

Farmland debacle

BY BERT ELY

The old saying that history repeats itself may soon come to pass for rural America, with disastrous consequences. The Farm Credit System, the prime culprit in the 1980s' agricultural crisis because of its aggressive lending in the 1970s, could do it again.

Clearly, the last thing rural America needs today is another round of increasingly aggressive lending by the Farm Credit System. Yet that is what has been happening in recent years, and it's about to get worse.

On July 14, the three-member board of the Farm Credit Administration, the system's federal regulator, quietly adopted a fundamental philosophical shift toward greater competition within the credit system. This is sure to greatly stimulate lending, increasing the threat to rural America's financial health.

Although less well known than its siblings — Fannie Mae, Freddie Mac and the Federal Home Loan Banks — the Farm Credit System is America's oldest government-sponsored enterprise.

Created by Congress in 1916, the credit system initially financed farm real estate in the following manner.

Farm borrowers would purchase stock in a local association in the credit system, thereby becoming its owners. Then the associations, by collectively borrowing funds in the capital markets to lend to their members, would leverage farmers' capital.

Further, because the credit system is a creature of the federal government, interest rates on its debt are just slightly higher than Treasury rates.

In the 1930s, the credit system's lending powers were broadened so that its associations also could make loans to farmers to finance the annual growing season.

Through the 1960s, the credit system was a relatively innocuous credit supplier to American agriculture. At the system's urging, though, Congress greatly liberalized its lending powers in 1971.

Congress authorized the system to lend up to 85% of the market or appraised value of farmland. Previously, it could lend up to 65% of the capitalized income of farmland, which often is a lesser amount than market

value.

A lending binge followed. The Farm Credit System increased its loans by a factor of five over the following decade as farmers, armed with this cheap credit, bid up farmland prices as they sought to expand their farms and ranches.

Over the decade, the average acre of farmland almost doubled in value, on an inflation-adjusted basis. What emerged was a classic speculative bubble fueled by the system's cheap, plentiful credit.

The high interest rates of the early 1980s popped that bubble, though. By 1986, farmland values

starting to emerge again.

Until recently, local Farm Credit System associations have had exclusive lending territories for the types of loans they make. It was thus a major departure when the system's regulator, the Farm Credit Administration, quietly adopted its new philosophy of not merely permitting, but actually encouraging unrestricted competition among lending institutions in the system.

These taxpayer-backed institutions, all of which lack effective stockholder discipline, are in effect being prompted to compete against each other. The Farm Credit System's tragic history could easily repeat itself.

What is especially troubling is the Farm Credit Administration's role in this situation.

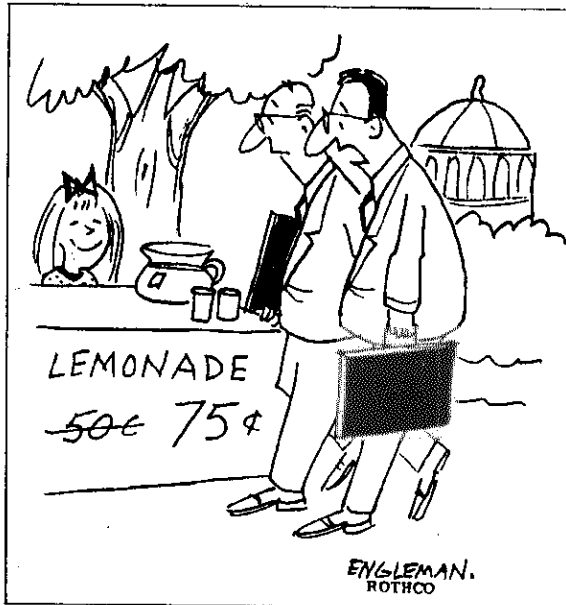
Instead of urging caution and restraint, as any prudent government safety-and-soundness regulator should, it is throwing caution to the wind by actively promoting potentially reckless lending.

For example, in explaining its new philosophy, the Farm Credit Administration Board stated that it wants to provide a "flexible lending environment" and a "broad interpretation of existing statutes."

This competition within the Farm Credit System also will stimulate substantial further consolidation within the system, which at present has \$64 billion in loans outstanding.

This could lead to a relative handful of large, multibillion-dollar lending associations even more disconnected from their purported owners than they now are.

Unless Congress does something soon to bar competition among farm credits associations while strengthening their regulation, America's farmers and ranchers — indeed, all of rural America — could be struck badly by another lending fiasco fueled by the Farm Credit System and promoted by the Farm Credit Administration.



"Wait until Alan Greenspan sees this!"

had plummeted to early 1970s' values, on an inflation-adjusted basis. Thousands of farmers went bankrupt, many small towns were denuded of farm-related businesses and almost 300 rural banks failed.

The Farm Credit System itself was badly hurt by loan losses, prompting Congress to authorize a \$4 billion taxpayer bailout in 1987. The credit system had been a reckless lender, and rural America paid the price.

By the mid-1990s rural America had largely regained its health as farm incomes rose and farmers paid down their debts. In recent years, however, farmland prices have begun to rise faster than the inflation rate, raising the specter of another farmland bubble — and another bust.

Farm income will decline this year because of droughts and low prices. The substantial disconnect between farmland values and farm income, so evident in the late 1970s and early 1980s, is

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