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The Farm Credit System: Another Source of Loanable Funds

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Those of us involved in financing agriculture have come through a decade of major changes in the agricultural sector that have challenged many of our traditional business systems. The use of farm debt rose from $53.0 billion in 1970 to $157.3 billion in 1980. Costs of agricultural inputs increased nearly threefold or 168.9 per cent. The number of farmers had decreased from 4.5 million just 10 years ago to 2.4 million in 1979. As a result, we now have fewer, larger farms providing for the needs of our own population plus a sizeable portion of the world population. Periods of double-digit inflation, energy costs that have quadrupled in the past six years, and market prices for commodities that fall below the cost of production are just a few of the elements that have caused the significant increase in demand for agricultural credit.

At the same time, and in particular during the past year, agricultural banking has gone through some changes. I am referring, of course, to the Depository Institutions Deregulation and Monetary Control Act of 1980—the omnibus banking act. It will affect the ways in which all banks and other financial institutions, such as thrift institutions and credit unions, operate — and, in particular, rural banks. We expect it will have an effect on how the Farm Credit System operates, too. I say this because the omnibus banking bill will affect the entire financial community of which the Farm Credit System is a part. In effect, we—all of us—are entering a new era.

Just as the agricultural and commercial banking sector is changing to meet changing credit demands, the Farm Credit System is adjusting to the changing needs of its primary borrowers—the farmers, ranchers, and aquatic producers of this country — through amendments to the Farm Credit Act of 1971. The 1971 Act was an omnibus act which mandated the system's institutions to assure that necessary credit could be obtained to improve the income and well-being of American farmers and ranchers.

The 1980 amendments deal with the growing needs for agricultural credit in the 1980s arising out of the changing environment. The centerpiece of this legislation is the authority to finance cooperative exports. But my assignment in this paper is to examine how the Farm Credit System may provide loanable funds to agricultural banks. As all of your are aware, a portion of the Farm Credit Act Amendments of 1980 deals specifically with this subject. However, before I enter into the discussion of other financial institutions and participation agreements, I would like to set the stage with a brief review of the Farm Credit System's history and how it is organized and funded.

The Cooperative Farm Credit System

The cooperative Farm Credit System operates under authority contained in the Farm Credit Act of 1971, P.L. 92-181, as amended. It is a system of federally chartered but privately owned banks and associations organized as cooperatives, supervised and examined by the Farm Credit Administration (FCA), an independent agency in the executive branch of the U.S. government.

Although originally capitalized by the Federal government, the last of the government's investment was repaid with interest in 1969. The Farm Credit System is now completely self-sustaining. Its banks and associations have no government capital in them. Capital is obtained through the purchase of stock by their borrowers. Farm Credit securities or other obligations are not guaranteed by the government. The expenses of the Farm Credit Administration are paid through assessments to the banks, comparable to the Comptroller of the Currency's arrangements with its federally chartered banks. It is the System's borrowers and not the taxpayers who pay the expenses of the Farm Credit Administration. The system is very proud of this and feels that it is a good example of government partnership with a segment of its people — in this case, farmers — to obtain a needed service.

The triumvirate that forms the Farm Credit System today — the 12 Federal Land Banks (FLB's) and the 492 Federal Land Bank Associations (FLBA's), the 12 Federal Intermediate Credit Banks and the 424 Production Credit Associations (PCA's), and the 13 Banks for Cooperatives (BC's) — are all borrower-owned cooperatives. These financial cooperatives differ from commercial banks in several ways.

First and foremost, they are owned by the people — or, as in the case of the Banks for Cooperatives, by the cooperative organizations — who borrow from them. Each member-borrower has a voice through his or her vote in how the cooperative is operated. Secondly, Farm Credit banks and associations are not depository institutions and cannot offer a full range of services such as checking or savings accounts. Another unique characteristic is that Farm Credit institutions are required by law to serve all agricultural areas during all economic times and conditions. In other words, they have to serve farmers, ranchers, producers and harvesters of aquatic products, agricultural and aquatic cooperatives, rural homeowners, and certain businesses which provide farmers and ranchers with services essential to their on-farm operating needs, no matter what the general credit or economic climate is. Futhermore, they cannot be selective. They must serve all who are eligible and creditworthy.

Another characteristic of the Farm Credit entities that sets them apart from commercial banks is that they operate under eligibility restrictions to ensure their status as agricultural lenders. For example, they cannot make a loan to someone who wants to build a shopping center or a housing development. They are committed to making loans for agricultural production and other eligible purposes.

And finally, I'd like to emphasize that farmers are their primary business. Even the cooperatives to which they make loans are not business entitites in the traditional sense. Cooperatives exist only as an extension of individual farmers operating as a group.

About five years ago, the Farm Credit System became the leader in market share of total farm debt outstanding (see Table 1). Before that, commercial banks were the leading holders of outstanding farm debt. As of January 1, 1980, the System held 30.9 per cent of the total farm debt outstanding, compared to 25.2 per cent for commercial banks, 23.4 per cent for individuals and others, 9.9 per cent for the Farmers Home Administration, 7.7 per cent for life insurance companies, and 2.9 per cent for the Commodity Credit Corporation.

The statistics show, however, that the Farm Credit System is the leading holder of total outstanding farm debt because of the shift in share of farm real estate debt. About five years ago, insurance companies began to retreat from the farm mortgage lending market (see Table 2). Commercial banks' share of farm mortgage lending has ramained relatively constant during that time. In outstanding non-real

TABLE 1
Outstanding Farm Debt, January 1, 1980[1]
(Amounts in Millions of Dollars)
Includes CCC Loans

	Farm Credit System	*%*	*Commerciul Banks*	*%*	*Life Ins. Companies*	%	*FmHA*	%	*Individuals And Others*	%	*Total*	%	*CCC Loans*	%	*Grand Total*	*%*
1970	$11,384	21.5	$13,875	26.2	$ 5,734	10.8	$3,065	5.8	$16,293	30.7	$ 50,351	95.0	$2,676	5.0	$53,027	100.0
1971	12,660	23.2	14,874	27.3	5,610	10.3	3,235	5 9	16,228	29.8	52,607	96.6	1,876	3.4	54,483	100.0
1972	14,195	2 4 0	16,716	28.3	5,564	9.4	3,389	5.7	16,987	28.7	56,851	96.2	2,262	3.8	59,113	100.0
1973	15,908	24.3	19,107	29.2	5,643	8.6	3,616	5.5	19,277	29.5	63,551	97.3	1,793	2.7	65,344	100.0
1974	19,061	25.7	22,625	30.5	5,965	8.0	3,890	5.2	21,845	29.5	73,386	99.0	750	1.0	74,136	100.0
1975	23,295	28 5	24,204	29.6	6,297	7.7	4,259	5.2	23,458	28 7	81,513	99.6	319	0.4	81,832	100.0
1976	27,073	29.8	26,456	29.1	6,726	7.4	5,141	5.7	25,078	27.6	90,474	99.6	358	0.4	90,832	100.0
1977	31,056	30.3	30,064	29.3	7,400	7.2	5,565	5.4	27,566	26.9	101,651	99.0	1,012	1.0	102,663	100.0
1978	35,273	29.6	33,489	28.1	8,819	7.4	7,123	6.0	30,079	25 2	114,783	96.2	4,489	3.8	119,272	100.0
1979	40,171	29.2	36,830	26.8	10,168	7.4	9,901	7.2	35,187	25 6	132,257	96.2	5,242	3.8	137,499	100.0
1980	48,631	30.9	39,657	25.2	12,165	7.7	5,538	9.9	36,857	23.4	152,848	97.1	4,500	2.9	157,348	100.0

[1]50-state **total.**

TABLE 2
Farm Real Estate Debt Outstanding[1]
January 1, 1980
(Amounts in Millions of Dollars)

Year	Federal Land Banks	%	Life Insurance Companies	%	Commercial Banks	%	Farmers Home Admin.	%	Individuals And Others	%	Total Farm Real Estate Debt	%
1970	6,671	22.9	5,734	19.6	3,545	12.1	2,280	7.8	$10,953	37.5	29,183	100.0
1971	7,145	23.5	5,610	18.5	3,772	12.4	2,440	8.0	11,378	37.5	30,345	100.0
1972	7,880	24.5	5,564	17.3	4,218	13.1	2,618	8.1	11,927	37.0	32,207	100.0
1973	9,050	25.3	5,643	15.8	4,792	13.4	2,835	7.9	13,437	37.6	35,757	100.0
1974	10,901	26.4	5,965	14.5	5,458	13.2	3,013	7.3	15,915	38.6	41,252	100.0
1975	13,402	29.0	6,297	13.6	5,966	12.9	3,215	6.9	17,408	37.6	46,288	100.0
1976	15,950	31.2	6,726	13.2	6,296	12.3	3,369	6.6	18,728	36.7	51,069	100.0
1977	18,455	32.6	7,400	13.1	6,781	12.0	3,688	6.5	20,266	35.8	56,590	100.0
1978	21,391	33.6	8,819	13.9	7,780	12.2	3,982	6.3	21,669	34.0	63,641	100.0
1979	24,619	34.1	10,168	14.1	8,557	11.8	4,121	5.7	24,767	34.3	72,232	100.0
1980	29,642	36.1	12,165	14.8	8,623	10.5	6,556	8.0	25,137	30.6	82,123	100.0

[1]50-state totals.

estate farm debt, commercial banks have maintained their market share and are by far the leading short-term lenders, providing 41 per cent, with PCA's a distant second with 24 per cent (see Table 3).

A recent study by the Farm Credit Administration projected that market shares of farm debt will continue to shift during the 1980s and that the Farm Credit System's share could gradually increase. The level of increase, however, will depend on several factors, including funding costs, the difference between the System's variable rates and interest rates charged by other lenders, and the availability of funds from other lenders, including government. We expect to see considerable innovation in bank lending to meet the general challenge of the farming environment of the 1980s, and the specific challenge of the Depository Institutions Deregulation and Monetary Control Act of 1980. With narrower spreads in commercial banks, we will undoubtedly see increased pressure for bank consolidation. Gradual but persistent changes are expected. No dramatic change in market share is anticipated unless there is a forfeiting of responsibility or a decision not to participate on the part of one of the key agricultural lenders.

Although the main reason for the establishment of the Farm Credit System was to ensure farmers a constructive and reliable supply of credit, the Farm Credit System does not want to monopolize agricultural lending. The system has shared a healthy, competitive relationship with other agricultural lenders over the years, and it wants that to continue in the best interest of all borrowers.

Since it has no depository authority, the Farm Credit System has successfully developed its ability to gather funds from the national money markets and distribute them to farmers across the country through its financial pipeline. In 1980, the Farm Credit banks will issue a total of $93.8 billion in securities. Only the U.S. Treasury exceeds the Farm Credit System in the amount of money raised through the money markets.

During their 64-year history, the Farm Credit banks have never failed to pay principal and interest on their obligations when due. As a result, Farm Credit securities enjoy a very high rating, even without any Federal guarantee, falling just below the rating given to U.S. Treasury bonds.

Raising this capital for agriculture begins with the system's Fiscal Agency in New York. Maintained by the 37 Farm Credit banks, the Fiscal Agency issues, markets, and handles Farm Credit securities through a selling group of approximately 170 dealers.

The Farm Credit banks raise their funds by issuing two types of securities. Federal Farm Credit Banks Consolidated Systemwide Bonds are issued in book-entry form 16 times a year on the first of each month and on the 20th of January, April, July, and October. Bonds with six- and nine-month maturities are issued on the first of each month and sold only in multiples of $5,000. Longer-term bonds are issued at least quarterly. Bonds with maturities of 13 months or longer are available in multiples of $1,000.

The Federal Farm Credit Banks Consolidated Systemwide Notes, on the other hand, are designed to provide flexibility in obtaining funds when unexpected demands occur by allowing financing between bond sales. These discount notes are issued daily, with maturities of 5 to 270 days, and are sold only in certificate form in $50,000, $100,000, $500,000, $1 million and $5 million amounts.

When a new issue of systemwide bonds is offered, the Fiscal Agency places notices in financial publications and major newspapers such as the ***Wall Street Journal, The New York Times, American Banker,*** and ***The Bond Buyer***. No public announcement is made of the daily sales of systemwide notes.

Coordination with the rest of the monetary system is an important consideration before any Farm Credit System bond sale. The system voluntarily coordinates its issues with the U.S. Treasury, the Federal Reserve, and with brokers and leading investment houses to assure that the issue will go through and fit into the monetary scheme. For example, the system takes into consideration whether another organization such as the Federal National Mortgage Association is coming into the market with any unusual demand. If the Farm Credit System was to enter the market with a bond sale at the same time, it might be hazardous to both.

Anyone other than FCA employees and certain system employees can purchase Farm Credit securities, and the list of investors reflects a variety of groups that have benefited by providing capital to the nation's food and fiber producers.

Commercial banks make up the largest single groups of investors in Farm Credit securities (46.2 per cent), followed by state and local governments, savings and loan associations, and corporations. To a lesser extent, mutual funds, savings banks, pension funds, and individuals also invest in Farm Credit securities. Foreign investors, mostly large European banks, also hold a small percentage of securities outstanding (see Table 4).

TABLE 3

Non-Real Estate Farm Debt Outstanding[1]

January 1, 1980

(Amounts in Millions of Dollars)

Includes CCC Loans

Year	Commercial Banks	%	FCAs[2]	%	Indiv. and Others	%	FmHA	%	OFI's	%	Total	%	Commodity Credit Corp.	%	Grand Total	%
1970	$10,330	43.3	$ 4.495	18.9	5,340	22.4	785	3.3	218	0.9	$21,168	88.8	2,676	11.2	$23,844	100.0
1971	11,102	46.0	5,295	21.9	4,850	20.1	795	3.3	220	0.9	22,262	92.2	1,876	7.8	24,138	100.0
1972	12,498	46.5	6,078	22.6	5,060	18.8	771	2.9	237	0.9	24,644	91.6	2,262	8.4	26,906	100.0
1973	14,315	48.4	6,607	22.3	5,840	19 7	781	2.6	251	0.8	27,794	93.9	1,793	6.1	29,587	100.0
1974	17,167	52.2	7,829	23.8	5,930	18.0	877	2.7	331	1.0	32,134	97.7	750	2.3	32,884	100.0
1975	18,238	51.3	9,519	26.8	6,050	17.0	1,044	2.9	374	1.1	35,225	99 1	319	0.9	35,544	100.0
1976	20,160	50 7	10,773	27.1	6,350	16.0	1,772	4.5	350	0.9	39,405	99.1	358	0.9	39,763	100.0
1977	23,283	50.5	12,233	26.6	7,300	15.8	1,877	4.1	368	0.8	45,061	97.8	1,012	2.2	46,073	100.0
1978	25,709	46.2	13,508	24.3	8,410	15.1	3,141	5.6	374	0.7	51,142	91.9	4,489	8.1	55,631	100.0
1979	28,273	43.3	15,041	23.0	10,420	16.0	5,780	8.9	511	0.8	60,025	92.0	5,242	8.0	65,267	100.0
1980	31,034	41.3	18,323	24.4	11,720	15.6	8,982	11.9	666	0.9	70,725	94.0	4,500	6.0	75,225	100.0

'50-state totals

[2]Includes aquatic loans, excludes rural home and farm related business loans.

TABLE 4
1980 Dealer Distribution*
(3rd quarter sample)

Type of Customer	%
Commercial banks	46.2
State and local government	16.7
Corporations	4.9
Savings and Loans	4.7
Pension funds	3.8
Foreign accounts	8.5
Savings banks	1.8
Individuals	2.6
Fraternal/charities	0.8
Credit unions	0.3
Other dealers	1.5
Miscellaneous	6.4
Insurance companies	1.8
TOTAL	100.00

*Figures reflect participation of 172 dealers in five bond issues—one six-month, one nine-month, and three term issues.

Interest rates on new security issues are set at the time they are sold and are consistent with current rates. The process of pricing Farm Credit bonds begins a week before the actual sale. The Fiscal Agency's financial experts contact the various dealers handling Farm Credit securities to get a feel for the market and for customers' interest. This market survey also includes an analysis of Federal Reserve buying and selling activity.

At the same time, the 37 Farm Credit Banks indicate their interest in participating in the upcoming bond sale. The finance subcommittee—a nine-member group comprised of three presidents from each banking system — sets the total size of the bond issue and bond maturities to be offered. The Fiscal Agency completes a market survey to determine appropriate interest rates for each of the maturities to sell, and price recommendations are submitted to the finance subcommittee. After the subcommittee approves the interest rates for the issue, final approval must come from the Governor of the Farm Credit Administration, who acts in the public interest.

Many misconceptions exist about the Farm Credit Administration and the system of Farm Credit banks and associations it regulates. Earlier in this paper, I briefly mentioned the unique structure of the system and alluded to its original capitalization by the Federal government. It is important at this point to present a clear picture of the System's structure before proceeding with the major portion of this paper — the discussion of loanable funds from the Farm Credit System.

Farm Credit Administration

The Farm Credit Administration is an independent agency in the executive branch of the Federal government. It is the regulatory, supervisory, and examining body over the Farm Credit System. It is a regulatory agency not unlike the Comptroller of the Currency for national banks or the National Credit Union Administration for federally chartered credit unions.

The head of the agency, the Governor, is appointed by the 13-member Federal Farm Credit Board. Membership on the Federal board is by presidential appointment. In making an appointment, the president is required to consider nominees presented to him by the lending units of the district involved. Members serve six-year, staggered terms and are not eligible for reappointment. The thirteenth member is appointed by and serves as the representative of the Secretary of Agriculture. The Federal board is the policy-making body for the Farm Credit Administration and the cooperative Farm Credit System.

The Farm Credit System

Much of the confusion over the relationship the Farm Credit System has with the Federal government stems from the fact that the system was, in fact, capitalized originally by the Federal government. Another factor in the confusion is the names of two of the banking systems which include the word "Federal" — the Federal Land Banks and the Federal Intermediate Credit Banks. And then there are our Federal Farm Credit Banks Consolidated Systemwide Bonds and Discount Notes, again with the word "Federal" in the name. Oddly enough, Federal savings and loan associations, Federal credit unions, and even commercial banks that have "Federal" or "National" as part of their name have escaped this confusion.

The fact of the matter is that, in spite of what the names of titles may indicate, the Farm Credit banks and associations are not government institutions. A Production Credit Association is no more a government entity than a federally chartered bank. The Farm Credit System with its 37 banks, 916 associations, and its Fiscal Agency in New York is a private structure with government authority—the same relationship national banks have in the commercial banking industry.

Each part of the Farm Credit System—the Federal Land Banks and Federal Land Bank Associations, the Federal Intermediate Credit Banks and Production Credit Associations, and the Banks for Cooperatives—was born of necessity and at different times. In each case, there was a strong need that was not being met by the commercial banks and other lenders of the day.

The first entity—The Federal Land Banks—was established by the Federal Farm Loan Act of 1916. The 20 to 30 years just before the FLB's and FLBA's (then called National Farm Loan Associations) were characterized by agrarian distress. Not the least of the problems was that available credit was geared to the needs of industry, not agriculture. Interest rates ranged from 7 to 10 per cent and were nearly doubled by special charges and fees. Foreclosures rose alarmingly as farmers were unable to make payments to absentee mortgage holders. A credit system adapted to agriculture's conditions was badly needed.

Congress recognized this need and, after considerable study, approved the Federal Farm Loan Act of 1916, which provided a permanent and'dependable source of long-term borrowed capital at reasonable rates and on terms suited to agriculture.

Initially the FLB's were capitalized by the Federal government, but the 1916 Act provided a means by which they would ultimately be owned by their borrowers through the FLBA's. In the FLB system, the bank is the primary lender, with the associations acting as the bank's agent. By 1947 all Federal capital was paid back and the Federal Land Banks became completely owned by the farmer borrowers.

Federal Intermediate Credit Banks

Although there was concern in Congress over the need for short- and intermediate-term credit at the same time, it was six years before a serious solution was tackled. The financial crisis of 1920-21, followed by an agricultural depression that continued through the decade, emphasized the difficulty farmers had in obtaining short-term operating credit.

Commercial banks in rural areas, dependent on farmers' deposits for their lending funds, made lonas for 30 to 90 days. Crops and livestock, however, took longer to produce. Farmers expected to renew their loans, but rural commercial banks, often short of funds, had the legal right to demand payment, and often did at times when farmers did not have the money. In an effort to provide agriculture with more credit — particularly of a short- and intermediate-term nature — Congress passed the Agricultural Credits Act of 1923. The Act provided for the establishment and capitalization of 12 Federal Intermediate Credit Banks.

It was expected that the FICB's would provide a new flow of funds from the money markets to rural commercial banks by discounting the notes of agricultural producers given to various financing institutions, thereby helping to fill the existing credit gap in which farmers were trapped. However, financial institutions did not use the services of the FICB's to the extent expected. The flow of funds was not more than a trickle, which left the credit needs of farmers unfilled.

Congress again acted with passage of the Farm Credit Act of 1933. This act authorized the establishment of local Production Credit Associations, which could discount farmers' notes with the FICB's. In effect, the PCA's become the retail outlets for credit available at wholesale from the FICB's — their only source of funds.

Like the FLB's, FICB's and the PCA's were initially capitalized by the Federal government. Under the congressional authority which established the institutions, PCA's are taxed as cooperatives whereas FICB's are not. Although not initially established to become borrower-owned like the FLB's, later changes in the laws governing these institutions paved the way for them to repay the government's investment. The PCA's assumed complete ownership of the FICB's in 1968, placing the FICB's on a sound basis as a vital part of the cooperative Farm Credit System.

Banks for Cooperatives

The Farm Credit Act of 1933 also established and initially capitalized the Banks for Cooperatives. The law was intended to help farmers gain greater control of their own economic destinies by providing dependable credit for their marketing, supply and service cooperatives.

Although the Agricultural Credits Act of 1923 provided for cooperative financing through the FICB's, for whatever reason it did not work to the extent expected. A few cooperatives were highly successful pioneers. However, generally the growth and development of early cooperatives were severely handicapped by their inability to borrow sufficient amounts of money.

Local banks were reluctant to finance new ventures owned by farmers who lacked experience in running businesses beyond their property lines. Even when cooperatives were relatively successful or had potential for success, the cooperatives' local competitors were often on the local banks' boards of directors. Local bankers usually could see cooperatives' weaknesses, but often did not understand the organizational differences between cooperatives and other businesses.

As a result, credit for agricultural cooperatives before 1933 was virtually nonexistent. With the 1933 Act, however, credit needs of farmers' marketing, supply, and business service cooperatives were recognized. The mandate of the 1933 Act was for the BC system to supply credit for agricultural cooperatives large and small. In addition, the Farm Credit Act of 1971 extended participation authority to BC's, which — in the case of larger cooperative loan demands exceeding the loan limitation of a BC — allows the BC to participate with commercial banks in making loans to cooperatives. Like the PCA's and the FICB's, the BC's became completely owned by their borrowers in 1968. The are also taxed as cooperatives.

Present Authority

While there were several other important legislative changes over the years, a most significant modification of the Farm Credit System was made with the .Farm Credit Act of 1971—the landmark legislation which decentralized authority and mandated the systems's role in "improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations." (P.L. 92-181; Sec. 1.1[a]) Had the system not made these changes, it would be out of touch today with the needs of agricultural producers. This Act has been amended several times, with the amendments of 1980 being the most recent.

Some of the major provisions of the Farm Credit Act Amendments of 1980 will

- Increase U.S. agricultural exports by authorizing banks for cooperatives to finance agricultural export transactions of U.S. cooperatives.
- Increase cooperation between System institutions and commercial banks in meeting the credit needs of farmers.
- Help low-equity and young farmers by permitting Federal Land Banks to make loans of up to 97 per cent of the appraised value of farm real estate when these loans are guaranteed by a Federal or state agency.
- Ensure that cooperative services will continue to be provided to farmers by lowering the farmer-member eligibility requirement of utility and supply cooperatives financed by the Banks for Cooperatives.
- Allow Federal Land Banks and Production Credit Associations to more fully finance the processing and marketing activities of farmers, ranchers, and commercial fishermen.

Another Source of Loanable Funds

I have taken the time to emphasize that the Farm Credit System is a Federally chartered, cooperatively organized, and borrower-owned credit system, that it operates at no cost to the U.S. taxpayer, and that it was established to ensure farmers a constructive and reliable supply of credit. I also indicated earlier that there has been authority for the system to provide funds to commercial banks and other financial institutions since enactment of the Agricultural Credits Act of 1923. This brings me to my specific assignment of discussing with you possible ways in which the Farm Credit System may provide loanable funds to agricultural banks.

I am pleased to discuss this topic at this time, for the Farm Credit Act Amendments of 1980 address this subject specifically in three ways: through expanded authority for the System banks to participate in loans with other lenders outside the system (new FLB-commercial bank participation authority), through an improved PCA-commercial bank participation program, and through an expanded OFI authority.

The intent of the Farm Credit System through participation agreements has been an effort to complement existing banks in meeting the credit needs of farmers who do not elect to become PCA members. Discount privileges through the FICB's for other financial institutions (OFI's) have continued to provide an alternative means of channelling funds from capital-surplus areas to agricultural areas, which historically have been capital-deficient, where dedicated lenders can demonstrate a bona fide need and do not have access to money markets similar to that available to the Farm Credit System.

This intent is in line with the system's mandate as stated in the Farm Credit Act of 1971. The Farm Credit System is committed to serving the credit needs of American agriculture. As a result, the system's attitude is that American agriculture and the public interest will best be served when all lenders are actively involved in providing sound and constructive credit to the nation's farmers and ranchers.

Participations

One of the provisions of the Farm Credit Act of 1971 established authority for PCA's to participate with rural banks on agricultural loans. The commercial bank-PCA participation loan program is similar to an overline arrangement between a commercial bank and its regional correspondent bank. The commercial bank and PCA sign an agreement specifying terms for the PCA to purchase a portion of larger agricultural loans from the commercial bank, normally representing amounts in excess of its individual borrower lending limit. The commercial bank continues as the primary lender servicing the complete line of credit.

Currently, both the PCA's and the BC's are authorized to enter into such participation agreements with unlike institutions. While this participation arrangement has not been an unqualified success, volume has steadily risen since the program was first instituted in 1974 and has worked well in many parts of the country (see Table 5).

Under current law each PCA, subject to rules and regulations prescribed by the board of directors of the FICB and approved by the Farm Credit Administration, may make, guarantee, or participate with other lenders in short- and intermediate-term loans and other similar financial assistance to (1) bona fide farmers and ranchers and the producers or harvesters of aquatic products, for agricultural purposes, and other requirements of such borrowers, (2) rural residents for housing financing in rural areas, under regulations of FCA, and (3) persons furnishing to farmers and ranchers services directly related to their on-farm operating needs.

TABLE 5

Production Credit Associations' Selected Monthly Loan Data Participations Purchased From Commercial Lenders for the Period Ended 9-30-80 ($000s omitted)

	Number of Part. O/S *September* 1980	*September* *1979*	*Per Cent Change*	*Amount of Part. O/S* *September* 1980	*September* 1979	*Per Cent Change*
Participations with Commercial Lenders						
Springfield	$ —	—	—	$ —	—	—
Baltimore	3	1	200.0	2,942	2,928	0.5
Columbia	5	4	25.0	479	1,256	(61.9)
Louisville	80	70	14.3	7,096	6,605	7.4
New Orleans	12	37	(67.6)	2,416	2,336	3.4
St. Louis	52	153	(66.0)	9,175	11,961	(23.3)
St. Paul	805	706	14.0	66,991	42,745	56.7
Omaha	214	214	—	29,381	28,994	1.3
Wichita	240	145	65.5	50,389	54,354	(7.3)
Texas	63	66	(4.5)	12,131	11,570	4.8
Sacramento	—	—	—	—	—	—
Spokane	6	1	500.0	593	285	108.1
Total	1,480	1,397	5.9	181,593	163,034	11.4

Source: Farm Credit Administration, Bank Services Division
10/27/80

The 1980 Amendments will remove several of the obstacles currently holding a partial lid on participation. The first proposal will provide the FLB's with the same basic authority which PCA's now possess to participate with other lenders in making mortgage credit available to farmers. Under current law, FLB's may participate in loans only with other FLB's. The new provision will allow FLB's to participate with unlike entities in the Farm Credit System — BC's, PCA's, and FICB's—as well as non-Farm Credit banking institutions such as commercial banks.

The second proposal will revise and streamline the participation arrangement. Under current law, non-voting stock in PCA's equal to not less than 5 per cent of the loan retained by the PCA's must be purchased in connection with each loan participation. The law requires that such non-voting stock, often referred to as participation certificates, be issued to the borrower. This makes the PCA a visible third party in the loan transaction with the borrower. Some banks' have feared that this PCA membership would cause customers to eventually move to a PCA.

Under the new legislation, the PCA ownership equity will not have to be purchased by the borrower, but the association could issue non-voting stock or participation certificates directly to commercial banks or other lenders. In effect, this will remove the PCA's as the visible third party from the transaction and minimize the tendency for the borrower to switch lenders.

OFI Discounting Privileges

Other financial institutions owned by commercial banks have had access to the Federal Intermediate Credit Banks' discount windows since enactment of the Agricultural Credits Act of 1923. Under current regulations, to qualify for discounting privileges at an FICB, an OFI must:

- Show that the need is not the result of denial or restrictions on its traditional sources of supplementary financing.
- Document that the FICB discounting is needed to maintain the average volume of agricultural loans experienced over the past three years by discounting.
- Have at least 25 per cent of its total loans in agricultural loans.
- Have a gross loan-to-deposit ratio of at least 60 per cent at the seasonal peak or justify a lesser ratio.
- Show evidence of capital structure to support an economically

feasible lending operation and actual or potential loan volume to permit a reasonably efficient lending operation.

In addition, the 1971 law restricts OFI's to discounting loans for agricultural purposes only. PCA's have broader authority to make loans to farm-related businesses, rural residents, and aquatic producers. In addition, PCA's have the authority to make loans for the other needs of agricultural and aquatic producers. The major impact that the new OFI provision will have is that for the first time FICB's could discount for OFI's the same types of loans, for the same purposes, that PCA's are authorized to make.

The second part of the OFI provision is designed to assure that the FICB discount privilege is available on a reasonable basis to qualifying banks and agricultural credit corporations. Under the 1971 law, OFI's have made only limited use of the FICB discount privilege. For example, as of June 30, 1980, 167 OFI's rediscounted with or were in a position to rediscount with the FICB's (see Table 6). This is an increase of 17.6 per cent over the previous year. Under the new OFI provision, it is estimated that more banks will have access to the FICB discount privilege.

The criteria established by the 1980 Amendments for determining access to the discount privilege, which FICB's will be obligated to use as the basis for access by OFI's, are:

1. Significant involvement in agricultural or aquatic lending.
2. Demonstrated continuing need for supplementary sources of funds to enable continued agricultural or aquatic lending.
3. Limited access to national or regional capital markets.
4. Willingness not to use funds to expand nonagricultural or nonaquatic lending.

Implementing regulations will define the specific requirements under each criterion. Congressional testimony would indicate that the agricultural portion of the total loan portfolio may be 15 per cent instead of the present *25* per cent requirement, with the loan-to-deposit ratio somewhere around 60 per cent.

Access to capital markets provision will be on a case-by-case analysis. The intention is that those banks affiliated with holding companies or large enough on their own to utilize managed liabilities, such as selling commercial paper on the national money market as the system itself does, would not be granted access to the FICB discount window.

TABLE 6
Other Financial Institutions
(Number of OFI's in each Farm Credit district rediscounting with or in a position to rediscount with the FICB as of June 30, 1980, by type of institution or affiliated institutions and statement of total amount rediscounted

Number by type of institution or affiliated institution)

Farm Credit District	*Total Number*	*Affiliates of Farmers' Cooperatives*	*Commercial Banks or Affiliates of Commercial Banks*[a]	*Affiliates of Privately Owned Businesses (Supply, Processing, Marketing, etc.)*	*Privately Owned Credit Corporations Not Affiliated with any Other Business*
Springfield	—	—	—	—	—
Baltimore	8	1	7		—
Columbia	3	—	2	1	—
Louisville	2	1	1	—	—
New Orleans	8		7	—	—
St. Louis	4	—	3	1	—
St. Paul	35	1	30	3	1
Omaha	38	1	34	1	2
Wichita	43	2	40	1	—
Texas	16	1	8	4	3
Sacramento	7	2	2	2	1
Spokane	3	—	2	—	1
System Total	167	10	136	13	8

[a] Eight commercial banks have direct rediscount privileges, the balance of the banks in this column are bank affiliates

This table includes only those other financing institutions that have executed rediscount agreements with the FICB and have collateral on deposit.

During the fiscal year ended June 30, 1980, 3 OFI's cancelled their rediscount agreements and 28 new OFI's were approved.

For the year ended June 30, 1980, OFI's rediscounted $1,697,840,987 with the credit banks as compared to the $1,416,918,235 that was discounted for the year ending June 30, 1979.

Potential vs. Problems

This paper has reviewed the organizational development and intent of the Farm Credit System as well as the current laws and changes to those laws governing OFI access to the FICB discount window and participation agreements. These legislative provisions represent a new attitude on the part of the Farm Credit System. It looks toward significant streamlining of the participation agreement program and liberalizing access to the FICB discount facility where a need can be demonstrated.

The Farm Credit System anticipates an expansion of participation programs and OFI discounting through the FICB's. The intent of the 1980 amendments is to ensure deserving farmers adequate credit through commercial bank relationships where this approach is a necessary and feasible part of the agricultural community.

Part of the responsibility for expanded agricultural bank discounting with the FICB's or participation in loan agreements with PCA's or other Farm Credit System entities lies with each agricultural bank. Although an increased number of banks have joined the trend toward use of participations, not all bankers view this favorably. Many bankers dislike the idea of getting too close to the PCA competition. Others dislike having the PCA as a visible partner in the loan (although the new legislation should eliminate this concern). And it must be admitted that some PCA's have cited similar reasons for reluctance to participate with commercial banks.

In some states—especially those with statewide branching—the need for participations is limited and is reflected in the degree to which PCA's are involved in the participation program (see Table 5). However, as the capital requirements of the farmer increase—and they will increase, in many cases, beyond the capacity of the individual PCA of rural bank—it will become increasingly advantageous for PCA's and commercial rural banks to set aside their differences and cooperate. PCA's and commercial banks that have crossed the "fear of competition" hurdle have found participation mutually beneficial.

Although the new OFI and participation provisions of the Farm Credit Act amendments of 1980 promise to liberalize and streamline the current systems, the question of implementation problems naturally arises. Problems are frequently in the eye of the beholder and in reality are only problems if not managed properly. For example, implementation of the provisions of the Monetary Control Act of

1980 could become a major problem completely disrupting the financial structure of this country. However, the upheaval facing financial institutions will be handled in phases, over a period of several years.

In a similar manner, the implementation of these provisions will be an evolutionary process. To irresponsibly open the floodgates could cause as much disruption to the agricultural financial sector of the economy as would similar action in the deregulation of the banking industry.

Any constraints of fund availability through Farm Credit System sources would be the result of sudden excessive demand that would put stress on the ability of the FICB's or PCA's to service applicants. However, in view of the fact that it took nearly half a century for commercial rural banks and other eligible financial institutions to utilize the FICB discount window, the Farm Credit System does not anticipate a rush on this service as a result of passage of the 1980 amendments.

The capacity of the Farm Credit System to provide loanable funds to the commercial banks serving agriculture as well as its own entities is based on what demand the money markets will bear. As indicated earlier, the Farm Credit System does not enter the money markets with security issues without first coordinating with the U.S. Treasury, the Federal Reserve, and with brokers and leading investment houses. Serving the demand of the system's entities for loanable funds must have primary consideration as required by law. But serving additional agricultural borrowers through other lending institutions is the basis for our partnership with commercial banking in the 1980s.