt



Source: U.S. Department of Agriculture

Poor prospects for farm income have combined with high real interest rates to exact a toll on farm real estate values (Chart 2). In the Tenth Federal Reserve District, land values have dropped a third from the market highs reached in early 1981—and land values were falling more rapidly as 1984 ended. Barring a decline in real interest rates or a rise in farm product prices, district farmland values seem destined to fall to about 50 percent of their previous market highs in the next year or two.

Farm financial stress appears concentrated among commercial-scale family farms. There are 2.4 million farms in the nation. Of these, 1.7 million are part-time farms with annual farm sales less than \$40,000. These farms receive most of their income off the farm and, as a result, remain financially sound. An additional 25,000 farms are very large commercial farms, with annual farm sales above \$500,000. These farms tend to be highly leveraged, but in general have the cash flow to

support their debt.¹ That leaves 675,000, or about a fourth, of all farms with annual sales between \$40,000 and \$500,000.

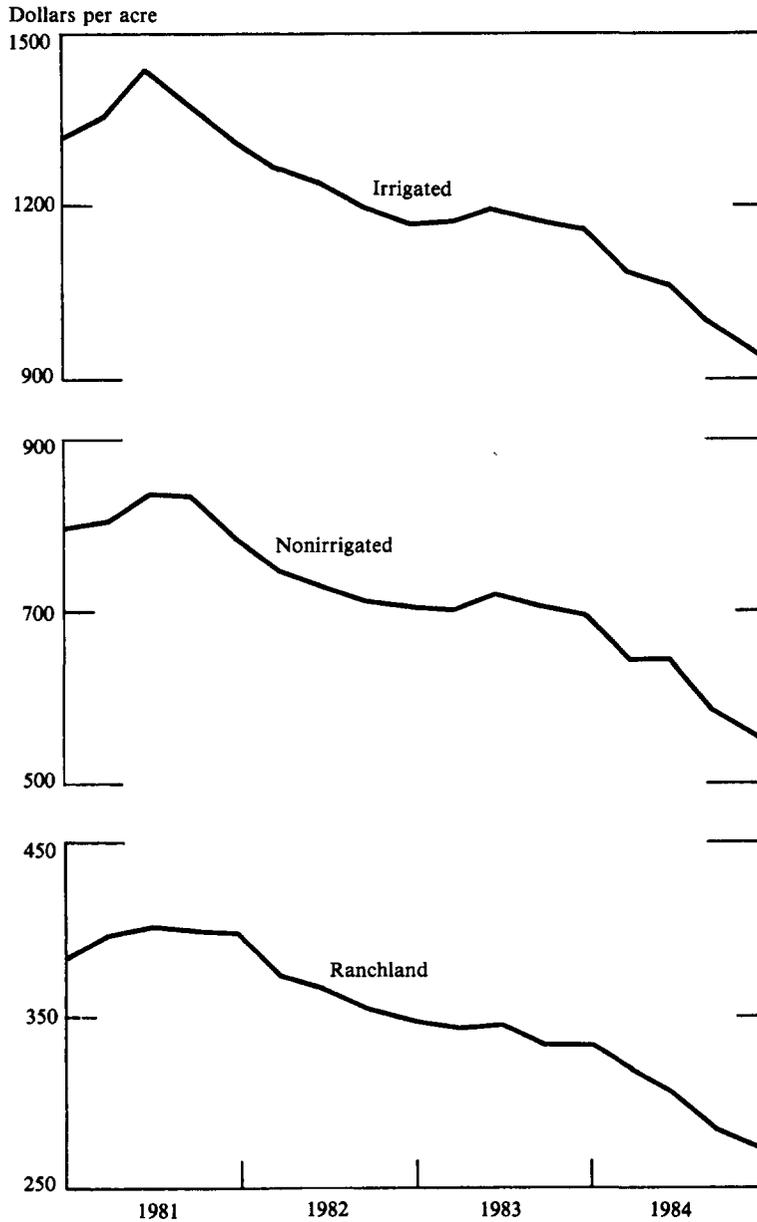
Farm financial stress is greatest on heavily leveraged farms in this sales class of between \$40,000 and \$500,000 (Chart 3). A 40 percent debt-asset ratio seems to be the dividing line between moderate and serious financial stress. About 210,000 of these farms have debt-asset ratios of more than 40 percent. These highly leveraged farmers hold 39 percent of farm operator debts and own about 14 percent of farm operator assets. Their assets total \$107 billion, and they owe \$73 billion.²

The outlook is particularly grim for farmers with leverage ratios more than 70 percent.

¹ Farms with annual sales of \$500,000 or more seem to be very profitable, as a group, despite high leverage. In the Tenth District, for example, most cattle feedlots and large confinement hog operations continue to generate sufficient cash flow to service debt.

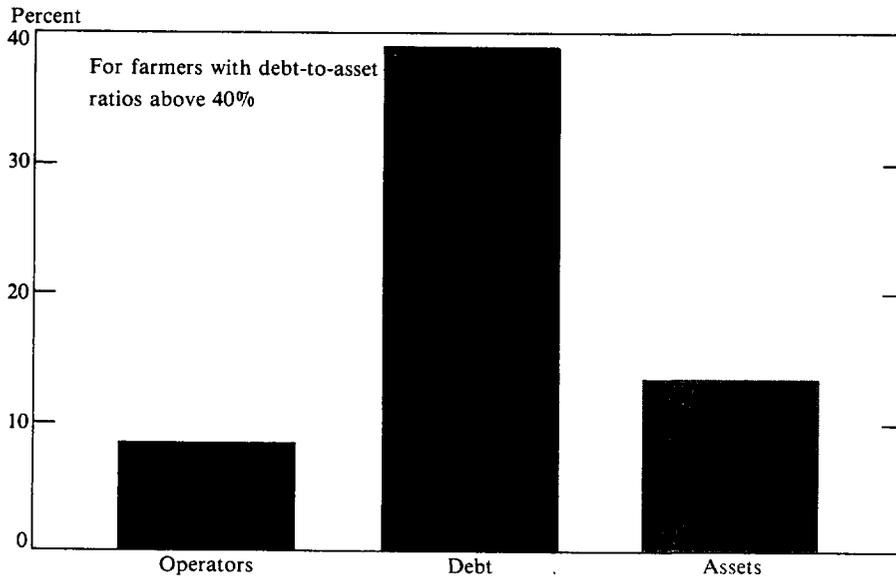
² Source: Board of Governors of the Federal Reserve System.

CHART 2
Farm real estate values



Source: U.S. Department of Agriculture

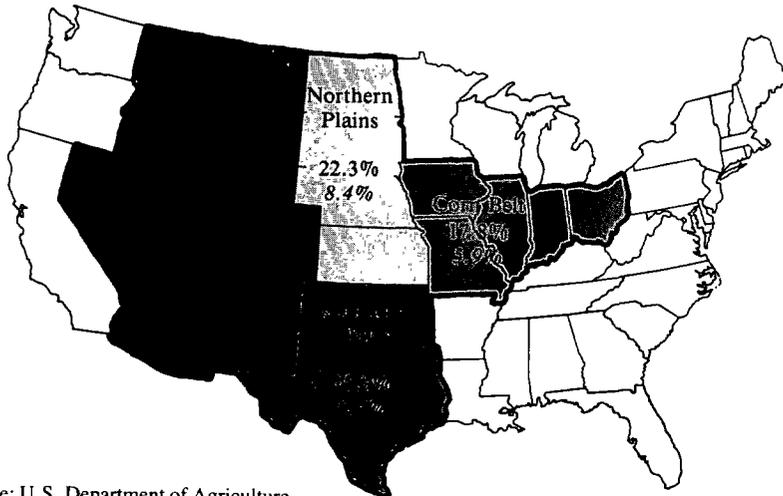
CHART 3
Farm debt and assets
for selected sales classes



Source: U.S. Department of Agriculture

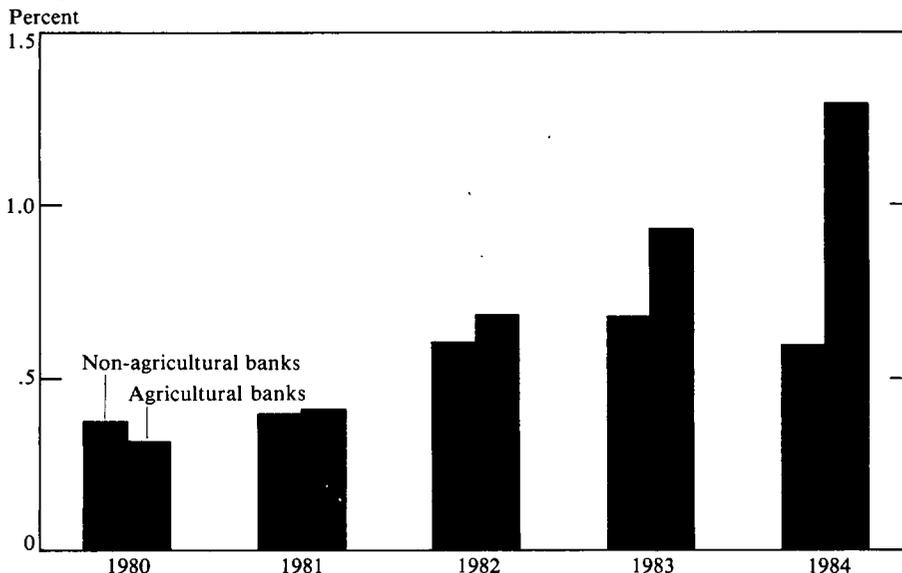
CHART 4
Highly leveraged farm operators

- Operators with debt-to-asset ratios above 40%
- Operators with debt-to-asset ratios above 70%



Source: U.S. Department of Agriculture

CHART 5
Total net chargeoffs as a percentage of total loans



Source: Board of Governors of the Federal Reserve Bank.

About 4 percent of the nation's farmers are in this situation. These farmers—nearly 100,000—hold about 5 percent of the assets owned by farm operators and account for about a fifth of the debt. Most farmers in this group seem destined to sell at least a substantial part of their assets over the next year or two or face actions by lenders to force them to settle their debts.

Although the stress currently may be worst in the western Midwest and northern Plains states, the problem appears national. The proportion of farmers with debt-asset ratios of 40 to 70 percent exceeds the national proportion in the Northeast, the Lakes states, the Cornbelt, and the northern Plains (Chart 4). The proportion with debt-asset ratios of more than 70 percent exceeds the national proportion in the Lakes states, the northern Plains, the Appalachians, the Southeast, the Delta states, the southern Plains, and the Rocky Mountain states.³

Farm financial stress has affected the performance of the nation's agricultural banks, banks with more than a fourth of their loans in agriculture. Loan losses at these banks at the end of 1984 were four times more than in 1980, moving agricultural banks well ahead of nonagricultural banks (Chart 5). Substantially higher loan losses are in prospect for 1985. So far, provisions for loan losses have kept up with the losses written off, but measured by returns to equity, agricultural bank profits have fallen sharply. Despite the reduction in earnings, capital ratios have been maintained at most agricultural banks.

Until recently, failures among agricultural banks were less than failures of other commercial banks of comparable size. The rate of agricultural bank failures climbed relative to nonagricultural banks in 1984. Of 79 bank

³ Source: U.S. Department of Agriculture.

failures nationwide in 1984, 25 were agricultural banks.

Growing financial problems in agriculture, as indicated by the growth of total net charge-offs as a proportion of total loans outstanding at agricultural banks, are of increasing concern to lenders. Agricultural bank performance has changed over the past few years from showing fewer loan losses than nonagricultural banks to showing substantially more loan losses than nonagricultural banks.

Losses also have mounted for the farmer-owned Farm Credit System (FCS). Production Credit Association (PCA) losses for 1984 totaled \$285 million, compared with only \$109 million for the entire decade of the 1970s.⁴ Together, PCA losses in 1983 and 1984 exceeded the combined losses of the previous 50 years. Five PCA's failed in 1984 and four have failed so far in 1985. Losses could be large at several Federal Intermediate Credit Banks (FICB's).

Federal Land Banks (FLB's), which have had relatively few loan losses so far, are bracing for what could be a marked increase in loan delinquencies and maybe loan losses later. The increase is expected because commercial banks and PCA's are increasingly reluctant to extend credit to farmers to finance land payments. While FLB's are well capitalized and loan losses are not expected to impair their stability, the losses could be large, especially in regions where financial stress appears greatest and land prices have declined the most.

Although banks serving agriculture and the FCS are both likely to have more loan delinquency and loan loss problems in 1985, it is important to keep the situation in perspective. Both groups of lenders have a high degree of resilience. Both the rural banking system and

the FCS should weather the current stress in relatively good shape.

Factors conditioning the policy response

Dimensions of the current stress in agriculture suggest the need to ease the adjustment underway, but three factors condition the scale and appropriateness of that response. One is the expected duration of farm credit problems. Another is the international dimension of the transition in U.S. agriculture. A final factor is the expected decline in farm asset values. So before proposed policy solutions are examined, the medium-term outlook for U.S. agriculture, the international constraints to domestic policy options, and adjustment in farm real estate values must be considered.

Financial outlook for agriculture

The expected duration of today's farm loan problems is important to the consideration of policies to ease the problems. There are two possible financial courses for agriculture over the next five years. One is pessimistic, and the other is more optimistic. Both have implications for the scale of public sector intervention needed to ease agriculture's adjustment.

The pessimistic course rests on the assumption that no progress is made to reduce the federal budget deficit. Huge federal deficits of about \$200 billion persist. Monetary policy is assumed to remain directed at keeping inflation under control by achieving monetary growth targets. This economic policy mix means that pressures on U.S. capital markets remain high, keeping real interest rates high and lending strength to the dollar. Under these assumptions, general economic growth would probably be sluggish over the next five years, maybe less than the economy's long-run potential of about 3 percent. Economic growth

⁴ Source: Farm Credit Administration.

also would be unbalanced, with industries producing defense and consumer goods doing well while industries producing capital goods, exports, and import-competing goods suffered.

Under this scenario, many troubled farm loans would likely end in liquidation. Most producers with debt-asset ratios much above 40 percent—except those in profitable dairy and specialty crop enterprises—would probably have substantial financial problems. Assets sold by troubled farmers would be acquired by well-capitalized producers and off-farm investors.

A more optimistic course for agriculture depends on the budget deficit problem being promptly addressed. In this case, it is assumed that in five years annual budget deficits are running no more than \$100 billion and are on a downward trend. In response to this change in fiscal policy, real interest rates would decline, even though restraining inflation

Policy that eases farm credit problems in the near term must be constructed so that it does not impair the competitiveness of U.S. farm exports in years to come.

would remain a primary objective of monetary policy. The dollar would weaken somewhat in response to the lower real interest rates and the large U.S. trade deficit. The general economy grows more vigorously than under the previous assumptions as lower real interest rates spur business fixed investment. Annual growth in real GNP is somewhat higher than the approximately 3 percent long-term potential rate of growth for the five-year period.

Farm loan problems are less severe under this scenario because farmland values stabilize earlier and farm income is higher. Although

substantial asset and debt restructuring is required, more producers that now have 40 to 70 percent debt-asset ratios will survive. Those with ratios of more than 70 percent are still likely to be forced out of business. The need for infusion of nonfarm equity would be less under this scenario, but the need would still be higher than in the past few decades.

In summary, if large federal budget deficits continue, real interest rates remain high, and the dollar stays strong, current farm loan problems will become more serious. In that event, there will be more need for public assistance to ease credit problems. If deficits are reduced, leading to lower real interest rates and a weaker dollar, the stress will ease, though the need for public assistance will remain for near-term problems.

The international dimension

The dimensions of the current financial stress and the prospects for continued stress may argue for substantial public sector assistance. The policy response, however, cannot overlook the international dimension of the current adjustment. American agriculture must compete in a world market for food and fiber, supplying products that are price competitive. Policy that eases farm credit problems in the near term, therefore, must be carefully constructed so that it does not impair the competitiveness of U.S. farm exports in years to come.

Agriculture has become more dependent on trade, along with the rest of the economy. Total U.S. trade (exports plus imports) is now more than a sixth of GNP, more than twice as important as it was in 1965. The opening of the U.S. economy to international trade carries with it two noteworthy implications for agriculture. One is that U.S. macroeconomic policy has become much more important to agri-

culture. The consequences of U.S. economic policy now spread far beyond our shores, with many food-importing countries feeling the effects of U.S. policy. Agriculture in this country suffers when economic policies raise real interest rates, and slow economic growth in developing countries.

The other implication for agriculture is the competitiveness that a more open economy brings. With many countries vying for world markets, U.S. firms must increase productivity and cut costs to keep a competitive edge in both their domestic and export markets—a conclusion that applies to agriculture as well as such industries as steel and automobiles. With many countries having made large capital investments in food production over the

Under various assumptions, farmland values could fall to a half to a fourth of their previous market highs.

last decade, U.S. agriculture competes in the world marketplace against an array of growing export competition. And greater competition keeps pressure on all segments of U.S. agriculture to trim costs. For producers, this has meant a secular decline in farm real estate values, an important part of crop production cost. For agribusinesses, it has meant consolidations of firms to eliminate excess capacity and reduce costs as well as limited opportunity to maintain profitable price margins.

A more open economy means agriculture cannot ignore international competitive pressures or implement agricultural policy that impairs its competitive position in a global food market. Moreover, agriculture has a great stake in U.S. economic and international policies that foster economic growth here and abroad.

Asset value adjustment

It seems clear that U.S. agriculture is in the midst of a major adjustment to both the market realities it currently faces and those that are in prospect. That adjustment will be more traumatic than any since the Great Depression. Moreover, it is agricultural asset values that appear likely to adjust most dramatically. Because farm real estate accounts for about three-fourths of all farm assets, and thus is a major determinant of the cost structure of U.S. agriculture, it is not surprising that farmland values have fallen sharply.

Under optimistic assumptions, it now appears that farmland values will settle at about half their previous market high.⁵ That loss will seriously affect the borrowing capacity of farmers carrying moderate amounts of leverage. Heavily leveraged farmers will experience greater financial stress that will probably require substantial asset restructuring.

Under the most pessimistic assumptions, the decline in land values could be more protracted—and much deeper. Asset values could decline for at least the next few years. Land values could fall to the range of 25 percent of market high before support was found.⁶ That pessimistic outlook would occur as the result of continued high interest rates, substantially weaker farm commodity prices than are now in prospect for 1985, and continued sluggish world economic growth. Such precipitous

⁵ That conclusion is based on the following assumptions. Investors were assumed to pay a value for Tenth District farmland determined solely by the net cash returns from a 50/50 crop share lease. In this case, 1985 USDA crop price forecasts were assumed and long-term interest rates were assumed to have declined to 8 percent as a result of a significant reduction in the federal budget deficit.

⁶ In this case, crop prices were assumed to fall to the levels estimated recently by Secretary of Agriculture Block if a market oriented farm program were enacted. Long-term interest rates of 12 percent, approximately current levels, were also assumed.

decline in land values would have far reaching impacts on farmers; even those who currently carry relatively light debt loads would find their borrowing capacity sharply reduced. Moderately and heavily leveraged farmers would experience severe financial stress. Lenders and agribusinesses also would share in the agricultural sector's severe financial stress.

Policy solutions

A rather sober view of farm financial conditions—and expectations of additional adjustment over time—have prompted calls for public assistance for financially troubled farmers. Such assistance, of course, would also help their lenders.

To grant more assistance than currently available would cut across current policy efforts to pare most categories of discretionary public spending. Moreover, most agricultural economists, and many policymakers, see the current adjustment as necessary if agriculture is to get its cost structure in line with the competitive demands of a world marketplace. Policymakers also fear—with good reason—the prospect of another large increase in farm borrowers dependent on subsidized government credit and unable to survive over a longer time horizon without continued infusions of soft credit.

There appear to be only limited bases for increased public intervention in easing agriculture's adjustment problems. One reason for public intervention would be to prevent the collapse of the rural banking system. Another would be to ease the adjustment while allowing it to continue but not so rapidly as to create chaotic conditions in farm asset markets. A third reason would be to help avoid a substantial undershooting of farm asset values below those that would be supported by market fun-

damentals. A sharp undershooting of asset values could bring a larger group of farmers into financial trouble than otherwise.

Data suggest that concern over collapse of the rural banking system is overstated. The performance of agricultural banks has deteriorated in recent years. By some measures, it now falls noticeably behind nonagricultural bank performance for similarly sized banks. Some banks will have serious problems because of this trend. But there is not compelling evidence that the commercial banking system is in jeopardy. Nor is the farmer-owned FCS in jeopardy. To the contrary, evidence suggests that most agricultural lenders have enough resilience to ride out the current stressful period.

Justification for public intervention, then, appears to be twofold: to moderate the adjustment in agriculture and to help avoid substantial declines in asset values below equilibrium values. Most proposals have these goals as their focus.

A number of proposals that have been suggested to ease farm financial stress are now evaluated.

Interest rate buydown

Proponents of an interest rate buydown suggest that lowering interest rates by two to three percentage points would go a long way in curing farmers' financial ills. The proposal typically calls for a buydown for farmers with federal funding or a preferential interest rate for agricultural lending instituted by the Federal Reserve System. This proposal seems fairly easy to dismiss as unworkable. First, an interest rate buydown would be a direct cost to the Treasury of at least a few billion dollars a year. In an era of fiscal austerity—and such a program benefitting only a small proportion of the population—an interest rate buydown may

not be feasible. Second, preferential interest rates granted by the Federal Reserve to a single sector of the economy or group of persons would entail credit allocation by the central bank. Neither Congress nor the Federal Reserve seems willing to pursue such a policy. Credit allocation programs have not worked well. There is likely no basis for policies favoring farmers over other groups, such as homebuilders, for example.

Some farm belt states are considering bond issues to provide low-cost loans to farmers. While such programs would ease the debt service burden of financially stressed producers, they have drawbacks. The programs would offset bond authority that might be used for economic development or capital investment. They would favor one sector of the economy over others. And they would generally provide benefits to all producers, when a targeting of benefits according to management skills and other criteria is probably more appropriate. States may find relocation and retraining grants to displaced farm operators a more cost effective use of funds.

The administration's debt assistance program

The administration's debt assistance program provides an opportunity for debt and asset restructuring with losses being shared by borrowers, lenders, and the federal government. For its borrowers, the Farmers Home Administration (FmHA) will provide a five-year debt set-aside on up to 25 percent of the borrowers' debt, for a maximum of \$200,000, with no interest on the amount set aside. For loans held by other lenders, the FmHA may guarantee up to 90 percent of a restructured loan, with a \$400,000 limit for operating loans and a \$300,000 limit for real estate loans, after the lender has taken at least a 10

percent writedown on the loan principal. In either case, the restructured loan must generate a breakeven cash flow.

The program appears to be quite successful with FmHA borrowers at this point. About 30 percent of the FmHA's 273,000 borrowers have asked for interviews to determine their eligibility. Apparently far less popular with nonFmHA borrowers and their lenders is the 90 percent loan-guarantee program, which until recently had only limited use.

A corporation to purchase farmland could be an attractive policy choice, but it has shortcomings.

The lack of participation by nonFmHA borrowers is a matter of substantial concern. With capital losses shared by borrower, lender, and government, the program appropriately does not stop the necessary adjustment in farm asset values and in farm structure. Instead, it moderates the speed of adjustment to a rate that is politically and socially acceptable. If the program does not work well, however, more drastic action by Congress is almost certain.

To improve the program's acceptance, the administration has made several improvements. First, FmHA has streamlined the certifying of approved lenders. This broadened the authority of lenders to act on debt-restructuring and loan-guarantee agreements—within prescribed guidelines—greatly speeding guarantee approvals.

Second, lenders participating in the debt restructuring and loan guarantee program are now allowed to take their required writedown in the form of a reduction in loan interest rates instead of an immediate writedown against loan principal. The change allows lenders to take their losses out of earnings over time instead of taking them out of loan loss reserves and capital.

Third, the program's initial requirement that the restructured loan generate 110 percent of cash flow requirements has been relaxed to 100 percent. If agriculture's prospects are to improve over the next two to three years, it may be enough to require that the loan generate only 100 percent of cash flow requirements.

Fourth, the funding authorization cap for loan guarantees is no longer a limitation. Greater guarantee authority will be available if needed.

These improvements may increase the number of borrowers and private lenders using the FmHA loan restructuring and guarantee program. That would mean more risk to the FmHA, and the possibility of agriculture becoming more dependent on public lending. To offset that risk, the FmHA could offer loan guarantees that decline over a fixed number of years. For example, a 90 percent loan guarantee could be in effect for the first three to five years of a restructured loan with the guarantee declining by ten percentage points a year thereafter. The private lender could then exercise credit discipline if the loan did not perform, and the FmHA loan guarantee portfolio would dwindle over time as private lenders assumed the risk associated with the credit.

A new federal lending agency

A new federal lending program has been proposed to provide needy farmers a new source of capital. While such a program might have merit in theory, it has many problems. With the current emphasis on reducing federal budget deficits, it seems unlikely that such an agency would be authorized and adequately capitalized. But even more relevant is how such an agency could be kept from becoming still another large and generous source of soft credit to borrowers that are no longer credit-

worthy and how the lending of such an agency could be limited to agriculture and not extended to include other troubled sectors.

Policymakers have discussed using the FCS as a vehicle for providing soft credit to agriculture to ease financial stress. In addition to other credit management problems that could result, the FCS would likely jeopardize its private sector status. If financial markets became concerned about the future quality of FCS bonds, borrowing costs to farmers through FCS outlets would rise, affecting both short and long-term loans. Consequently, this seems to be an unwise alternative.

A federally chartered private corporation has been proposed for acquiring agricultural land from financially troubled farmers. The corporation would raise funds in national capital markets to buy land and hold the land for a few years before offering it for sale to farmers. Farmers that had sold the corporation their land would have the right of first refusal. Land would be leased back to farmers by the corporation during the holding period.

A federally chartered corporation has some appeal. It might be a way around state laws limiting corporate ownership of land. Its federal charter likely would enable it to raise large amounts of capital through the sale of bonds. Its presence in land markets would promote more optimism about the future of farm asset values. And the corporate approach represents a private sector, rather than government, solution to a knotty public policy problem.

But the proposal is not without problems. To stabilize land markets effectively, the corporation would need to become operational in a relatively short period of time. Political pressures might cause the corporation to support farmland values higher than market fundamentals dictate. Since capital losses in farmland are likely to continue for another few

years, the corporation would need enough capitalization to withstand portfolio losses on a mark-to-market basis during that time. And finally, since agriculture is not alone in facing capital losses, political pressures would be strong to authorize lending by the corporation to other troubled sectors, such as energy and heavy manufacturing.

On balance, the corporation may be an attractive policy choice if land values decline substantially over a period of years. It could ease the financial problems of farmers and lenders that would accompany such a decline. Nevertheless, the corporation would need to be carefully crafted to avoid some potentially large shortcomings.

Helping lenders hold assets

Lenders are expected to take possession of large amounts of farm real estate over the next two to three years as a result of foreclosures and other actions to settle problem loans. In the past, lenders usually have put such property on the market promptly. But that option does not seem reasonable in the current adjustment. With land values falling and much more property for sale than usual, to place more land on an already crowded market would be to depress prices even faster and maybe even further than market fundamentals would require.

As a result, many lenders are now holding land in their portfolios and they may need to continue holding land for a few more years. Federal banking regulations seem flexible enough to allow property to be held up to ten years, but if property values decline from those determined when the property was acquired, banks must establish reserve accounts at least equal to the excess of book value over fair market value or writedown the value of the assets directly. In short, banks

must mark to market the real estate. Some state banking laws are more stringent, requiring annual writedowns on the property until it is written off the bank's balance sheet.

Despite their good intentions to hold land off the market, then, few lenders will be able to hold large amounts of land for several years. To do that when the land market was declining would be to impair the banks' capital. As a result of this problem, agricultural banks would be aided by forbearance, where appropriate, on the part of national and state bank regulators regarding holding of real estate by lenders.

Federal Reserve discount window

Because of the problems in agriculture, a significant number of agricultural banks may approach the Federal Reserve discount window. Assistance could be provided under two Federal Reserve extended credit programs. Under the seasonal borrowing privilege, banks that can show a clear problem of seasonal liquidity needs may qualify for advances of credit for up to nine months. For small rural banks, that need typically is the result of "regular and recurring deposit and loan flows associated with a crop production cycle."⁷ The Federal Reserve can also provide extended credit where exceptional circumstances or practices adversely affect an institution's ability to obtain funds elsewhere. These special circumstances include sustained deposit drains, impaired access to money market funds, or sudden deterioration in loan repayment performance.⁸ Under either of these pro-

⁷ *Operation of the Federal Reserve Discount Window under the Monetary Control Act of 1980*, Federal Reserve Bank of Kansas City, p. 6.

⁸ *Extensions of Credit by Federal Reserve Banks*, Regulation A, Board of Governors of the Federal Reserve System, September, 1980.

grams, the primary consideration in extending credit is the liquidity strains of the particular institutions.

On March 8, the Federal Reserve Board announced modifications in its seasonal borrowing program. The changes were designed to further assure that small and medium-sized agricultural banks can meet their temporary liquidity needs arising from providing credit to farm borrowers during the current production cycle. The changes were twofold: a revision of the regular seasonal credit program and addition of an alternative simplified program. These changes are summarized in the accompanying box.

Under some circumstances, institutions in the FCS also might find it helpful to use the discount window. FICB's, lenders to agriculture for production purposes, have statutory access to the discount window. Requests from these institutions could be honored if special circumstances, as noted above, created substantial liquidity needs.

Attracting new investors

While much debt restructuring remains to be done by farmers and their lenders, restructuring alone will not solve the problems. Much farm property will need to change hands

Modifications in Federal Reserve Seasonal Borrowing Program

Modification of regular program

The regular seasonal borrowing privilege has been modified to increase the amount of seasonal funds available. In the past, the program has required banks to fund a portion of the seasonal swing in its net need for funds from its own resources before it can borrow from the Federal Reserve. Equivalent in concept to a deductible, that amount has been reduced from 4 to 2 percent for the first \$100 million in deposits, from 7 to 6 percent for the second \$100 million in deposits, and remains at 10 percent for deposits over \$200 million. In addition, discount window officials will take a more flexible approach in administering the seasonal program, taking into account special factors in the farm economy that might modify historical seasonal patterns.

Temporary simplified program

Available through September 1985 as an

alternative to the regular program, the simplified program makes discount window credit available to fund half of a bank's total loan growth in excess of 2 percent from a base level—either the average for February or for the two weeks just prior to application. The total amount of credit extended under the program may not exceed 5 percent of a bank's deposits. The credit extended is expected to be used for agricultural or agriculturally related loans. The interest rate on credit advanced in the program will be fixed for the time credit is outstanding. The rate was initially set at 8.5 percent, and borrowings must be repaid by February 1986.

To qualify for the temporary simplified program, banks generally would have less than \$200 million in deposits and would have a ratio of agricultural loans to total loans greater than 17 percent, the average farm loan ratio for the banking system. In addition, banks must have loan-deposit ratios above 60 percent to be eligible.

over the next few years. For example, most of the property in which the current owner has no more than 30 percent equity will likely need to move into stronger hands.

Thus, over a longer period, it could be desirable to increase the number of potential investors in farmland, including farmers and nonfarm investors. But many states have restrictions on farmland ownerships by aliens and corporations. Because insurance companies, pension plans, and other corporate entities could be an important source of demand for farmland, it seems appropriate for states to reconsider their restrictions on ownership. To ease farmer concern over nonfarmer control of agricultural assets, the length of time such assets could be held by aliens or corporations might be limited, say, to between ten and 15 years, with family farmers given the right of first refusal when the corporations sell.

Summary

American agriculture is in the midst of a difficult but necessary adjustment. Much of the current financial stress in agriculture comes from the inflationary excesses of the 1970s. The current and prospective financial

problems resulting from adjustment to slower world economic growth, increased international competition, and greater price stability are putting farmers and their lenders under great stress. The stress could become more intense before it eases.

Unusual cooperation is needed among borrowers, lenders, regulators, and the government.

It is important that the adjustment be completed without rupturing the social and political fabric of the nation's rural economy. To avoid such a rupture, unusual cooperation is needed among borrowers, lenders, regulators, and the government. Large capital losses will be realized in agriculture and may need to be broadly shared. If farm asset values continue to decline over the next few years, a strong pressure will build for new public sector mechanisms to ease agriculture's transition to new market forces. The challenge for all involved is to use both private and public sector mechanisms to their fullest in addressing the current and emerging farm financial stress problems.