The U.S. Experience in Providing Financial Assistance

to Small Farmers[1/]

by

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The United States government has provided direct credit assistance to farmers for over half a century. The amount of credit supplied has always been a small proportion of total farm credit and the credit has been designed to supplement and assist rather than to replace private financing. However, public credit has had an important impact on many individual farmers and has provided support for the private financial system by financing high risk situations.

The eligibility requirements, terms, purposes and availability of public funds have been frequently modified through time, resulting in nearly continuous redirection of public financing efforts. In general these changes have been in response to changing economic environment and evolving political and social attitudes, but some have emanated from the lessons learned from experimenting with public credit procedures. This paper traces the evolution of public credit for agriculture from its beginning in the early 1900's to the present. In general, the paper covers the Farmers Home Administration and its predecessor agencies. Credit supplied by the Commodity Credit Corporation, Agricultural Stabilization and Conservation Service and similar agencies is excluded since the credit supplied by these agencies was generally designed to facilitate government price support activities or encourage certain farming practices rather than assist with basic business financing. Most of the lending by The Farm Credit System is omitted because the government provided only seed money to get this farmer cooperative started and nearly all of the funds lent to farmers are borrowed in financial markets.

Government Entry Into Agricultural Credit

Direct lending to farmers by the government started with emergency seed loans to farmers in selected states in 1918 [22]. These loans were made for the purchase of seed and, in the southern states, fertilizer. Loans were authorized only in states that had suffered some type of natural disaster such as flood, drought or hail.

The original funding for this effort was not appropriated by Congress but was a fund put at the joint disposal of the United States treasury and the United States Department of Agriculture by the Administration. The funds were administered by the Federal Land Banks which had been established in 1916.

Starting in 1921, Congress appropriated funds for seed loans for some type of emergency nearly every year. For example, appropriations were made for 11 of the 15 years between 1921 and 1935. The average loan size made during this period was $135 and about 10 percent of the farms in designated areas received loans. Between 1921 and 1933, loans were administered by branch offices of the Farmers Seed Loan Office, later the Emergency Crop Production Office, of the Department of Agriculture. These branch offices were the first government run farm loan offices.

Seed loans were originally granted only for the purchase of seed and fertilizer. As time passed, the purpose was gradually expanded to include feed for work stock, fuel and oil used in tractors for crop production, feed for livestock and "general rehabilitation".

Prior to 1932, justification for seed loans was based on the expected inability of local credit sources to meet credit needs following a physical disaster. In 1932, this authority was expanded to allow the Secretary of

Agriculture to make loans wherever farmers are unable to obtain loans for production. Thus, economic distress became an accepted justification for granting loans. This was a significant departure from the requirement that some type of physical disaster be involved and obviously resulted from the economic environment of the depression. Under this expanded authority loans were made in every state except Rhode Island [7].

In a continued response to the depressed economic conditions, the intent of the 1934 and 1935 legislation was modified to allow loans on a relief rather than strictly business basis. Loan volume was high. Many farmers received loans each year during the mid thirties and came to believe that the loans were in the nature of government grants for relief, and that they need not be repaid. Although the size of loans was small, averaging $240 in 1934 and 1935, a high proportion of the loans, nearly 45 percent for those made in 1934-35, were effectively grants since they were not repaid. As farm conditions improved in the late 1930's, the government had to take explicit steps to counter the impression that loans need not be repaid. Starting in 1938, loans were made only to farmers who were believed would undertake in good faith to repay the loan according to the terms of the loans and no loans were made in states where state or local authorities might encourage farmers to avoid payment.

A Focus on Low Income Farmers

Until the mid 1930's, government loan programs were available to all farmers in areas covered by a physical disaster or, starting in 1932, areas of economic distress. Small farmers or low income farmers received loans but they received no special treatment. Although the physical disaster program in a similar form has been continued to the present, a major new thrust was

initiated in 1934 with the establishment of the Rural Rehabilitation Division of the Federal Emergency Relief Administration. The purpose of "rural rehabilitation" was to make it "possible for worthy destitute farm families eligible for relief to become self supporting on a plane consistent with American standards and insofar as possible on their own farms'" [11]. At this point the program was aimed at people who were eligible for relief and thus focused on the very poor. The objective was to provide rural relief at a low cost to the government. The expectation that borrowers would, in the long run, become self-supporting was important from the beginning, although the early loans made during the heart of the depression only required that the loan result in some reduction in public relief costs.

At that time, the cause of much rural poverty was believed to stem from use of submarginal land. Thus, the rural rehabilitation program was transferred to the Resettlement Administration which was established in early 1935. Under the Resettlement Administration low income farmers were assisted by the government purchasing their submarginal farm land and retiring it from agriculture and resettling the family on good soil. Loans to needy farm families at their current location were made primarily as an interim step until the families could be moved to better land.

It was soon learned that resettlement was not going to work. In addition to the personal problems involved with resettlement, there was not enough good land available that could be acquired to provide good farms on which these people could resettle. Rehabilitation in place was increasingly emphasized and supervision and guidance of farm and home practices were stressed in an effort to maximize the use of the resources the family had rather than attempt major changes in the resource base itself. This approach

was considerably more successful and acceptable. To reflect the change in approach and activities the name of the agency was changed in 1937 to Farm Security Administration.

At the time the rural rehabilitation program was initiated, loans were made only to people at or near the relief level. However, by 1938, "persons considered eligible for standard loans were low income farmers who were unable to obtain adequate financing for their farms from agencies other than the Farm Security Administration and who showed evidence of acceptable industry, ability and managerial capacity to profit from farm and home management guidance and instruction as well as financing" [11, p.5]. From that point on, rural rehabilitation began to lose its relief aspects and loans were increasingly aimed at establishing and improving family size farms to a standard of productivity and financial position that would allow continued operation at a self-supporting level without government assistance.

Basic Loan Policies and Procedures Established

Within only two or three years the Farm Security Administration had established many of the basic policies and procedures that continue in use today. With few modifications these policies and procedures have provided the basic form for direct government lending to farmers since that date.

Management supervision

A unique feature of these loans was the farm and home management assistance provided by the loan officer. The loan officer supervised the preparation of a Farm and Home Plan which was a written plan prepared at the beginning of each crop year indicating how the business was to be operated and what improvements in management and operation were to be made during the

year. The loan officer was allowed to prescribe agreements on the part of the borrower relating to farming practices. Stress was placed on use of improved varieties and better farming practices. The plan included provision for the subsistence of the family during the year.

Since the loans were generally made to individuals with limited resources, managerial capacity or experience, the close level of supervision was used to increase the changes of success and, thus, reduce loan risk. It was also designed to increase the managerial skills of the operator in hopes of making him (her) permanently self-supporting at some point in the future.

Credit unavailable elsewhere

To obtain a government loan the individual had to be unable to obtain credit elsewhere at reasonable rates and terms. Farmers who were able to obtain credit from the Farm Credit System, Commercial banks or other federally incorporated lending institutions were ineligible. This provided a rather neat separation of public and private credit and avoided expenditure of scarce government funds for financing those who could obtain needed funds from private sources.

During the late thirties and early 1940's, interest rates on rehabilitation loans were similar to those charged by private lenders, usually at or less than one-half percent below private rates [9]. Under these conditions there was little economic incentive for individuals to attempt to obtain public funds if they could obtain needed financing from private sources and maintaining separation of public and private financing was reasonably successful.

More recently, however, interest rates have fallen far below market rates and this has put great stress on the test for credit. In some cases, it is in the long run interest of the private lender to collude with the

borrower by indicating an unwillingness to provide funds and, thus, help the borrower pass the test for credit and obtain FmHA financing. Under these conditions the test for credit has increasingly become a matter of judgment on the part of the FmHA supervisor.

A goal of permanent self-support

The original rural rehabilitation legislation indicated that the objective was to allow families to "become self-supporting on a plane consistent with American standards" [11]. While early loans were made to some people on relief who were likely incapable of achieving that level of self-support, the improved farm economy of the late 1930's and early 1940's resulted in greater emphasis on loans based on productive capacity. Loans were made to people above the relief level but below the credit standards of private lenders who could be expected to eventually produce a sufficient volume of production to attain permanent self-support in a market economy.

Borrowers who appeared to have the potential of achieving a self-support level but in fact failed to do so did, in effect, represent at least some substitution of credit for public relief or welfare. The amount of this that has occurred is currently largely unknown but has certainly varied through time with changes in the welfare orientation of the Federal Administration. However, throughout most of the period since the 1930's, any substitution of loans for welfare has been an unintended result of operation of self-support oriented programs.

Family sized farms

1937 legislation stressed the acquisition by a borrower family of a farm which was "an efficient farm management unit". Such a unit was defined

administratively as "a farm which furnished full, productive, year-round employment for an average farm family and which an average farm family can operate successfully without employing outside labor, except during brief peak-loan periods at planting or harvest time" [11]. Although we could all argue about what a family farm is, that is a reasonable definition. Obviously, the program was not designed to foster large farms.

On the other side of the issue, less than family size, efficient farm management units also received little support. The exception was disabled veterans who could count their veterans benefits in determining whether the farm provided sufficient income for the family. In recent years programs have been developed to assist the operators with less than family size farms and part time farms have increasingly been recognized as family farm units, but, in general, only emergency loans have been available for larger than single family size farms.

Service only to farm families

Only families earning a major portion of their income from farming were eligible for loans. Thus, the program was designed for and limited to farmers. While this may not seem to be an important distinction at first blush, it has likely been responsible for maintaining a public credit program that has farmers as its number one cliental group and, because of that, provides a continuous strong loan program for agriculture. With a broader mission the program expanding potential of a large number of people in urban areas could easily have siphoned energies from service to agriculture. Programs have been expanded to include rural housing, rural community facilities and other rural development activities which although all "rural", have reduced the focus on agriculture in many areas.

Farmer advisory committee

The Bankhead-Jones Act of 1937 inaugurated the use of local committees in connection with farm loan programs. These committees consisted of three individuals from the county, usually three farmers but sometimes one member was an ag-related business person. This committee examined all applications and assessed the farm and operation of the farm. In addition to evaluating loans, these committees were a source of technical management advice for the loan officer as he carried out his loan supervisory function after loans were made.

Cash flow lending

Although it was considered experimental at the time [11], the Farm Security Administration was given the authority to make 100 percent loans. The reason many borrowers were unable to obtain credit from nongovernment institutional lenders was that they could not meet normal equity requirements. Thus, the soundness or safety of loans had to be judged by other criteria, and the agency moved to a cash flow or ability to repay criteria. A loan was considered sound if the "future income of the business under careful planning and guidance, as estimated by a carefully developed budget, was sufficient to meet family needs, pay operating expenses and repay the loan." The security of the loan was not the sale value of assets but the productive capacity of the business.

Graduation

As stated earlier, the objective of the rural rehabilitation loan program was to move the borrower to a position of permanently sustainable self-support. Further, loans were not available to individuals who could obtain funding elsewhere. Thus, a fully rehabilitated borrower should not need a government

loan and it was administrative policy to require borrowers to "graduate" to other credit sources as soon as they were able. This freed up federal funds for loans to others, maintained the loan portfolio of existing borrowers in a status consistent with the eligibility criteria for new borrowers and insured that the government would not be financing farmers that private financial institutions could and should be financing.

Longer loan terms

Making nonreal estate loans for periods greater than one year was pioneered by public credit. Nonreal estate loans could be made for periods of up to 5 years in a period when the standard for such loans was one year or less. Use of such extended terms was not accepted by private institutional lenders for over 20 years [9].

Forty year real estate loans were authorized in 1937. This was the same as the maximum term for Federal Land Bank (FLB) loans but only the Farm Security Administration made consistent use of the maximum term.

Basic Loan Programs Established

By 1937, the two basic loan programs that have been used to provide nonemergency funds to farmers were in place. Minor modifications have been made in these programs periodically since that time, but the basic framework remains intact.

Farm operating loan program

What is now the farm operating loan program, which provides nonreal estate loans, started as the "rural rehabilitation" loan during the depth of the depression. These loans were for feed, seed, fertilizer, work animals and other livestock. The loan was secured by a lien on the crop for crop loans

and by a chattel mortgage on items purchased for recoverable goods. Loans were made for a period not to exceed five years and carried an interest rate of 5 percent.

When the Farmers Home Administration replaced the Farm Security Administration in 1946, the "rural rehabilitation" loan program was replaced by the "production and subsistence" loan program. In 1956, the name was changed to "operating loan." During this period, (1) the loan purpose was gradually modified to include such items as farm machinery, refinancing and family subsistence, (2) maximum term was extended to 7 years, (3) interest rates were changed with market rate movements and (4) maximum loan sizes were increased with farm investment; but the basic structure and intent of the program remains as it existed in 1937.

Farm ownership programs

In 1937, a tenant purchase program was established[1/] to enable tenants, farm laborers or sharecroppers to acquire farms and make necessary repairs and improvements thereon [10]. Loans were made for up to 40 years, with the complete principal amortized over that period, and with interest at 3 percent. A mortgage on the farm unit was taken as security. Loans could only be made for farms of sufficient size to constitute an efficient farm unit. The legislation was designed to encourage the growth in number of owner-operator family farms.

This basic loan program to enable the ownership of farms has continued to the present. However, the changes in the program have been somewhat more substantial than occurred with the operating loan program. The original

1/ By the Bankhead-Jones Farm Tenant Act.

program had a variable repayment plan where "a surplus above the required payment will be collected in periods of above normal production or prices and employed to reduce payments below the required payment in periods of sub-normal production or prices" [12]. The variable repayment plan worked quite well in early years. In 1941, borrowers made payments of 140 percent of their required payment level. However, even then it was recognized "that there is an almost overpowering impulse to use money available to correct . . . deficiencies in tools, equipment, clothing, household furniture, etc. rather than pay ahead of schedule." Borrowers with incomes above expected levels increased capital improvements 91 percent over planned levels. Because of the tendancy for borrowers, with the concurrance of sympathetic loan officers, not to make advance payments, a fairly detailed set of priorities for use of excess funds was established and supervisors were expected to apply this in conjunction with Farm and Home Plan supervision. In spite of these very deliberate procedures, the variable payment plan was hard to administer and a fully satisfactory basis for computing annual payments could seldom be determined. Thus, the variable payment plan has been abandoned in favor of optional or reserve payments [12, 13].

As originally conceived, the tenant purchase program was designed to reduce tenancy. In effecting this, Congress distributed the funds to states on a very strict allocation basis according to the number of farms and prevalence of tenancy in each state. This concentrated loans in the southeast and did not take into consideration the relative availability of good land or the quality of farming opportunities. With the transfer of these programs to the Farmers Home Administration in 1946, the allocation procedure was changed to provide more funds for other states. Also at that time, "the

focus changed from reducing tenancy to encouraging ownership of efficient units." Loan authority was expanded to allow "farm-enlargement and farm development loans to low-income farmers who already owned their farms but whose status as farm owner-operators was economically insecure" [4]. Thus, the discrimination against owners in favor of nonowners was eliminated and it became more feasible to use farm ownership loans throughout the entire U.S.

Program Success

While data are not currently available to definitively judge the degree of success of these programs, some indication of the achievements can be indicated.

Number of farmers served

As indicated earlier, the importance of direct government loans to farmers cannot be adequately measured by the proportion of U.S. farmers served because the majority of farmers can and should obtain financing from private rather than public sources. However, a partial indication of the impact of the program can be obtained by looking at the number of people receiving loans.

The number of operating type loans peaked in the early 1940's (Table 1). At that time, approximately six percent of U.S. farmers received operating loans each year. In more recent years this percentage has dropped to approximately two percent. Since many of the loans are for more than one year, the number of people being served by these programs during any year exceed the number of loans made. In recent years the number of active borrowers has been nearly twice the number of new loans. However, this proportion has increased over time and it is likely that the maximum percent of all U.S. farmers with operating loans was approximately seven or eight percent in the 1940's, declining to approximately four percent currently.

Table 1 Farm Ownership and Farm Operating Loan Programs
Loans Made, Obligations and Number of Active Borrowers
1935 - 1977

Year	Number of Farms in U.S. (1000)	Farm Operating Loans a/			Farm Ownership Loans		
		Number Loans Made	Total Obligations ($1000)	Number Active Borrowers b/	Number Loans Made	Total Obligations ($1000)	Number Active Borrowers b/
1935	6,814	c/	676	c/			
1936	6,739	c/	76,286	c/			
1937	6,636	c/	74,501	c/			
1938	6,527	c/	70,191	c/	1,864	9,167	c/
1939	6,441	c/	118,774	c/	4,568	24,145	c/
1940	6,350	298,722	97,286	c/	6,525	37,165	c/
1941	6,293	349,490	117,230	c/	8,776	47,984	c/
1942	6,202	370,660	121,472	c/	8,616	47,976	c/
1943	6,089	254,124	95,595	c/	6,269	31,270	c/
1944	6,003	160,664	66,623	c/	5,703	22,074	c/
1945	5,967	127,772	66,788	c/	2,908	11,739	c/
1946	5,926	115,320	82,036	c/	3,928	28,020	c/
1947	5,871	173,205	89,974	c/	5,906	45,403	c/
1948	5,803	108,930	59,973	c/	2,534	16,891	c/
1949	5,722	100,632	74,999	c/	3,552	23,006	c/
1950	5,648	91,249	84,998	c/	4,561	32,123	c/
1951	5,428	69,297	84,999	c/	5,678	40,194	c/
1952	5,198	58,888	109,998	c/	3,606	29,772	c/
1953	4,984	58,485	119,999	c/	3,384	29,683	c/
1954	4,798	73,137	139,999	c/	3,012	29,069	c/
1955	4,654	64,641	122,499	c/	4,935	50,932	c/
1956	4,514	72,454	137,499	c/	5,136	57,917	c/
1957	4,372	82,298	179,999	c/	6,154	76,079	c/
1958	4,233	76,876	175,789	c/	3,890	50,268	c/
1959	4,097	73,575	186,999	c/	4,452	64,733	c/
1960	3,963	69,416	197,099	c/	2,966	43,771	c/
1961	3,825	74,740	232,100	c/	3,971	57,229	c/
1962	3,692	74,677	275,000	c/	11,788	183,007	c/
1963	3,572	77,992	300,000	c/	14,407	221,755	c/
1964	3,457	76,611	300,000	c/	13,558	206,281	c/
1965	3,356	72,597	300,000	100,334	12,186	182,591	77,957
1966	3,257	64,743	275,000	97,291	14,279	233,237	84,137
1967	3,162	64,899	300,000	95,584	13,987	259,999	88,463
1968	3,071	52,321	275,000	93,751	10,814	204,998	92,629
1969	3,000	50,811	274,999	91,565	13,702	277,120	97,472
1970	2,949	46,657	274,999	89,039	11,491	261,496	101,904
1971	2,902	42,180	274,999	81,751	10,956	268,436	103,453
1972	2,860	43,845	337,285	76,465	13,755	355,762	107,266
1973	2,823	50,980	454,644	76,654	15,492	408,117	108,643
1974	2,795	53,865	524,993	79,180	11,997	352,161	109,958
1975	2,767	49,254	550,786	83,307	10,598	351,632	109,634
1976	2,738	51,173	616,092	81,155	14,644	564,084	110,640
1977	2,706	40,539	542,343	78,951	11,122	451,239	109,560

a/ These loans were termed Rural Rehabilitation loans from 1935 to 1947. Rural Rehabilitation loans were terminated in fiscal 1947 and replaced by the Farmers Home Administration "production and subsistence" loans. In 1956 the name was changed to "operating loans".

b/ June 30 for 1965-1975, September 30 for 1976-1977.

c/ Not Available.

Source: Farmer Program Statistics 1939-1975, Farmers Home Administration USDA; Farmer Program Statistics 1976-1977, Supplement, Farmers Home Administration, USDA; Total Obligations Through Fiscal Year 1976 and Transition Quarter, FmHA, USDA; Farm Income Statistics, ESCS, USDA. Statistical Bulletin 609. July 1978.

The number of Farm Ownership loans has generally been limited by the availability of funds. In the first year of the program, there were 100 applications for each loan that could be made. In the first nine years of the program the total number of loans was only two percent of the number of tenants counted in the 1940 census [2]. Loans were made to about one tenth of one percent of U.S. farmers each year during the early 1940's. The rate of loan making declined from that level in the late 1940's and then increased irregularly to the current rate of approximately one half percent. Since most of these loans are long term, the number of people with loans at any point in time far exceeds the number made each year. The proportion of all U.S. farmers served is currently at its maximum level of approximately four percent.

Loan loss rates

Loss rates for these programs have generally been low. Losses on Farm Ownership loans amounted to only 0.6 percent of total loans made during the first 20 years of loan activity [3]. More recently losses have been even lower. For example, for 1976 (including the transition quarter) write-offs amounted to only .03 percent[1/] of total outstanding loan volume.

Losses on operating loans made prior to 1946 (rehabilitation loans) were approximately 11 percent of the total amount loaned [3]. The lowest repayment rates occurred in the south where poverty was more prevalent and complete rehabilitation was less frequently achieved. Since World War II losses on operating loans have been much lower. During the late 1940's and 1950's the cumulative loss rate was less than one percent of maturing principal. For 1976, the loss was 0.71 percent of outstanding loan volume.

1/ Calculated from U.S. Department of Agriculture Budget Explanatory Notes.

Considering the fact that these borrowers are so high risk that they cannot obtain credit elsewhere, these loss rates appear surprisingly low. There are two apparent reasons for the low loss experience. First, the management guidance and assistance provided by the supervisor and the increased planning forced by use of the Farm and Home Plan likely increases the rate of success over what it would be without such assistance. Secondly, general inflation in land values and other farm assets has offset operating losses. Many poor loans (made by all lenders) have been made good by inflation. In most situations if the farmer can remain in business for a number of years with only modest annual operating losses, he can sell the assets for enough to pay off any remaining loans. In some years nearly 40 percent of the borrowers paying off their indebtedness to FmHA have done so by selling off their farm.

Characteristics of borrowers served

Current studies of the characteristics and progress of FmHA borrowers are in progress.1/ Studies conducted in 1956, 1959 and 1966 [1, 4, 5, 6] found FmHA borrowers to be younger than the average of all farmers and younger than borrowers from banks and the Farm Credit System. FmHA borrowers also had lower equities, were more likely to be tenants and operated smaller businesses than operators borrowing from other lenders. These researchers reported that, in general, borrowers obtaining loans from the FmHA "comprised a special group who apparently could not have obtained similar loans from other sources" [6]. Thus, it appears that the FmHA has been successful in getting loans to those for whom the program was intended, at least during the period covered by these studies. Any program of this nature will result in some substitution

1/ The author is currently conducting such a study in cooperation with the Economics, Statistics and Cooperative Service and the Farmers Home Administration of the U.S. Department of Agriculture.

of government credit for private credit, but it appears that this was being held to a minimum.

Borrower success

The only study of the progress made by the FmHA borrowers was conducted in the mid 1950's on a sample of borrowers who obtained loans during 1947-1953 [4]. This study found little relationship between beginning equity and change in income under the loan program. Success was related to the level of assets controlled after the loan was obtained. This could indicate that personal characteristics rather than prior development of equity determined loan success, or that selection of borrowers without much equity was sufficiently rigorous to insure an equal level of success.

Families with FmHA loans were able to increase their incomes. In areas where median family income according to the census was less than $1000, borrowers increased their incomes by $448 in the North, $828 in the West and $397 in the South. In areas where median incomes exceeded $2000, incomes increased by $1300 in the North, $1750 in the West and $1431 in the South. However, when farms from equally poor communities were compared the income gain was similar for all regions.

More Recent Changes

Since the creation of the Farmers Home Administration in 1946 to take over these loan programs, there has been little structural change in program operation. There have been changes in emphasis and trends in administrative procedure which impact on the effect of these programs on farmers and agricultural finance.

Sources of funds

The sources of funds used by the FmHA have been changed as other program changes have occurred. The initial emergency Seed Loans in 1918 were funded out of moneys set aside by the administration. From then until 1946, all program funding was provided by direct appropriation from Congress. Since 1946, funds from other sources have also been used with direct appropriations becoming an increasingly smaller proportion of total funds used. Current direct appropriations are made primarily for administrative expenses, interest subsidy and grant programs.

In 1946 the participation of private lenders was encouraged through the development of an insured loan program for Farm Ownership loans. This insured loan program was different from many others in that the FmHA conducted all loan making, loan supervision and collection. Thus, the only function provided by the private lender was that of providing the loan funds. If a borrower became deliquent, the FmHA notified the lender and advanced to the lender the principal and interest due. In some years, if a borrower were in default for more than 12 months the lender could assign the mortgage to FmHA and receive the entire outstanding balance from an insurance fund. To provide the money for conducting the insurance function, an insurance fund was created with an initial appropriation and that fund receives one-half of a one percent annual insurance charge assessed on the outstanding balance of each insured loan. The insurance fee is part of the interest charge the farmer pays.

From the farmers point of view, the only difference between a direct and insured loan was that the maximum loan was 90 percent of appraised value and the mortgage was to a lender other than the U.S. Government. However, in order to simplify the loan process, mortgage loans made since 1955 run to the U.S. Government. And, in 1961, FmHA was given the authority to make 100 percent insured loans.

Since 1974, the FmHA has obtained its loan funds from the Federal Financing Bank, an agency established to obtain funds for FmHA and a number of other government lending agencies. It was the original intent of the Federal Financing Bank to sell its bonds, backed by the government insured mortgages and notes, in the money market. However, the rate they were able to achieve with this procedure was higher than expected so the Federal Financing Bank now borrows directly from the treasury at the treasury's cost for money with the length of term desired. Direct borrowing from the treasury was not new to FmHA since that had been their source of funds for their rural housing program since its inception in 1949.

In 1972 a new method of financing using an old source of funds was established. This was the guaranteed loan program. Under this program commercial banks, The Farm Credit System, insurance companies and other commercial lenders provide the funds and make the loan. The FmHA guarantees 90 (formerly 80) percent of the loan. The guarantee is available only on loans that the lender would not make without the Government guarantee. In early legislation the interest rate was set by the government for most loan programs. These rates were frequently lower than desired by lenders so relatively little use was made of this program. This was changed in 1978 when the rate was moved to a rate negotiated between the borrower and the lender.

The 1978 law also raised the maximum loan size for guaranteed loans above that for insured loans. For example, on ownership loans, the maximum insured loan was set at $200,000 while the maximum guaranteed loan was set at $300,000. Similarly the maximum insured and guaranteed operating loan was set at $100,000 and $200,000, respectively. These higher loan limits on guaranteed loans obviously imply that larger farmers can be served and that FmHA can assume the risk lender position for a high proportion of the small and intermediate sized farmers in the U.S. More will be said about this later.

The Guarantee program has a number of decided advantages. First, it facilitates and, possibly, speeds up the graduation process. Since the borrower works directly with the private commercial lender throughout the period of association with FmHA, the borrower can develop confidence in and rapport with the private lender while he/she has FmHA support. Graduation from public credit will not require changing lenders. It will require only an agreement on the part of his lender that a government guarantee is no longer needed.

Second, use of a guaranteed rather than an insured or direct loan program increases the farm loan volume available for private lenders [8]. With a larger loan volume the agricultural community is able to support a larger and stronger private agricultural credit market. In areas where agriculture is the primary industry and agricultural investment is high, a healthy, competitive agricultural credit industry is relatively easy to maintain. However, in areas where agriculture is less dense or requires only modest investment, which includes a high proportion of the United States, there may be only enough farm business to maintain two agricultural lenders, the minimum needed for competition. If one of the two lenders is the Federal Government, private lender competition is stifled and private lender service to agriculture is reduced. Use of guaranteed loans only in times of emergency and for borrowers at the risk margin could help maintain agricultural lender competition in many areas.

Loan size

A second area in which change has occurred is loan size. The size of loans made by FmHA have increased significantly over time. For example, the maximum insured operating or nonreal estate loan allowed by law increased

from $5000 in 1946 to $100,000 in 1978, a 20 fold increase. The average size of actual loans made increased by about the same magnitude. Over the same period, prices, as indicated by the Consumer Price Index (CPI), increased only 2.7 times. However, at the same time, the maximum and average real estate loan increased slightly less than the increase in real estate prices. The index of land values increased 7.2 times since 1948 while the average loan has increased only 6.3 times. Since 1961 when a specific dollar limit was first placed on real estate loans, the maximum loan authority has increased 3.3 times while the price of land has increased over 4.5 times. The maximum loan was raised to $200,000 in 1978.

From another perspective, average total farm investment has increased by over 12 times since 1946 and FmHA insured loans have increased by 20 times for nonreal estate and 6 times for real estate. These data lead me to conclude that the average size of farms financed by public funds (insured loans) relative to average farm size has not increased significantly in recent years.

However, the 1978 act allowed guaranteed loans to be made at higher levels, $200,000 for operating loans and $300,000 for real estate loans. This allows FmHA to assist farms through the guarantee that are 2/3 larger than is possible with the insured loan program and represents a similar increase over what was previously the case, thus, significantly expanding the number of farm businesses that are eligible for FmHA assistance.

<u>Expansion of emergency loan authority</u>

Emergency loan programs similar to those started in 1918 have been in effect nearly continuously since that date. While the administering agency changed frequently prior to 1946 when the Farmers Home Administration was given the role of administering emergency programs, the main trend during

the period is an expansion of emergency loan capacity. The original loans were for seed and fertilizer. In 1931 the authority was expanded to include such expenses as feed, gasoline and oil. In 1933 emergency real estate loans were initiated in the form of "Land Bank Commissioner" loans which were secured by mortgages on real estate. Emergency loans were generally available to farmers in areas that had been declared a disaster area by the Secretary of Agriculture or the President because of physical phenomenon such as flood or drought. By 1961 emergency loans could be made for any agricultural purpose [18].

Economic Disaster Loans, that is loans to farmers who have not experienced a physical disaster but have suffered losses due to general economic conditions, have been available during certain periods. This occurred first in 1932 when production emergency loans were available for a period to people who were unable to obtain credit due to economic conditions. Between 1953 and 1961, economic emergency loans were available in areas where the President and the Secretary of Agriculture had determined that an economic disaster had caused a need for credit that could not be met by other established lenders. Also in 1953, special livestock loans were authorized to provide emergency credit to established producers and feeders of livestock suffering production losses and unable to obtain credit due to economic distress in the livestock industry. In 1978 an economic disaster loan program was again developed to provide credit to farmers unable "to obtain sufficient credit from normal credit sources to finance actual needs at reasonable rates and terms due to national or areawide economic stresses, such as a general tightening of agricultural credit or an unfavorable relationship between production costs and prices received for agricultural commodities." During 1978 and 1979 the entire United States has been considered eligible.

Potentially, the most important change in the physical disaster program in 1978 is movement of the disaster designation process from the President and Secretary of Agriculture to the FmHA state directors. This should make the process more responsive to local community needs and reduce the bureaucratic process of designation. However, it is also likely to increase the effectiveness of local political pressure and result in designation of any area that has suffered minimal losses.

Assumption of farm lending risk

The combined effect of the expanded emergency credit program, increased loan limits and the ability to guarantee loans to high risk borrowers of larger size than could previously be served, represents a significant expansion in the amount of farm lending risk that is assumed by the government. If the risk on a particular loan is high at the time it is made, the government will either make the loan on an insured basis or guarantee the loan of a regular lender. If a borrower who is having trouble making his payments to a private lender lives in an area that suffers economic or physical disaster, which most areas do periodically due to the nature of agriculture, FmHA can refinance them or guarantee the private lender's loan. This results in the government effectively bearing most of the risk of lending for most small and moderate sized farms. Many private lender agricultural loan portfolios have been greatly improved by declaration of a disaster in their service area. While this reduces the risk of loss on loans made by private lenders it could lead to sloppy loan making on the part of private lenders who know the government will bail them out of any poor lending decision.

Expansion of FmHA loan programs

In the past 30 years the FmHA has been transformed from a farm lending agency to a farm and rural development agency. Many new rural development

financing activities have been added FmHA loan authority. The earliest addition (1949) and the largest program is the rural housing program where FmHA can make 100 percent loans on modest sized rural housing both with and without an interest subsidy. There has been a gradual expansion of Community Facility loans which can now be made for water systems, sewer systems, health facilities, fire departments and other community needs in rural communities. More recently (1972) the Business and Industry program has been added to facilitate improved economic activity in rural communities by making loans to keep or locate small businesses in rural areas.

Use of the FmHA to administer rural community programs has likely improved the service rural communities receive over what would have occurred had the loan programs been administered by the Small Business Administration or some other national or urban oriented agency. And since farmers live in rural communities, these programs have improved the level of life in the areas where farmers live. However, it has reduced the attention and focus given to farmers and farm problems, particularly in periods when "rural development" is receiving strong emphasis by the President and Secretary of Agriculture. The main reason for this is that staffing levels have not kept pace with program authority. In order to make these "rural development" loans, less time must be spent with farmers. The impact of this has been a reduced level of farm loan supervision.

<u>Reduced loan supervision</u>

As indicated earlier in this paper, a high level of loan supervision and the management assistance provided in this process was a hallmark of the FmHA farmer programs. Supervision was believed to allow service to higher risk borrowers without increasing the level of loan loss. With less time available

for farm loans, less supervision can be given. In addition, the initiation of other types of loans has led to staffing of some FmHA offices with people who's primary interest is housing or other types of nonfarm loans, and the level of agricultural expertise of many people making agricultural loans is considerably below the level needed in order to provide sound management advice. Recognizing this, FmHA in some states has attempted to encourage or even insist that borrowers obtain assistance from the extension service or other management service organizations. However, the effectiveness of this procedure is limited because the extension or management service representative does not have the leverage to bring about change that is inherent in the FmHA supervisor's position as primary or sole lender.

If supervision has been fulfilling its designed role, the long run impact of reduced supervision could be serious. A decline in the rate of farming success among borrowers and an increase in the level of loan losses could occur. At a minimum FmHA needs to carefully analyze which borrowers need supervision in order to effectively allocate scarce supervisor time. Some specialization among loan supervisors might also help alleviate this problem.

Interest rates

As indicated earlier, interest rates charged by the Farmers Home Administration were approximately equal to private commercial rates during the 1940's. However, as the general level of interest rates has increased, some FmHA rates have not kept pace. For example, the Farm Ownership loan rate was maintained at 5 percent until 1978. Interest rate subsidization was not perceived in the initial legislation and the loan programs were not designed to stimulate agricultural investment. Subsidized rates were supported as a means of increasing the net incomes of farmer borrowers. This created a significant incentive to obtain FmHA credit and resulted in demand far

exceeding the supply appropriated by Congress. Many borrowers did not necessarily need the lower payments to remain in farming but could make higher incomes and greater progress with the subsidy.

In an effort to realign supply and demand and to retarget the interest subsidy, the rate on ownership loans was raised to the Treasury cost of funds and a special "limited resource" program initiated in 1978. The limited resource program is designed to provide interest subsidy only to those who could not make debt payments without it and each borrower is examined periodically to determine if the subsidy should be continued. The major difficulty with this program is defining exactly who should receive the subsidy--a question which remains in the process of being determined.

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