

Views on Restructuring Agriculture

DURING the ABA National Agricultural Conference in Dallas last month, one of the best attended concurrent seminars was the one devoted to "Restructuring Agriculture."

Moderator Alan R. Tubbs, president, First Central State Bank in DeWitt, Ia., described briefly the ag problems of today and the current status of Farm Bill legislation. He then introduced the two panelists. The first was Dr. Michael D. Boehlje, head, Department of Agricultural and Applied Economics, the University of Minnesota, St. Paul. The second was Frank W. Naylor, Jr., Under Secretary of Agriculture for Small Community and Rural Development, U.S. Department of Agriculture, Washington, D.C.

Some of Dr. Boehlje's comments follow: The impact of financial stress in agriculture on the U.S. economy might be visualized as a series of waves.

- The first wave will involve those highly-leveraged farmers who cannot service their entire debt load.

- As these highly-leveraged farms attempt to resolve their financial stress through the sale or other disposition of assets, the remaining farm population will incur costs in the form of reduced land values and thus impaired credit worthiness because of declining collateral. This is the second wave.

- The third wave occurs when farmers reduce their purchases of capital items from local suppliers and are not able to pay on open accounts and trade credit extended by input supply firms. Thus, the local community absorbs part of the loss or cost because of reduced retail sales and economic activity, as well as losses from non-payment on accounts receivable and bankruptcies.

One of those institutions which will not receive payments from financially stressed farmers is the lending institution.

Adjustments Needed

Five major long-run adjustments appear necessary to obtain a more financially stable agricultural sector:

1. **Lower interest rates.** A 1% decline in interest rates on the over \$200 billion of U.S. agricultural debt would result in an approximate \$2 billion increase in net farm income. A balanced budget would reduce the dollar value by 20%, lead to a 10% increase in exports in two years and perhaps 20% increase in the long run.

2. **Mothball excess capacity.** We have an estimated 5% to 10% excess production capacity. Conversion of 20-30 million acres of steep, erosive and low-yielding grain land to grass or non-use is one way to eliminate excess production and reduced soil erosion.

3. **Lower resource values.** Land values are 35-40% below the peak of the early 1980s and may fall further.

4. **Reduce debt.** About one-third of farmers owe approximately two-thirds of the debt. This "excessive" debt must either be redistributed or eliminated. Probably a significant amount of ag debt will be discharged or written off over the next 3-5 years by the public and private lending institutions that service agriculture—at significant costs to lenders in the short run, and will improve agriculture's financial condition in the long run.

5. **Restructuring asset ownership.** Some farmers with very high debt loads cannot "afford" to own all of their assets, and these must find new owners on the market.

Assistance Program Beneficiaries

Any program should establish guidelines as to farmers, lenders and others who would reasonably be benefitted by the program. These are:

- Farms so weak that debt and asset restructuring is not effective or feasible. This group is *not restructurable* and their most likely option is to exit agriculture.

- *Restructurable* farms - those who can reorganize debts and assets and can become profitable under economic conditions likely to prevail over the next 5-10 years. This group

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Iowa News

Iowa Bankers Insurance & Services, Inc. will hold a Life Licensing School on January 13-14 at the Holiday Inn - Capital Plaza, Des Moines.

Fee for the school is \$55 for bankers and \$65 for nonbankers. School hours are 9-5 the first day and 8-5 the second day. For registration, contact Jeanette M. Ellington at (800) 532-1423 or (515) 286-4371.

CEDAR RAPIDS: Merchants National Bank has announced the formation of two new divisions. D. William Coppock has been named director of the new personal services division and James H. Struve was appointed head of the corporate services division. Jerry N. Trudo was

appointed director of the correspondent services division, which will include the agriculture department. He succeeds John Mangold, who is retiring January 1. Also announced was the election of Robert J. Louvar as assistant vice president in the correspondent bank division. He joins the bank with ten years banking experience.

SIOUX RAPIDS: Jay Rehnstrom has been named an assistant vice president of the First State Bank. He previously was with Toy National Bank, Sioux City.

STORM LAKE: Security Trust and Savings Bank has recently announced the completion of its remodeling and expansion project. The bank will be holding an open house for all bankers and their spouses on Saturday, December 7, from 2-5:00 p.m.

Nebraska News

LINCOLN: Lincoln Bank South recently elected Carol A. Jones as operations & compliance officer.

Minnesota News

SAINT PAUL: Jane K. Dodge has been promoted to vice president of consumer banking and Sandra K. Johnson to assistant vice president in trust at American National Bank.

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includes farmers with return to equity from - 20% to +5% in 1984.

- *Profitable farms* - those which earned more than 5% on equity in 1984. Also includes possible or recent entrants who have taken advantage of lower asset values and started farming.

Policies to Aid Transition

Five of the more frequently discussed policies are:

1. **Debt Restructuring.** Rewriting debt to longer term can be useful for those who need marginal help, and

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improve cash flow may result. Long-term benefits should not be over-estimated. May be encouraged by FmHA 90% loan guarantee of principal if lender writes down debt at least 10% so debt cash flows.

2. **Principal forgiveness or write-down.** Whether the write-down will resolve the problem depends on the debt service obligation in relation to income. A write-down initiated by examiners represents a direct loss of equity on the lender's books. A principal buy-down is typically initiated through a public credit policy -FmHA guarantee, for example. Principal forgiveness or buy-down may lead to ill-will on the part of other farmers who see this as an "unfair advantage."

3. **Interest buy-down**—interest rate reductions on an existing loan. Government pays part, if lender reduces the rate. A 4% interest rate reduction on all debt owed by farmers with debt-asset ratios over 40% would require about \$4 billion.

4. **Foreclosure-moratoria.** In essence, conditional moratoria are a means to encourage the reluctant lender to cooperate with and assist those borrowers facing financial stress.

5. **Inventorying or facilitating changes in ownership patterns of assets.** Lending institutions might be encouraged to take title to property in lieu of debt obligations and lease back to the original debtor. Then, other resources such as machinery and equipment would not require liquidation. To avoid lender illiquidity on such loans, the government would likely need to provide funds (Fed window or guaranteed bonds). Original debtor has first option to buy. Programs needed to hold land off the market, and rules eased for lenders holding land.

6. **Other.** Three additional approaches deserve brief mention. A. Farm price and income policies have been a traditional approach to raise



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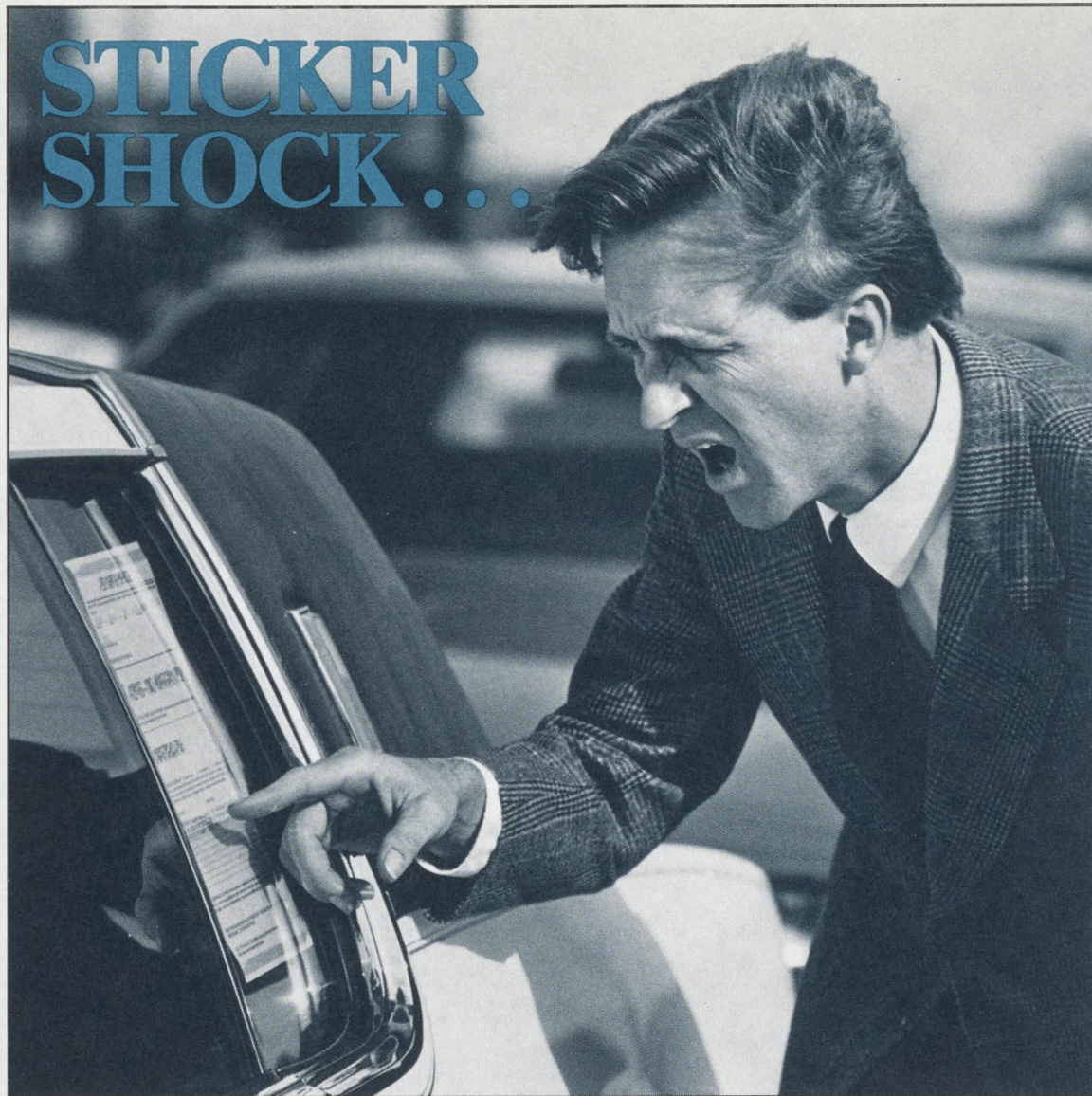
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farm income and ease financial problems. B. Monetary and fiscal policies — lower real and nominal interest rates would be helpful to the entire ag sector. C. Increased attention should be given to programs and policies to help people make the transition out of farming.

USDA's Naylor Speaks

Under Secretary Frank Naylor's comments follow.

Mike has laid out the options with which we have to deal. Two actions are under way in Washington to deal with them: First, the Farm Bill and, second, the Farm Credit System proposal.

Regarding the Farm Bill, the House Bill has major problems. The present Senate Bill - or both - would be vetoed. This might be a cop-out for Congressional members who, after a veto, could then work on a Farm Bill in a totally different environment. There is no small risk that we may go into the next session of Congress with a vetoed bill, or one in doubt.

If they don't get it resolved prior to Christmas, Congress resumes January 20, takes two quick vacations and you're then in April and May.

We must have a significant reduction in the loan rate and the opposite side of this - a target price. How do you deal with income transfer payments we must make over the next 4-5 years, and to what extent do we support income in that period? The irony of the farmer's current income supports is that they haven't worked and need change.

I can't see where a consensus will come in Congress. Where do we get income for farmers for the income transfer period?

FCS Second Major Issue

The second major issue is the Farm Credit System. Here is our perspective and what we are evaluating.

Because of wide variances in accounting systems it is impossible to make meaningful comparisons. A top team of the Treasury has been on this job two months and Price Waterhouse is on the outside for the first time in FCS history. I doubt if we will have the full story on FCS' true condition by even year-end.

The initial report shows a \$500 to \$600 million loss, due to re-assignment of money to reserves. If correct accounting procedures were applied to the entire system it would be showing a profit!

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We accepted their own numbers in looking at the need to deal with \$13 billion in problem loans the next few years. The *prospective* loss on these loans the next six years is \$6 billion. They can fully reserve \$3 billion in three years, and by 1988 could turn around into a strong, profitable system. This is using their *own* numbers, which are worse than we think they are.

At their *worst* point - in late '87 - they should still have \$500 million in reserve and more than a billion in capital.

Is the problem massive? Yes.

The issue of federal intervention revolves around FCS assisting itself and having access to the Fed window.

Steps FCS Must Take

We've insisted on them taking two steps:

1. Eliminate the management role of the FCA and make it a twin to the Comptroller of the Currency - a regulator.

2. Marshal and utilize their resources within the system.

If the FCS bill has \$6 billion of credit help in it, it will never see the light of day. Seven Congressional Committees want a piece of the action on this bill so it will require very close cooperation of all parties. It will be difficult, but not impossible.

Nothing for Banks

So far as commercial banks are concerned, nothing is anticipated in this bill and I don't think there will be. The best bet for them is the interest rate buy-down proposal.

We either deal with this bill now, or it carries into the next session.

(Ed note: An omen? When Mr. Naylor, in response to a question said he "couldn't see any realistic move in Congress to move the FCS bill to the Senate Ag Committee," as requested by ABA, the ABA logo sign on the podium chose that exact moment to jar loose and fall to the floor with a thud!) □

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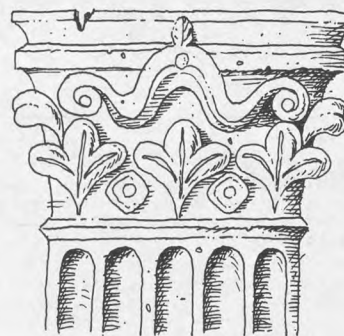
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